Think Ahead ACCA

FRC Discussion Paper *A Matter of Principles: The Future of Corporate Reporting*

Invitation to comment to the Financial Reporting Council

Comments from ACCA
February 2021

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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the Financial Reporting Council's discussion paper, *A Matter of Principles: The Future of Corporate Reporting*. This has been done with the assistance of members of ACCA's Global Forum for Corporate Reporting.

We agree that there is a need for the corporate reporting system to evolve from meeting the perceived needs of a single set of primary users (investors), to addressing the information needs of a wider group of stakeholders. In this context, we welcome the FRC's aim of placing non-financial reporting on a similar statutory footing as financial reporting.

However, we would urge the FRC to consider the implications of the proposals in the paper on audit and assurance, because this is an important matter of public interest. If the assurability of information is not sufficiently considered from the outset, there is a significant risk that the audit expectations gap may widen, thus further damaging public trust in corporate reporting. This is particularly problematic given the current diversity in how practice assurance engagements are performed on non-financial information.

In ensuring that corporate reporting and non-financial reporting in particular is consistent and comparable, high-quality global standards are key. For this reason, we would encourage the FRC to monitor and align its reporting reforms with international developments in the area, including:

- the IFRS Foundation's proposals to set up a Sustainability Standards Board,
- EFRAG's preparatory work to develop future EU non-financial reporting standards
- the outputs from the collaborations between CDP, CDSB, GRI, the IIRC and SASB, and
- the roll-out of mandatory TCFD reporting in jurisdictions around the world, including the UK.

In this context, the timing of the next steps that the FRC and the UK Government takes in relation to the proposals set out in the discussion paper will need to reflect the timelines of these international developments.

Although we agree that different stakeholders' information needs are not mutually exclusive, we do believe that the identification of the primary user of each report is helpful in ensuring that the report meets its communication objectives. This is particularly pertinent in the context of the global drive for harmonisation in non-financial reporting, in which the information needs of different stakeholder groups remain a key consideration.

If further information is needed, please get back to us.

SPECIFIC COMMENTS

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

We agree with the concept that different reports may fulfil different objectives and that often, the objectives of different audience groups may overlap. We also agree with the paper's focus on non-financial reporting, and we fully support the aim of placing non-financial reporting on a similar statutory footing as financial reporting.

However, the separation of reporting into three distinct reports and other network reports raises risks of duplication and challenges with regards to the scope of audit and assurance. If the assurability of information is not sufficiently considered from the outset, there is a significant risk that the audit expectations gap may widen, thus further damaging public trust in corporate reporting. This is particularly problematic given the current diversity in how practice assurance engagements are performed on non-financial information.

A prerequisite of consistent and comparable information is high-quality non-financial reporting standards. In this respect, we would encourage the FRC to monitor the IFRS Foundation's proposals to set up a Sustainability Standards Board (SSB), EU non-financial reporting standards, and other international initiatives such as the joint work of CDP, CDSB, GRI, IIRC and SASB (hereafter referred to as the 'Group of Five'). It would be important to ensure that any proposals for a new corporate reporting system is aligned with the direction of international harmonisation in this area.

The presentation of principles at three levels – system level attributes, report attributes and content communication principles – seems complicated and we are not certain whether that will lead to better reporting practice. In our view, it is possible and perhaps preferable to have one single set of principles that apply to all forms of corporate reporting generally. (Please refer to our response to Q4.)

We broadly support the proposals on technology. The use of XBRL tagging would do much to improve access to corporate reporting information by stakeholders other than investors. It would also enable greater connectivity between information published in different reports, as well as connectivity between financial and non-financial information. However, further consideration is needed to determine whether and how tagging can be applied to narrative information. This is important in ensuring that users can consider the strategic context behind companies' performance, rather than viewing reported information as a discrete set of data points. Access to, and analysis of, narrative information is also important in capturing aspects of companies' value creation, preservation and erosion which may not currently be quantifiable.

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?

The duplication of information across reports, and across different sections of the same report is a key area of practical challenge.

In today's reporting system, where information considered relevant for investors is reported in one single mainstream annual report, there is already a significant duplication of information. Risk disclosures, for example, arise in two or three different sections in the Strategic Report (discussions on external trends and factors, and principal risks and uncertainties) as well as the Viability Statement. The understandability of the report could be compromised if different risks are reported in these sections, or if the same risks are discussed but in an inconsistent way.

The introduction of three separate reports with different objectives but covering the same entity, period and events could further increase the scope for duplication and add further complexity to reporting. This could reduce the understandability and usefulness of corporate reports, and potentially further impair the trust that users place on them.

At this stage, we feel unable to comment on the cost and benefits of this new model. On the one hand, it would seem to increase the reporting burden, since companies would be producing additional reports. On the other hand, this burden could be less than what one might assume if the majority of UK PIEs already apply sustainability reporting standards such as GRI, and include related disclosures in a separate sustainability report or appendix to annual report. This area is worth further investigation and consultation.

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

We agree that there is a need for the corporate reporting system to evolve from meeting the perceived needs of a single set of primary users (investors), to addressing the information needs of a wider group of stakeholders. We also agree with the observation that often, the information needs of different users do overlap.

The proposal that reports should be objective-driven rather than audience-driven is an interesting one. The three overarching objectives outlined in sections 5 and 6 seem reasonable:

- to provide information that enables users to understand how the company creates long-term value in accordance with its stated purpose (Business Report),
- to enable assessments of financial performance and position of the company (financial statements), and
- to provide information about how the company fulfils its obligations in respect of the public interest (Public Interest Report, 'PIR' hereafter)

Although we agree that different stakeholders' information needs are not mutually exclusive, we are not certain whether it is possible or desirable to clearly identify reports' communication objectives without considering who their primary users are. In particular, we note that the consideration of primary users is central to both the IFRS

Foundation's proposals to set up a SSB, and the joint work of the Group of Five. The latter's joint paper, *Reporting on Enterprise Value*[1], particularly highlights the helpful distinction between reporting on enterprise value in an investor-focused report, and sustainability reporting aiming to 'inform assessments and decisions by a wide range of users who want to understand a company's positive and negative contribution to sustainable development.' We believe that the identification of the primary user of each report is helpful in ensuring that the report meets its communication objectives.

Further, we would recommend that the FRC provides more clarity over the objective of the PIR: for example, how 'public interest,' 'public interest matters' and 'relevant stakeholders' (as referred to on p.27 of the paper) might be defined – by statute, by those charged with governance in the entity themselves, or through other means. It would seem difficult to clarify the objective of the PIR without identifying its primary user. The appropriate form and content of a PIR would seem to depend on whether its primary user group is regulators, or the stakeholders directly affected by the entity's operations.

In addition, it would be helpful to have more specific examples as to the objectives that the network reports might serve.

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?*

No, we do not believe that the three-tiered approach to principles would be helpful. This approach seems over-complicated and it's unclear how dividing the principles into three levels would improve the quality of corporate reporting in practice. It would seem to be more effective to have one core set of principles that apply to corporate reporting in general.

As global harmonisation in non-financial reporting is progressing apace, we would recommend that the principles adopted are directly aligned with those that emerge from international initiatives. The joint paper *Reporting on Enterprise Value*, published by the Group of Five, maps the principles of reporting common to existing non-financial standards and frameworks to the fundamental and enhancing characteristics from the *Conceptual Framework for Financial Reporting*. There are also strong calls for the IFRS Foundation to develop a Conceptual Framework for Corporate Reporting as a whole, should it set up a Sustainability Standards Board[2]. If this takes place, any mandatory or

[1] CDP et al. (2020), *Reporting on Enterprise Value: Illustrated with a Prototype Climate-Related Financial Disclosure Standard*, https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf, accessed 27 January 2021

[2] See ACCA's response to the IFRS Foundation's consultation on sustainability reporting, https://www.accaglobal.com/gb/en/technical-activities/technical-resources-search/2020/december/acca-reponse-ifrs-consultation-sustainability-reporting.html; Accountancy Europe's response, https://www.accountancyeurope.eu/consultation-response/ifrs-foundations-consultation-paper-and-comment-letter-on-sustainability-reporting/, and CPA Australia and CA ANZ's joint response,

non-authoritative principles advocated by the FRC would best be rooted in the global consensus.

As observed in our policy paper, *Tenets of Good Corporate Reporting*[3], there is a high degree of commonality between existing financial and non-financial reporting standards and frameworks. The following qualitative characteristics would generally apply:

- Relevance and materiality
- Completeness
- Reliability – neutrality and freedom from error
- Comparability
- Verifiability
- Timeliness
- Understandability

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 broadly agree with the proposals for a reporting network, and note that the concept reflects Accountancy Europe's proposals for a CORE and MORE reporting model, which has generally been welcomed.

However, there is a need to clarify the form that network reports may take. For example, might information published on the corporate website constitute a network report? Clarifying the scope of the reporting network would have significant implications both for directors' responsibilities and for audit and assurance.

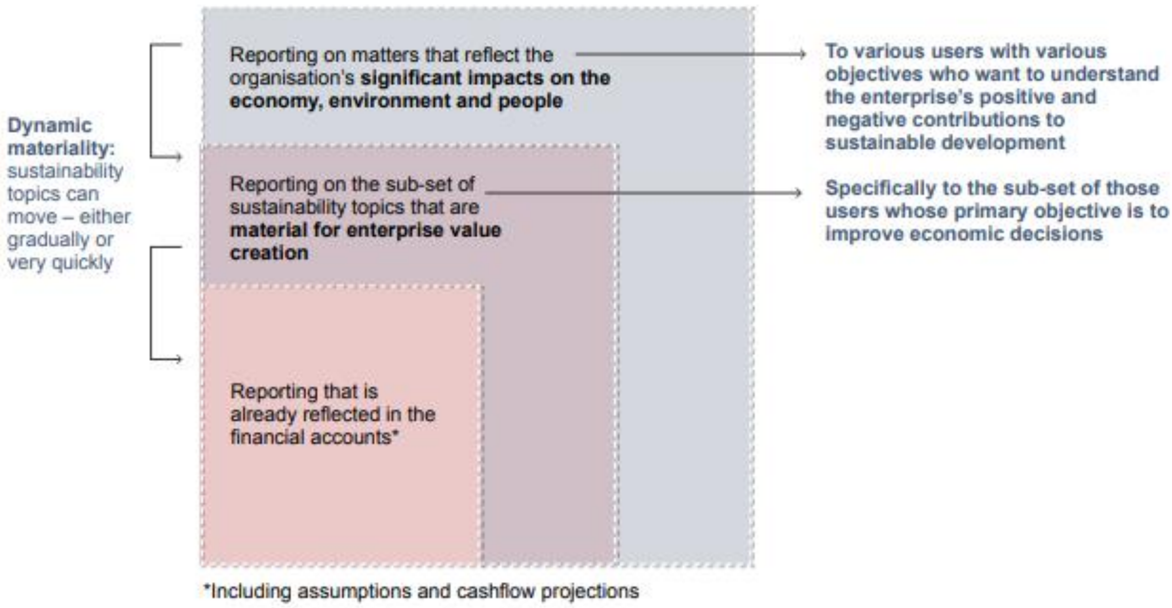
6 We are proposing that there should no longer be a single test for materiality that is based on accounting standards but instead materiality will be dependent on the objective of a report. Do you agree with this approach, please explain why?

Although we agree with the concept that materiality should be determined in relation to the objective for each report, more clarity is needed to understand how that would be put into practice.

Given the direction of international initiatives, the FRC would benefit from considering the dynamic materiality concept, as proposed by the Group of Five, may apply to the new model set out in the paper. Their *Statement of Intent to Work Together towards Comprehensive Corporate Reporting* highlights three inter-linked lenses to materiality.

https://www.charteredaccountantsanz.com/news-and-analysis/advocacy/policy-submissions/submission-on-the-consultation-paper-on-sustainability-reporting

[3] ACCA (2018), Tenets of Good Corporate Reporting, https://www.accaglobal.com/uk/en/professional-insights/global-profession/Tenets-of-good-corporoate-reporting.html (accessed on 14 December 2020)



Source: CDP, CDSB, GRI, IIRC and SASB (2020), *Statement of Intent to Work Together towards Comprehensive Corporate Reporting* https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf

At the level of the core reports, we understand the financial statements would relate to the smallest of the boxes shown above, and thus be subject to financial materiality. The Business Report can be understood to cover the scope of the middle box, with the application of enterprise value creation materiality.

However, it is at present unclear how the materiality filter might be applied to the proposed PIR. Greater clarity about the objective of the PIR is needed, as we have highlighted in our response to Q4, to enable consistent application of materiality.

Similarly, the possible objectives of other network reports need to be spelt out more clearly in order for materiality approaches to be developed. This is also needed to apply materiality at the reporting network level: at present, it is unclear how preparers can assess whether information reported across the reporting network is complete.

We agree that there is now greater need for entities to disclose the basis on which materiality judgements have been made. We also agree that disclosures about the oversight exercised by the board, and the timeframes considered, are both relevant and useful.

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?

Yes, we believe that there is a need for regulatory standards for non-financial reporting. In this context, we welcome the IFRS Foundation's proposals to set up a Sustainability Standards Board ('SSB').

In order to be aligned with international initiatives and the direction of non-financial reporting requirements in the EU, we would support a broad scope to non-financial reporting standard-setting. This should cover a wide range of topics related to natural, human, social, intellectual and manufactured capitals. We believe the collaboration between the Group of Five and the WEF forms a good starting point for future broad-based non-financial reporting standards. The principles and pillars of the TCFD Recommendations, although focused on climate-related financial disclosures, also lay the ground for other areas of non-financial reporting.

If a SSB is set up, we would encourage the FRC to work closely with it to further scope out the objectives and contents of the Business Report and the PIR. There is currently a potential tension with the IFRS Foundation proposing that the SSB would initially look at climate reporting only – thus a much narrower scope than the proposed Public Interest Report.

Given the current focus on. and increasing adoption of, the TCFD Recommendations, we would encourage the FRC to carefully consider and clarify how the reporting network model can accommodate TCFD disclosures. It is unclear currently whether these would be in the Business Report or in the PIR (which would then require modifications to the materiality filter). If not addressed, this could cause confusion to users.

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

Although we understand that the proposals respond to the specific recommendations of the Brydon Review, there is a risk that requiring companies to provide information about how they view their obligations in respect of the public interest could result in boiler-plate information that does not ultimately improve the decision-usefulness of the PIR for stakeholders. In our view, the directors' obligations in respect of the public interest are best strengthened through Companies Act legislation about directors' responsibilities (such as the duty to promote the success of the company in section 172 of Companies Act 2003), and corporate governance codes and guidance.

We would note, also, that the wording in the paper regarding 'how the company views its obligations' is unhelpful. It is those charged with governance in the company, rather than the company as a legal person, that should be held accountable for meeting its obligations in respect of the public interest. Therefore, such obligations should be considered and addressed by the company's directors, rather than by the company.

Further, the use of the term 'obligations' could be misleading. It may be helpful rather to refer to directors' duties under s.172 of Companies Act 2016, thus ensuring alignment with existing legislation.

Finally, if PIRs are to be mandated, we would support an approach to stakeholder identification that is entity-specific and driven by the entity's strategy and business model. This strategically-focused approach to stakeholder identification would lead to more relevant reporting on performance and risks.

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

It's unclear whether the introduction of a separate public interest report would improve information reported to stakeholders other than investors. We note that the citizens' jury confirmed (p.35) that annual reports are difficult for non-experts to navigate and comprehend. In our view, the publication of a separate PIR would not necessarily resolve this issue, especially with the added complication that the same transaction may be reported both in the Business Report and in the Public Interest Report, from different perspectives.

We agree that it is crucial to place non-financial reporting on a similar statutory basis as financial reporting. In addition, we would emphasise that non-financial reporting should also be subject to the same level of assurance as financial reporting. We understand and welcome the FRC's ongoing work in considering the future of audit and assurance: assurance in the light of rapid developments in the area of non-financial reporting is an area that would merit particular focus. For example, the implications of potentially disclosing non-financial information in multiple reports which may be published at different times (PIR, Risk Report and other network reports) on audit and assurance need to be carefully considered.

Finally, we note that the text illustrating societal outcomes and external impacts at Figure 4 is identical – this seems to be an error.

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 agree that there are significant opportunities for current and new technology to improve both the quality and accessibility of corporate reports. We also agree that XBRL tagging should be on a cross-regulator basis, as this is a key area where the benefits of tagging can arise.

Figure 5 is a good and clear illustration of how XBRL tagging and central storage of data can work in practice. We note that this can potentially benefit regulators and investors: the ability to filter and interrogate tagged data via a public filing platform (ie Companies House) would enable a wider group of investors who may not have the advanced technological capabilities of large institutional investors, to dig deeper into the data reported.

In addition, simple access to tagged publicly-available information could also benefit decision-making by smaller businesses, by enabling them to adopt the best practices of large listed entities. For example, where large entities publish the internal carbon prices that they use to inform investment appraisal decisions, these internal carbon prices can be tagged – making it possible for smaller businesses to benchmark their own internal carbon pricing against the internal carbon prices adopted by their larger industry peers.

However, the degree to which this may meet the needs of other stakeholders (employees, customers, suppliers and communities) is less clear. There is also a risk that tagging errors and omissions could cause information to be interpreted out of context, leading to reputational damage for companies.

It will be particularly important to ensure that non-quantitative, narrative information are appropriately captured in the XBRL database. This is crucial both for ensuring that users do not miss the strategic context behind performance indicators, and non-financial information which cannot yet be quantified reliably.

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

The proposals seem reasonable. In particular, we support keeping the scope of the requirement to prepare the Business Report the same as for the current Strategic Report. Should the PIR become mandatory, we would also support initially limiting the requirement to prepare the PIR to the very largest companies.

We note, however, that interactions with other UK reporting requirements and international initiatives need to be considered. The scope of mandatory TCFD reporting in the UK, for example, would need to be considered in defining the scope of Business Report and PIR requirements. Trickle-down effects through the value chain, for example through large UK groups requesting disclosures from their suppliers in order to meet their PIR reporting requirements, also need to be borne in mind.

For some smaller entities, there may well be both internal and external benefits to publishing of good quality non-financial reports. However, we would recommend that non-financial reporting is adopted on a voluntary basis by SMEs, so that adoption is driven by a clear business case for doing so, rather than by regulation.

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?

Assurance

Assurance over the information reported is a key challenge that doesn’t seem to be covered adequately in the paper. Separating the contents of today’s annual report into three or more distinct reports, each subject to a different audit or assurance engagement, could result in unintentional changes to the scope of external audit and assurance. Even just in the context of the statutory audit, the implications of separating out the Business Report (Strategic Report) from the annual report on the application of ISA 720 *The auditor’s responsibilities relating to other information* should be carefully considered.

The provision of external assurance or agreed-upon procedures on non-financial reporting is still relatively new, and the regulation and monitoring structure around such services remain far from mature. In some jurisdictions, external assurance on non-financial information may be provided by practitioners who are not subject to the level of professional oversight, and are not bound by professional codes of ethics, to the same extent that the professional accountancy profession is. Assurance conducted without full regard to the assurance standards and ethical codes could have impacts on public trust in business and audit and assurance.

For this reason, we would encourage the FRC to consider the assurability of information under existing audit and assurance frameworks as a priority in developing future corporate reporting models.

Timing and frequency of reporting

The timing and frequency of reporting also deserves further consideration. We note that the Brydon Review suggests that the Risk Report should be published before the annual report. However, this could affect the connectivity of information between the Risk Report, the Strategic Report and the financial statements. Again, this would also have implications for audit and assurance.

Alignment with international initiatives

A number of significant developments are taking place in the area of non-financial reporting right now, and some initiatives have developed swiftly since the publication of the discussion paper. In this context, we would encourage the FRC to consider how the proposals in the paper may interact with other UK and international initiatives (including UK mandatory TCFD reporting, EU non-financial reporting standards, IFRS Foundation’s consultation on sustainability standards). Notably in respect of the proposed adoption of TCFD reporting in numerous jurisdictions around the world, the focus is very much on the mainstream annual report. There could therefore be a risk of regulatory fragmentation, and hence increased reporting burden on UK companies, if the FRC’s proposed reforms diverge from the international direction of travel.