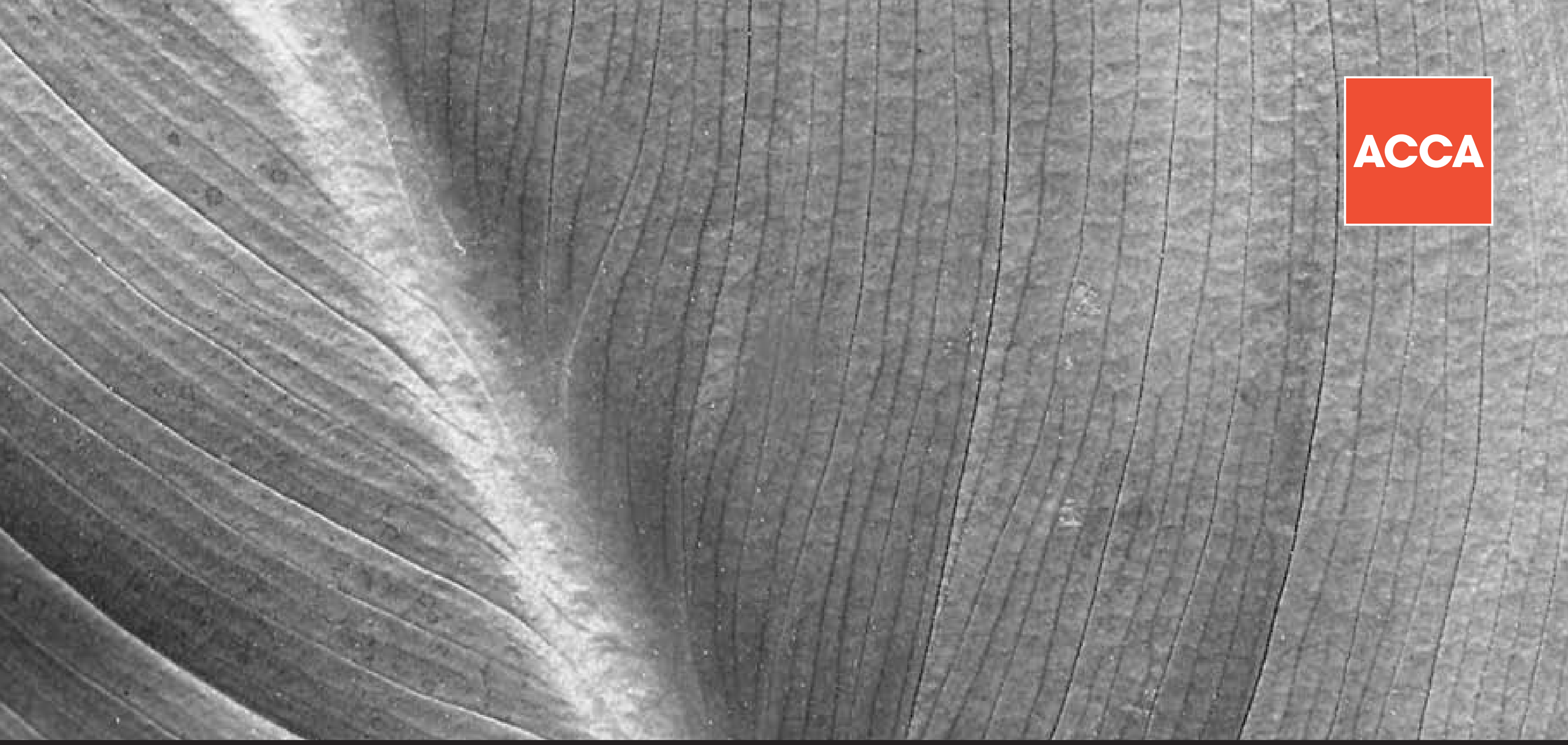
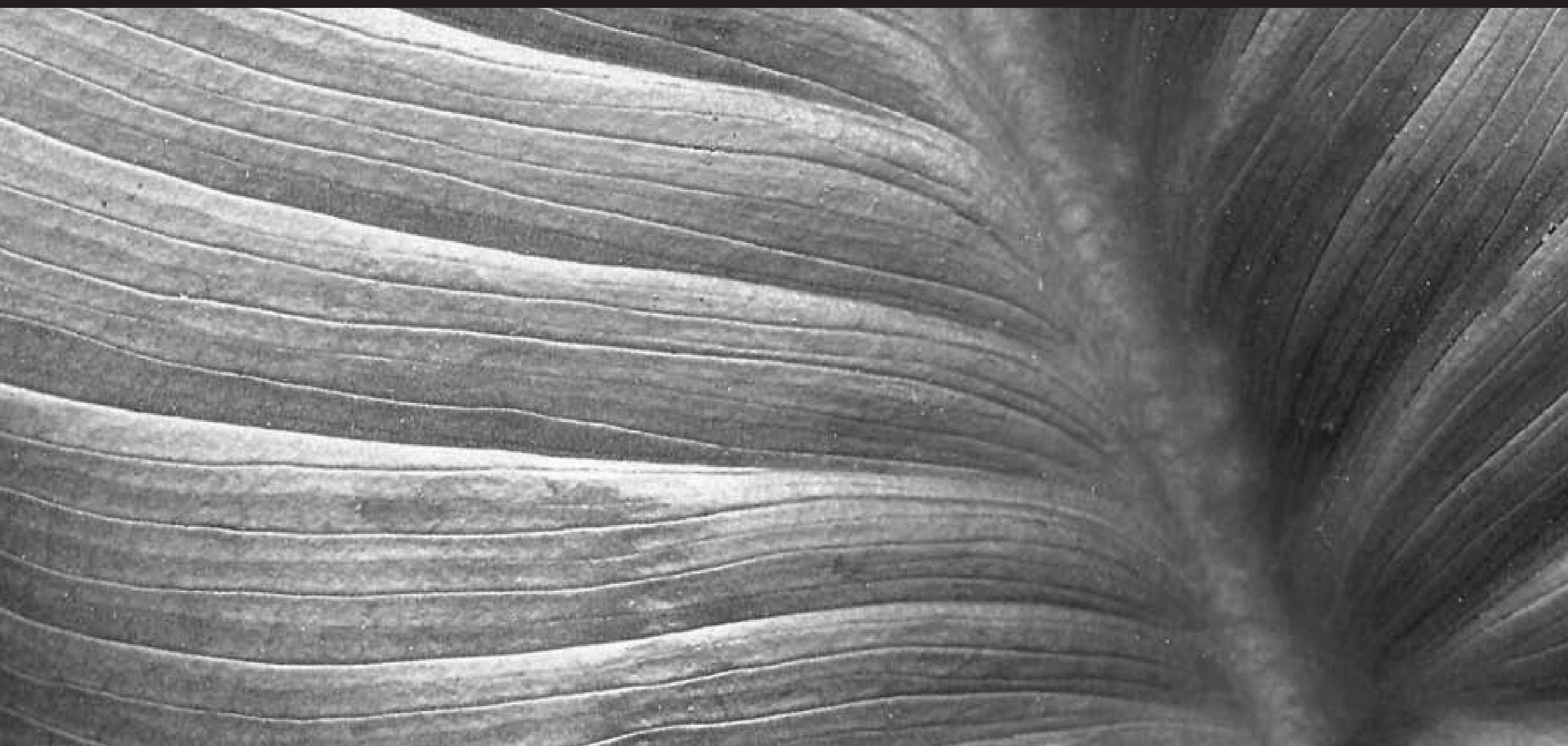


ACCOUNTANTS FOR BUSINESS

Understanding investors: directions for corporate reporting



About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 154,000 members and 432,000 students in 170 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of over 80 offices and centres and more than 8,400 Approved Employers worldwide, who provide high standards of employee learning and development.

ABOUT ACCOUNTANTS FOR BUSINESS

ACCA's global programme, *Accountants for Business*, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

www.accaglobal.com/ri

This report is the second of a four-part project examining what investors want from corporate reporting and how organisations are responding to their needs.

It outlines the kind of information investors need to make their decisions, how they now like to receive that information (both the format and the communications channels), and their level of trust in what they receive.

Contents

Foreword

ACCA has consistently argued that the role and interests of investors need to be better understood and placed more centrally in policymaking processes by legislators and standard setters. The investors' voice is often not heard strongly enough, which is perhaps understandable given the range of organisations and interests that can fall under the heading of 'investors'.

In order to address this need for greater understanding of the investor landscape, ACCA, in collaboration with Longitude Research, has developed a four-stage project examining the changing investor universe, post-global financial crisis, and what investors want from corporate reporting. The project examines how pressure to respond to the needs of investors may change the approach taken by companies in reporting their activities and engaging investor groups.

Over the four stages, the project examines:

- recent developments in the investor landscape, trends and emerging issues since the global financial crisis
- the kind of information investors need to make their decisions, how they now like to receive that information (both the format and the communications channel), and their level of trust in what they receive
- the move towards 'real-time' reporting, and how companies are responding to calls to disclose certain information with much more immediacy, rather than at the end of a quarter or year
- how companies are already changing their investor engagement and reporting activities to reflect evolving investor demands, and what this means for the finance function and the CFO.

This report is the second stage of that process. While it uses the UK and Ireland investor base for its analysis, the trends it identifies have a much wider resonance, internationally.

Helen Brand
ACCA chief executive

Executive summary

ABOUT THE RESEARCH

This report, which was written by Longitude Research on behalf of ACCA, is based on a survey of 300 investors, conducted in March 2013, and a programme of in-depth interviews with leading figures from the investment community.

Half the survey respondents represent institutions with more than US$500m in assets under management. There was a good spread across sectors: 38% represented pension funds, 30% insurance companies, 10% private banks and family offices, and 11% other asset-management firms. A further 9% were investment advisers or analysts, and the remaining 2% corporate treasurers.

Respondents were based in the UK (80%) and in Ireland (20%), and analysis of both sets of respondents found that these two groups differ very little in their outlook on the issues covered in this report. More than 50% of respondents were C-level executives. We would like to thank everyone who took part in the research.

IN-DEPTH INTERVIEWS

In particular, we would like to thank the following, who provided in-depth interviews with our research team.

- Tim Barker, head of credit research, Old Mutual Asset Managers
- David Blood, founder, Generation Investment Management, leading sustainability investors
- Jon Exley, partner, Investment Advisory Practice, KPMG
- Chris Higson, associate professor of accounting practice, London Business School
- Guy Jubb, global head of governance and stewardship, Standard Life Investments
- John Kay, FT journalist, visiting professor of economics at the London School of Economics, chair of the Kay Report
- Samantha McConnell, chief investment officer, IFG Pensions, Investments and Advisory Services, Ireland
- Jonathan Pitkänen and Iain Richards, Threadneedle Investments
- David Stewart, chief investment officer, Santander Asset Management UK
- Robert Talbut, chief investment officer, Royal London Asset Management
- Jean Claude Tanqueray, chief investment officer, Single Family Office
- Harlan Zimmerman, partner, Cevian, activist investors.

THE KEY FINDINGS

Investors have lost trust in corporate information since the global financial crisis.

Almost two-thirds of investors say that they place greater value on information or commentary that has been generated outside the company than on traditional corporate reporting. As the speed of investment decision making accelerates, sometimes to rates of milliseconds, investors are constantly looking out for sources of information that will give them the edge. This means that, increasingly, they rely on non-traditional and non-audited information, such as analyst presentations, online news and social media. Concerns about traditional corporate reporting are accelerating this trend, with more than two-thirds of investors saying that since the financial crisis they have become more sceptical about the information that companies provide.

The annual report is still an important information source but criticisms are growing.

Asked about the most valuable sources of input for making investment decisions, more respondents indicate the annual report than anything else, by a considerable margin. Yet there remains a significant minority of investors who express reservations about the quality and relevance of corporate reporting, with 45% arguing that the annual report is no longer a useful tool. A key concern is clutter – almost two-thirds of respondents say that corporate reporting is now too complex. Asked about where they would most like to see improvements to the annual report, respondents emphasise the cash flow statement, with information on the balance sheet and income statement coming a close second and third.

Investors are seeking greater assurance.

Timeliness of information may be important, but investors in the survey stress that assurance is just as critical – if not more so. Nearly two-thirds believe that management has too much discretion in the financial numbers reported, suggesting that there is a demand for audit to play a bigger role in providing assurance for the information that companies provide. Investors are particularly keen for assurance when it comes to liquidity and general financial information. With other aspects of reporting, such as emerging risks, speed of information is regarded as more important.

Opinions are sharply divided over quarterly reporting.

A majority of investors see quarterly reporting as the optimal timeframe over which companies should release audited financial statements. Three-quarters of investors say that, despite its flaws, the quarterly report remains a valuable input to investment decision making. Yet, at the same time, almost half of investors believe mandatory quarterly reporting should be abandoned, while almost two-thirds think the increase in information and real-time communication has encouraged 'hyper-investment'. Many investors interviewed for this report expressed strong views that quarterly reporting drives short-termism in the market and consumes management time. This suggests a 'tragedy of the commons' effect, whereby individual investors want to consume quarterly reporting for their own self-interest, despite recognising that this focus on shortening time horizons is damaging for the overall market's long-term interests.

Investors have a strong appetite for integrated reporting.

More than 90% of investors polled believe it would be valuable for companies to combine financial and non-financial information into an integrated reporting model. The main benefit, according to investors, would be an enhanced understanding of the long-term outlook of a company. More than two out of five investors believe that integrated reporting would provide a better explanation of the linkage between sustainability and long-term corporate performance; and a similar number believe that it would provide greater information on how long-term risks, such as climate change, could affect a company's business model.

Almost a half of investors are using XBRL, but not all find it useful.

XBRL promises to allow companies to publish their financial statements so that information can be extracted in a variety of formats to meet the particular needs of each user. Among our respondents, 45% are using XBRL, although only around half of this group say that they find it useful. There is, however, latent demand for the technology: two out of five investors say that they are not yet using XBRL but would find it valuable to do so. The main benefit of using XBRL, say investors, would be the ability to compare performance between companies more easily, although detractors worry that there remains a lack of standardisation in the use of taxonomies.

THE CHALLENGES AHEAD

The survey reveals a number of findings that should provide food for thought for accounting standard setters, policymakers and the audit profession. The key challenges that they will need to consider over the next few years include the following.

Address concerns about clutter.
Investors surveyed clearly have concerns that reporting remains too complex and that new initiatives tend to add to volume, rather than relevance, of information that companies provide. Initiatives to 'cut clutter' should be re-invigorated and debates held over how to minimise the burden of information on investors.

Set appropriate boundaries for management.
The fact that almost two-thirds of investors think that management has too much discretion in how it reports the numbers suggests that more work should be done to ensure that there are appropriate boundaries around how and what management can report. There is, of course, a balance to be struck here – set the boundaries too tightly and a box-ticking mentality will ensue, but set them too loosely and management may look for ways to obfuscate or embellish the figures.

Consider the long-term future for the annual report.
Most investors in the survey continue to see the annual report as a key source of information, but there are worrying signs that its value may be declining. The fact that 44% no longer consider the annual report to be a useful tool should be cause for concern. The consideration of how the annual report can evolve and stay relevant in the long term should be a key priority.

Address the quarterly reporting dichotomy.
Investors are in two minds about quarterly reporting – a large majority think it helps them make investment decisions, but a similarly large proportion would like to see it abandoned. The concern is that what is good for individual investors is bad for the market as a whole. Equally, to what extent should companies be allowed to determine their own reporting frequency? A careful balance must be struck between the need for timely information and its impact on short-termism in the markets.

More work needs to be done to explain integrated reporting.
The survey shows near-unanimous support for integrated reporting in principle, but some confusion over what it can achieve and how it will work in practice. There is clearly more work to be done by policymakers to educate and engage investors and build on current enthusiasm to create a set of solutions that are practical and consistent.

Speed must be balanced against assurance.
Investors clearly value the rigour that assurance brings and prioritise this over speed of disclosure for some types of financial information, although there is also a desire for a wider range of information to be received in real-time. Would auditors have the resources and capabilities to provide assurance over quarterly reports – or real-time information? These will be important issues to consider as the needs of investors and corporates evolve.

1. A broader range of information sources

For now, the annual report remains the primary input for making investment decisions.

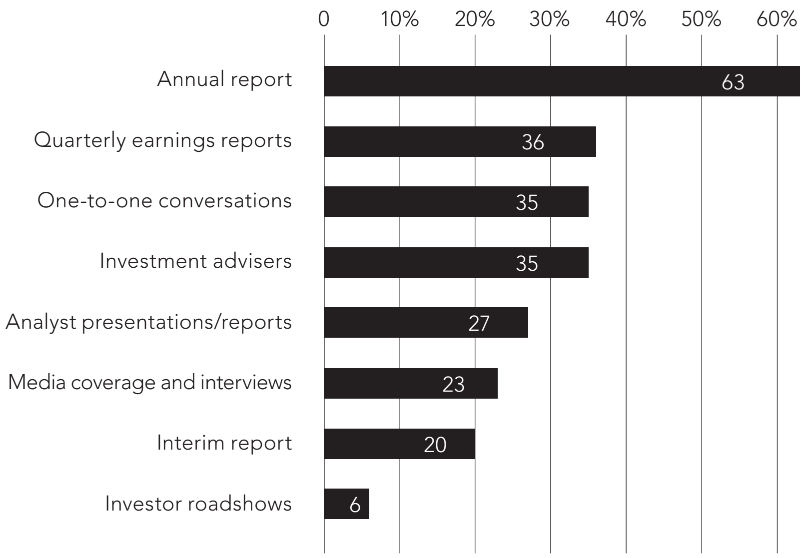
We live in an age of instant information. Google's CEO Eric Schmidt once famously claimed that in just two days, the world now creates as much information as it did from the dawn of civilisation until 2003. So it is no surprise that we see a similar phenomenon in the world of investment. Investors today have an ever-growing array of information sources.

New technologies, media channels, social and mobile media – all have helped transform the corporate information landscape, creating a tsunami of financial data and analysis to support decision making. Moreover, an increasing proportion of this information is available on a real-time basis. Investors can unearth new information via blogs and social media, newsfeeds, as well as from an array of consultants and specialised ratings agencies – and, of course, from the companies themselves.

Despite this proliferation of information, research conducted for this report finds that, for now, the annual report remains the primary input for making investment decisions.

Almost two-thirds of responding investors in the UK and Ireland say that it is among the most valuable sources of information that they use (see Figure 1.1). 'The annual report is the main document we use as an investor to

Figure 1.1: Which of the following sources of information are most valuable for you as an input for decisions about investing in a company?



understand a business', says Jonathan Pitkänen, head of investment-grade research at Threadneedle Investments. This finding is consistent with previous research, (ACCA 2011), showing that half of investors used the annual report as their main information source, and hence underlines the importance of policymakers satisfactorily addressing criticisms of the annual report.

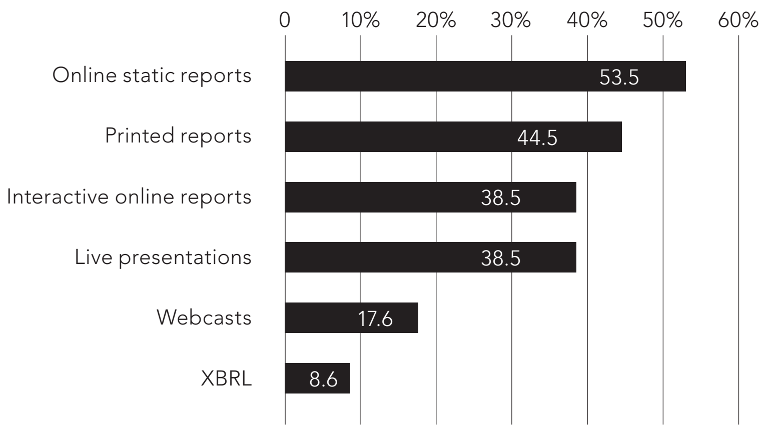
Investors are also relatively traditional in their preferred formats. The online static report is seen as the favoured format for receiving information from companies, with printed reports not far behind. More recent developments, such as webcasts and XBRL, receive less support (see Figure 1.2).

The annual report may be the primary source of information for investment decision making, but it is far from being the only one. As Figure 1.1 shows, investors in the UK and Ireland today make use of a wide variety of different information sources, including one-to-one conversations with companies, feedback from investment advisers, and analyst presentations. 'The annual report is simply the opening of a conversation', says Pitkänen. 'It provides information and raises questions that need to be answered, which, in turn, enable investors to form an opinion about a company.'

This reliance on a diverse range of inputs reflects investors' desire to build

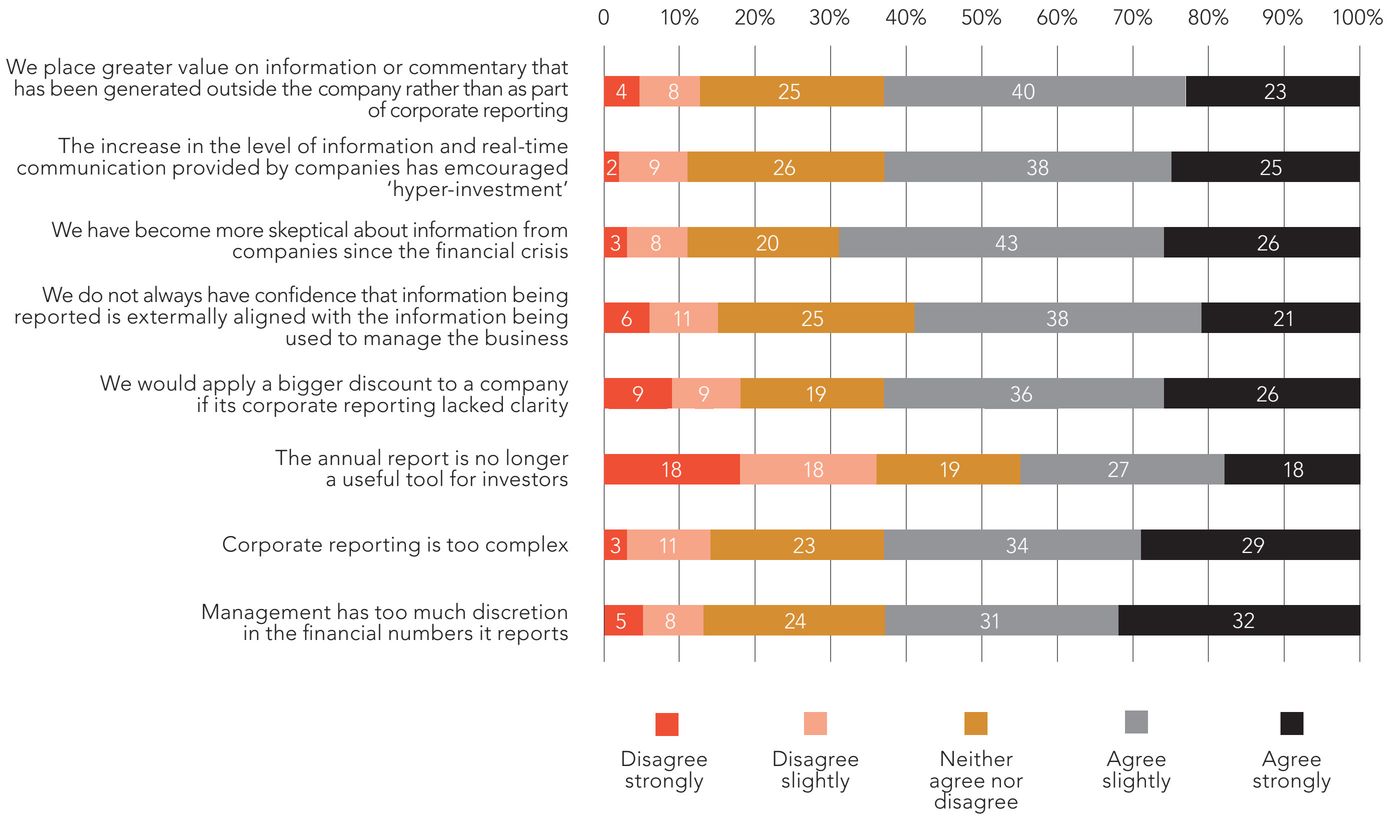
63% of investors say they place greater value on information or commentary generated outside the company rather than as part of corporate reporting.

Figure 1.2: In which of the following formats would you most like to receive information from a company?



as complete a picture as possible of a company's profile and prospects. In a notable finding, 63% of investors say they place greater value on information or commentary generated outside the company rather than as part of corporate reporting (see Figure 1.3). 'Investors value a wide range of information sources, first and second-hand, to help them develop a richer understanding of the business', says David Blood, co-founder with Al Gore of Generation Investment Management, a leading sustainability investment firm. 'That may be anything from looking at traffic in retail stores, to learning about the background of the management team. All these little nuggets of information build up a more complete picture.'

Figure 1.3: Please indicate whether you agree with the following statements.



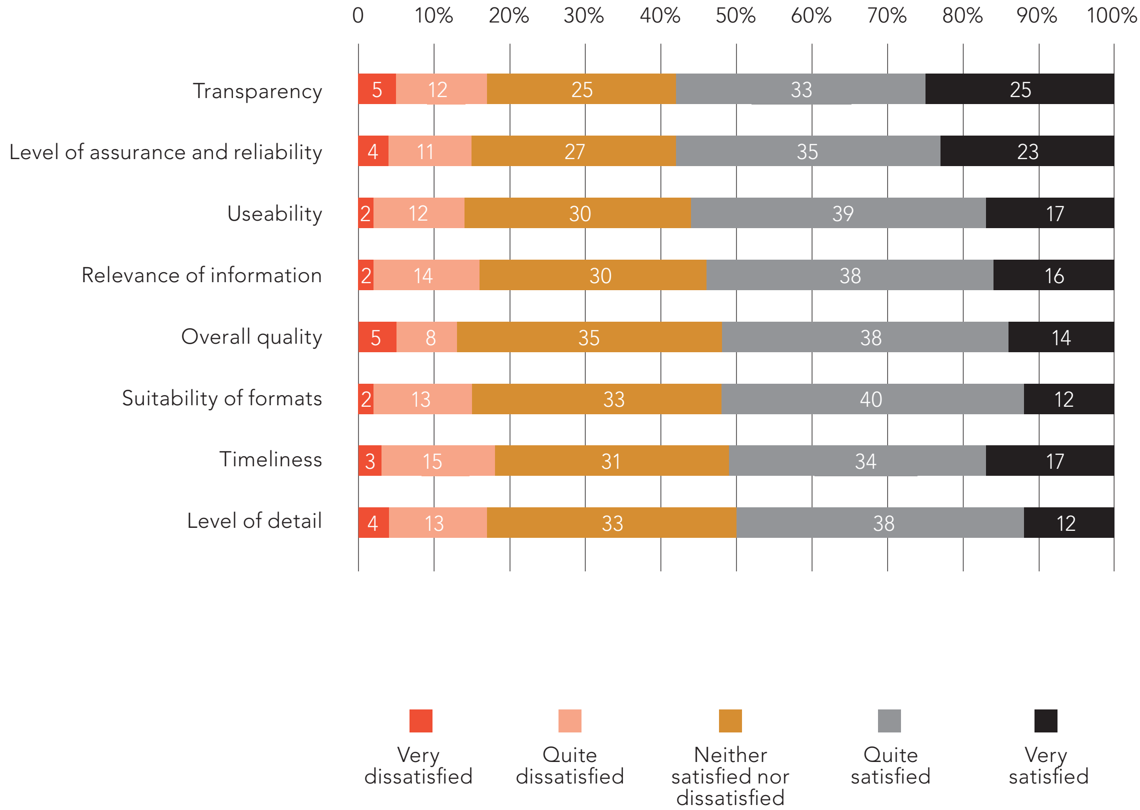
2. The pressure for speed

In addition to wanting more information to guide their decisions, investors increasingly want it more quickly. Technology has dramatically increased the speed of information flow in recent years, as more and more of people's lives have taken on a '24/7', around-the-clock pace. This phenomenon also affects financial markets, in terms of both the speed that information is released by organisations to the market, and in the speed that trades are completed. Fixnetix, a company that provides outsourced trading services, claims that is has produced a chip that can process trades in just 740 nanoseconds (Millar 2011).

The result is that investors now have access to information on a much timelier basis than ever before. When trades are taking place in timeframes measured in the billionths of seconds, it does raise questions about whether traditional corporate reporting provides information quickly enough to be valuable for investors.

Only 51% of investors are satisfied with the timeliness of company information.

Figure 2.1: How satisfied are you with the following aspects of the information that companies provide as it relates to your investment decision-making?



Almost half the investors believe that mandatory quarterly reporting should be abandoned.

The survey finds some level of concern about the currency of information that companies provide, with only 51% of investors saying that they are satisfied with its timeliness (see Figure 2.1). 'The delay between the full-year end or the half-year end to the actual publication date is excessive', says Pitkänen.

What about frequency of reporting? The practice of quarterly reporting has been implicated in the increasing short-termism in the stock markets. Indeed, in an important early report on short-termism in the US in the 1980s – *Breaking the Short-Term Cycle*, by the Business Roundtable Institute for Corporate Ethics (CFA Institute 2006), – quarterly reporting was seen as synonymous with short-termism. This report defined short-termism as 'the excessive focus of…investors and analysts on short-term quarterly earnings and lack of attention to the strategy, fundamentals and conventional approaches to long-term value creation'.

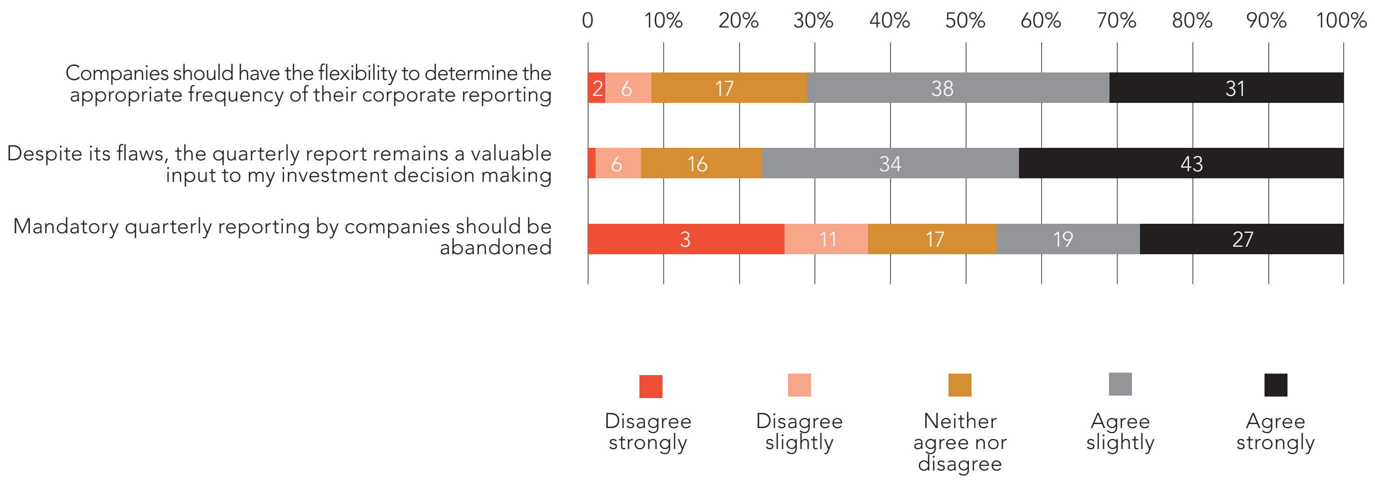
In 2012, the *Kay Review of UK Equity Markets and Long-term Decision-making*, (BIS 2012) set up to examine the impact of UK equity markets on the long-term performance of companies, came down clearly on the side of less frequent information flows: 'A large majority of respondents, whether they represented companies or investors, considered that quarterly reporting and interim management statements fell into the category of useless or misleading information', notes the report. 'They took the view that this frequency of reporting was excessive for many businesses.'

Almost half the investors believe that mandatory quarterly reporting should be abandoned (see Figure 2.2). Again and again in interviews, long-term investors stressed that quarterly reports do not help them make decisions.

'We've been quite clear in talking to policymakers and others that we would prefer to move away from quarterly reporting, and the whole reporting framework that seems to be heading towards feeding information to high-frequency traders', says Pitkänen.

This is not to say, however, that all investors have such a long-term focus. Momentum and high-frequency traders will inevitably base their models on

Figure 2.2: Please indicate whether you agree with the following statements.



> 'No business should be managed on the basis of what it's going to do over the next three months.'

short-term information and, for them, the quicker information can be released, the better.

Some investors worry that company management spends too much time on quarterly reports.

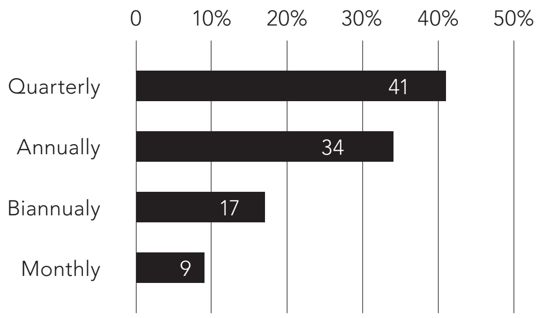
'No business should be managed on the basis of what it's going to do over the next three months', says Robert Talbut, chief investment officer of Royal London Asset Management. 'We suspect that management end up spending so much time managing their earnings expectations on a quarterly basis that it actually takes them away from their real job building longer-term success.'

For others, it is the earnings guidance that is the problem. 'Our concern is the whole dance around giving guidance to your quarterly numbers and having research analysts in the market trade around that guidance – that's what we're uncomfortable with', says Mr Blood. 'We believe it fosters and encourages short-termism as studies have shown (and anecdotal evidence confirms) that companies often end up managing towards quarterly guidance numbers as opposed to building a business for the long term. So, if you're either required to or you choose to provide quarterly information, then so be it – but don't provide guidance.'

REAL-TIME REPORTING

The next report in this series will return to the concept of real-time reporting but it is worth highlighting here that this is a development that presents companies, investors and policymakers with some challenging decisions. On the one hand, there is clearly appetite for more information to be provided in real time: investors say that greater adoption would help them to react more quickly to information and improve investment returns. The wider impact of real-time reporting on financial markets is, however, viewed less favourably. Real-time reporting would, investors say, increase a tendency to short termism, increase market volatility and even increase the cost of capital for companies.

Figure 2.3: How frequently do you think companies should release audited financial statements?



VALUE OF QUARTERLY INFORMATION

Despite the strong views of detractors, many investors in the UK and Ireland undoubtedly believe that quarterly reporting provides valuable information.

Three-quarters of investors say that despite its flaws, the quarterly report remains a valuable tool for investment decision making (see Figure 2.2). Indeed, when asked how frequently they think companies should release audited financial statements, the preference among 41% of investors is for companies to release audited financial statements on a quarterly basis (see Figure 2.3). Larger investors, with assets of more than $1bn, valued quarterly earnings reports more than other investor groups.

So what is the explanation for this sharp divergence in views? For Talbut, it all depends on whom you ask: 'If you were to ask people whose livelihood is based upon high turnover and trading mentalities, and potentially momentum players, then they may well see the benefit in more and more reporting, because that provides more and more opportunities for trading activity and for mispricing to occur, but if you talk to genuine longer-term investors, they do not see the benefits of quarterly reporting.'

More generally, this desire for audited quarterly information also reflects an innate desire for more information and for assured information. 'I would certainly value having access to quarterly audited figures', says Tim Barker, head of credit research, Old Mutual Asset Managers. 'As an analyst, I tend to have an unlimited desire for information – so for me, the more information the better, although we sometimes run out of time in the day to process it all.'

> 'There can be commercial pressure to focus on the short term.'

In addition, in a period of considerable economic uncertainty, the extra information may provide comfort for investors. 'If you ask investors in isolation would they prefer short-term clarity rather than uncertainty, they are going to say they prefer short term clarity – even the ones that view themselves as long-term investors', says David Stewart, chief investment officer of Santander Asset Management UK. 'But there is a cost – I don't think there's any doubt that quarterly reports are something of a distraction.'

Peer pressure is also a factor. 'There can be commercial pressure to focus on the short term', adds Mr Stewart. 'This comes from the sales force and senior management who look at the quarterly or monthly performance figures, whereas most fund managers' investment strategies are not focused on what will happen over the next month, but the next one to three years.'

The prospect of quarterly audited figures clearly raises a lot of questions, about not just policy, but also timing. For example, when would audited quarterly figures actually be released? Samantha McConnell, chief investment officer at IFG Pensions, Investments and Advisory Services in Ireland, struggles to see how this would work. 'Look at it purely from a timing perspective', she says. 'When it comes to yearly audited financial statements, you have a substantial – and unsatisfactory – delay, as the audit can take months and months. So how are you going to audit your quarterly information and get it out in a timely manner?'

A key challenge with this time lag is that other, unaudited, sources of information become available, which means that information in quarterly reports will already have been priced in by the time they are released. 'Certainly you do need assurance that the figures you are getting are correct', says McConnell, 'But the market is quite a leveller and market prices tend to move way ahead of the fundamentals. So by the time you've got your assurance, the market is probably priced on something else.

Even if the audited accounts aren't out, there will be some information out there in terms of how the company is trading. You may not have got it from the company itself, but you'll get it from the suppliers or from customers. Information gets out.'

There are cost implications, too. McConnell adds: 'For a lot of smaller companies you've also got the cost involved. If you wanted to be a publicly listed company and you're weighing up the costs, you have to weigh in the fact that you now need to get your quarterly statement audited.'

> 'So how are you going to audit your quarterly information and get it out in a timely manner?'

3. The need for improvement

The fact that investors in the UK and Ireland consume a wide variety of information in order to build up a picture of a company does not, in itself, suggest dissatisfaction with current corporate reporting. Yet investors surveyed for this report do have their reservations about the current model. It is notable that, when asked about their level of satisfaction across a range of different metrics, the proportion expressing satisfaction is, on average, only around 50% (see Figure 2.1).

A key problem is complexity – almost two-thirds of respondents think that corporate reporting is now too complex (see Figure 1.3). Moreover, a sizeable group of investors – two out five – believe the annual report is no longer a useful tool. This suggests that, while still the dominant source of information about a company, the annual report is not meeting the needs of investors as well as it should.

'In the UK, we now lay out in front of people every piece of information and then just let them get on with it', says Talbut: 'I think we've lost sight of the idea that financial reporting should be about informing longer-term providers of capital to a company to reach a decision about how well the company's management are actually performing in managing the assets over time.'

> Investors' confidence in company reporting has fallen and scepticism has risen since the global financial crisis.

> A key problem is complexity – almost two-thirds of respondents think that corporate reporting is now too complex.

Investors' confidence in company reporting has fallen – almost 7 out of 10 investors say they have become more sceptical about information from companies since the financial crisis (see Figure 1.3). 'You always tend to see increasing scepticism amongst investors in the aftermath of a financial crisis', says Stewart. 'What was different about the global financial crisis was that it was unprecedented both in severity and speed, and also the fact that it hit everything at once; the greater the crisis, the greater the subsequent increase in investor scepticism.'

Dissatisfaction with traditional corporate reporting is a key factor that is driving investors to look more broadly at other information sources, such as analysts and industry experts. 'This is really a second-best solution because I think investors would rather have a report and accounts that was a much more useful document', says Talbut.

Even face-time with management is not a panacea. Although this is valued by more than one-third of investors polled, they need to be careful about how they interpret the management information presented to them in one-to-one meetings.

'Dialogue with management is an important touchstone', says Mr Blood. The picture you build up year after year talking to management is invaluable – in addition to talking to a broader group of people within the company, including board members. But you need to remember that management has an agenda, and you should not take everything they say at face value.'

In general, it seems as if the reporting model works well, and indeed has improved over recent years. According to Chris Higson of London Business School, 'The accounting model has increasingly focused on giving us a comprehensive account of income, and on providing a balance sheet that is complete in assets, and in the claims against those assets. That's what we need and, with one or two exceptions, it is what we get. But the continuing debate is whether all of this should be measured at cost, or at value.'

The area where investors see the greatest need for improvement is the company's cash-flow statement – a shortcoming that was highlighted during the crisis. When asked about the aspect of the annual report that they thought was most in need of improvement, the most common response – given by half the investors – was the cash-flow statement (see Figure 3.1).

'The cash-flow presentation at the moment involves far too much aggregation', says Barker. 'For each line in the cash flow statement you may have three or four different notes to the account and references, so you have to

> 'I worry about the off balance-sheet risks that companies are running.'

work backwards from that to try and get to the figures that might be more useful. In general, the problem is that there is just too much netting off.'

Investors would also like to see improvement in the company's balance sheet – an area identified by 46% of respondents. Debt, leases and pensions are a particular concern.

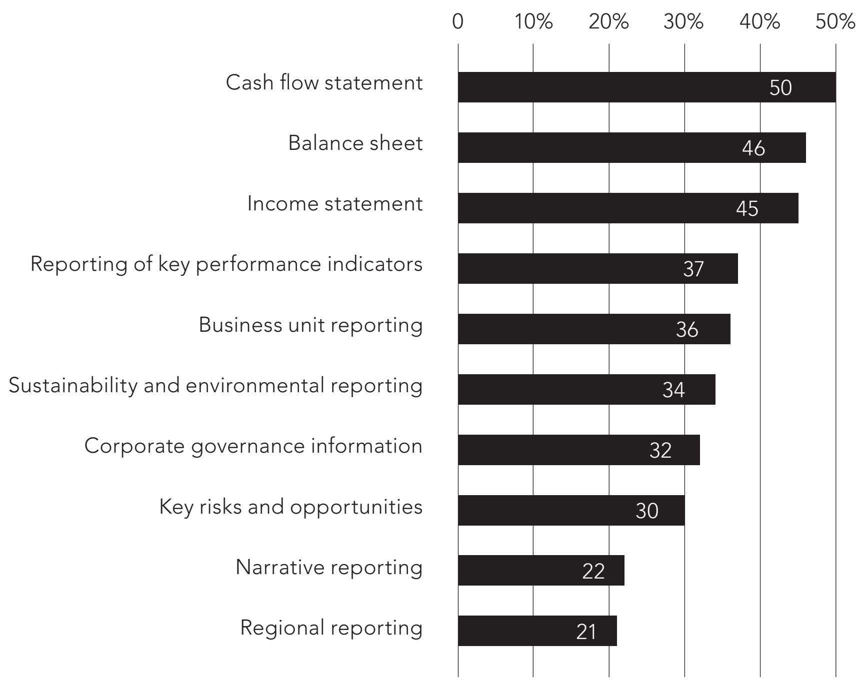
'I worry about the off balance-sheet risks that companies are running, which you don't get a clear handle on in the annual report', says McConnell. 'It's very hard, for example, to get any idea about defined benefit pensions from the annual report and accounts. There's lots of content that potentially should be highlighted more that doesn't get the attention.'

Barker echoes this perspective. He says: 'There are several different ways of looking at total debt, even if it's split up between long and short term. It would be better perhaps for companies to be a little bit more explicit with their other long-term liabilities, with regard to what the pension proportion of that is, for example.'

MORE COMMUNICATION ON RISK

Interestingly, investors in the UK and Ireland do not seem overly concerned with risk reporting. Only 30% of investors identified key risks and opportunities as the area of the annual report that needed greatest improvement. Risk does feature more prominently when investors are asked about improvements needed in narrative reporting. Indeed, respondents cite key risks to the business as the type of information that is most important to include in the narrative reporting section (see Figure 3.2).

Figure 3.1: In which of the following areas do you think the annual report needs greatest improvement?



'I think we have made a lot of progress in terms of narrative reporting but there is still more to be done in terms of improving the communicative aspects', says Guy Jubb, global head of governance and stewardship at Standard Life Investments.

Interestingly, only a small minority of investors surveyed think that improvements to narrative reporting are required. When asked specifically on this topic, the emphasis is on obtaining more insight into key risks to business, an area that has long been of concern, key growth opportunities and longer-term expectations for the business.

In interviews conducted for this report, a number of investors highlighted shortcomings in the way risk information is reported.

'The vast majority of companies produce something on risk disclosures, but only a small proportion provides any substantive commentary or description of the risks', says Pitkänen. 'So you get every kind of risk thrown in – a bland statement where the quality of information is very poor.'

Risk is a sensitive area, however, and some believe there may be a limit to the amount of information that companies are willing to provide. McConnell commented: 'I think most companies won't disclose what's in their risk framework because there's too much in it and they would be concerned about giving away sensitive management information. Often, the company is going to tell you it's low risk or low to medium.

So you may need to assess risk based on information you can get from a variety of different sources, not rely on information specifically from the company.'

Figure 3.2: Which of the following types of information do you think are most important to include in the narrative reporting section of an annual report, in terms of aiding your investment decisions?

MORE ASSURANCE

Today's increasingly sceptical investors are looking for greater assurance. There is a trade-off here. Assurance takes time and slows down the flow of information. The extent to which investors prefer speed to assurance varies depending on the nature of the information (see Figure 3.3). For example, investors are more likely to express a strong preference for assurance when it comes to general financial information and liquidity. By contrast, they are more likely to express a strong preference for speed when it comes to emerging opportunities and, to a lesser extent, profit warnings. 'The auditor has an increasingly important role in providing more general assurance to shareholders over management actions as they relate to the asset base', says Talbut.

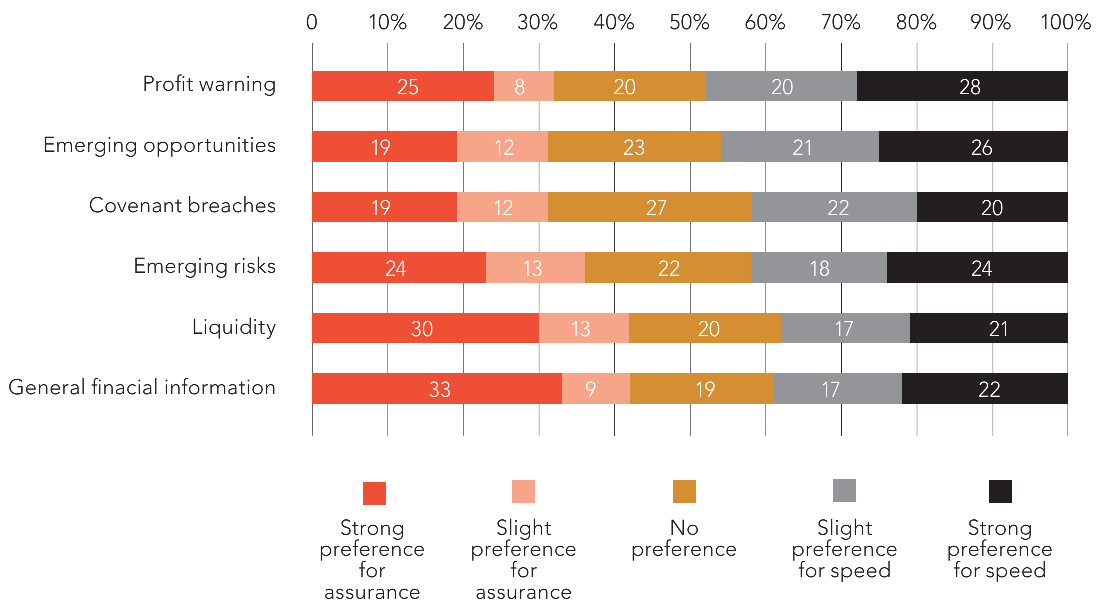
> 'The auditor has an increasingly important role in providing more general assurance to shareholders.'

> There is a trade-off between speed and assurance of information.

At the same time, investors are keen to see an improvement in auditing itself. Current proposals from the International Auditing and Assurance Standards Board (IAASB) promise more informative audit reports, which should have a positive impact. 'I think the bar has been raised when it comes to audit', adds Talbut.

'There is a growing demand to improve the level of dialogue and challenge between audit, the audit committee and shareholders, to highlight some of the key judgements which underpin the financial statements but also to get greater clarity around the relationship between the auditor and the audit committee.'

Figure 3.3: For each of the following types of reporting information from companies, would you prioritise speed or assurance?



4. Future trends in reporting

INTEGRATED REPORTING

Over time, company reporting needs to be responsive to a world that is changing through economic turbulence, new regulatory initiatives and new business priorities. Sustainability and corporate social responsibility (CSR) together form one such area. While an increasing number of companies are providing CSR and sustainability information to accompany annual reports, there tends to be less linkage between the data in these different outputs. Generation Investment Management's founder, David Blood, explained: 'Most environment, social and governance (ESG) disclosure is not currently conducive to mainstream use by investors, since these reports typically lack clear links with the company's financial performance and long-term prospects for success.'

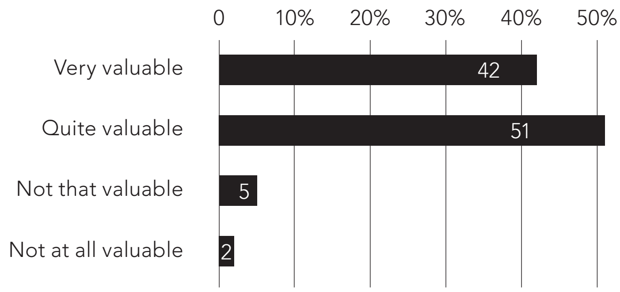
There is strong support among investors in the UK and Ireland for integrated reporting.

'Nor is this information provided in any meaningful way that can be compared with figures for their peers.'

Integrated reporting combines financial and ESG performance in one report, and aims to communicate more fully an organisation's strategy, governance, and performance, together with the way in which non-financial information fits into its operations. By presenting this information in aggregate, it promises to align the interests of investors and corporates towards long-term value creation.

There is strong support among investors in the UK and Ireland for integrated reporting. More than 90% of investors surveyed said it would be valuable for companies to combine financial and non-financial information into an integrated reporting model (see Figure 4.1).

Figure 4.1: How valuable do you think it would be for companies to combine financial and non-financial information into an integrated reporting model?



Investors believe integrated reporting would provide a better explanation of the linkage between sustainability and long-term corporate performance. A similar number believes it would provide greater information on how long-term risks such as climate change will affect a company's business model.

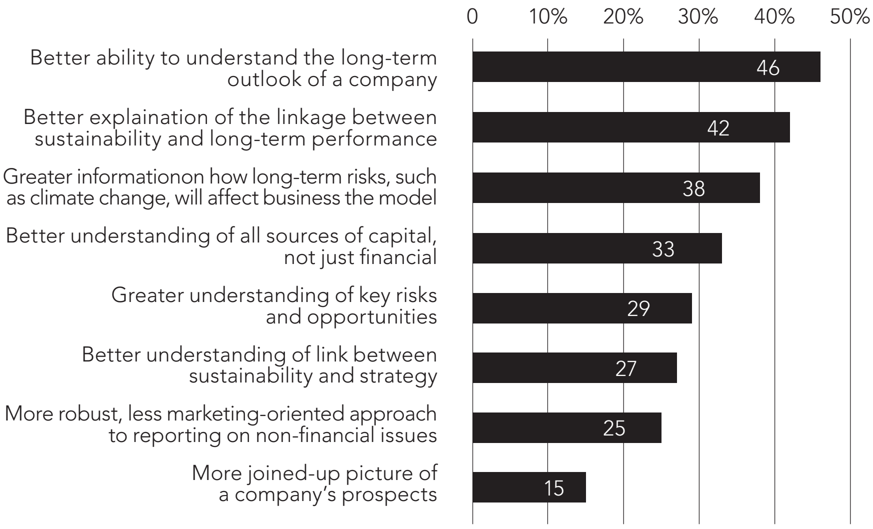
> 'Integrated reporting should help put the concept of stewardship right at the heart of the corporate reporting system.'

The key benefits of integrated reporting, according to respondents, are the ability to gain a better understanding of the long-term outlook for the company, and a strengthened explanation of the linkages between sustainability and long-term performance (see Figure 4.2).

'A company's social responsibility and sustainability efforts are integral to the longer-term wealth and health of the company and reputation', says Standard Life Investments' Guy Jubb. 'Integrated reporting would be a big help here – identifying asset categories that are not captured in current reporting and the value aspects of the company, and providing a degree of accountability as well. And it should help put the concept of stewardship right at the heart of the corporate reporting system, which is of particular importance to the shareholders and other long-term stakeholders of an organisation.'

Despite the support for integrated reporting, it seems some investors continue to harbour reservations about its benefits. Among the survey respondents, the main reasons that investors do not consider integrated reporting valuable is that they see it as too complex and are not convinced it will achieve its goals (see Figure 4.3). Given that investors are already worried about 'clutter' in the annual report, this suggests that policymakers will need to think carefully about how integrated

Figure 4.2: What would you consider to be the main benefits of a shift towards integrated reporting?



reporting can be implemented in a way that does not add to the information burden that affects many investors. It will also be important to communicate clearly the benefits of this approach to investors.

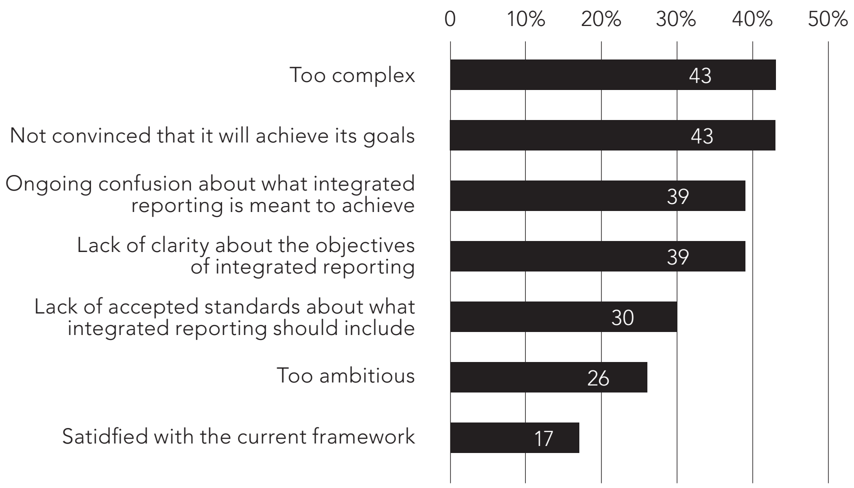
'It shouldn't be too complex to understand the key drivers of your business – that's exactly what an integrated report is', says Mr Blood. 'It should have the financial and ESG metrics that are accurate, consistent and easily accessible, but most of all, material to the business. The materiality part is critical, which is why we support the work Jean Rogers is leading at the Sustainability Accounting Standards Board (SASB, is focused on developing and disseminating industry-specific, material sustainability accounting standards for inclusion in SEC form filings.) So when we talk about integrated reporting, it's not the goal in itself.'

'In practical terms, there is much less consensus in terms of what we actually mean, what it would look like, how different it would be and how it would be better.'

'Integrated reporting is a reflection of integrated thinking within a company, and that's ultimately what they should be striving for.'

While conceptually there is a very clear attraction to integrated reporting, some are unsure about the practical steps to get there. 'I think everybody agrees it would aid the creation of an overall picture of the business and its prospects', says Mr Talbut. 'But in practical terms, there is much less consensus in terms of what we actually mean, what it would look like, how different it would be and how it would be better. We need to build a better consensus in order to advance this.'

Figure 4.3: Which are the main reasons why you would not consider integrated reporting valuable?



XBRL: THE CHALLENGE OF ELECTRONIC DATA

Extensible Business Reporting Language (XBRL) is fast becoming a global standard for the sharing of financial data. Essentially, it provides an identifying 'tag' for each piece of financial information, thereby enabling an automated approach to processing, sharing and storing that data. Around the world, numerous projects using XBRL are under way. In 2010, the Australian government launched Standard Business Reporting, which is based on XBRL, to allow companies to file financial reports online with different government agencies.

In the UK, HMRC has required mandatory filing of tax returns using XBRL since 2011, while in the US, the Securities and Exchange Commission requires all companies to submit their filings using XBRL.

Just under half of investors surveyed are using XBRL (see Figure 4.4). A recent survey from the CFA Institute found similar use patterns. Among end users of financial reports, 47% said they were aware of the worldwide standard for electronic reporting, compared with 45% in 2009 and 41% in 2007 (CFA Institute 2011).

The main benefit of using XBRL, say investors, would be to compare performance between companies more easily (see Figure 4.5).

Figure 4.4: Which of the following statements best describes your current use and opinion of XBRL?

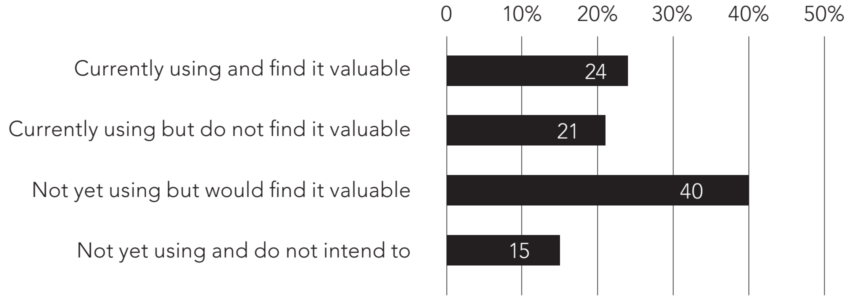
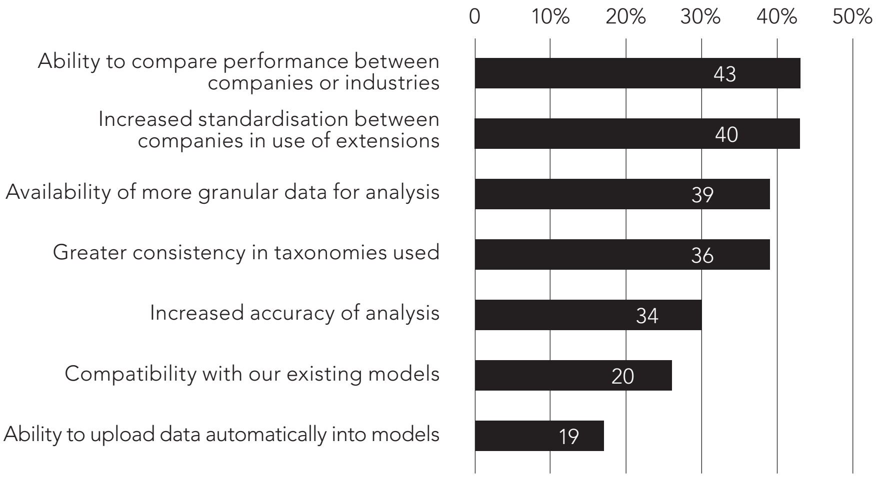


Figure 4.5: Which of the following do you or would you consider to be the greatest benefits from the adoption of XBRL in corporate reporting?



The use of taxonomies should mean that information obtained from one company can be compared with information from another. XBRL should also be of benefit for companies' internal reporting practices, because it will facilitate the sharing and access to standardised data across regions, functions and subsidiaries.

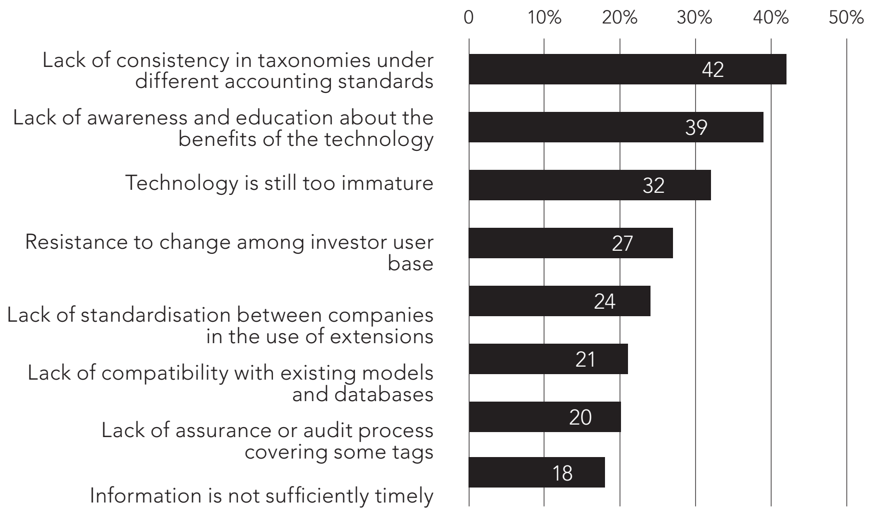
Among the survey respondents, there is certainly some latent demand for XBRL: two out of five investors say they are not yet using it but would find it useful to do so. Even so, it is clear that this is an area that divides opinion among investors. Among the 45% of investors who say they use XBRL, only around half think that it is useful (see Figure 4.4).

Despite the potential benefits from using common taxonomies, the group of investors who do not find XBRL valuable worry that there is still a lack of consistency in taxonomies under different accounting standards (see Figure 4.5). A key challenge is that taxonomies can be somewhat different under IFRS from the approach under GAAP. This makes one of the key benefits of XBRL – comparability – less obvious.

'I think XBRL is potentially useful', says Santander's David Stewart. 'But the main thing for me, certainly with respect to big companies and particularly banks and insurers, is for these companies to have more of a standardised approach in terms of how they report.'

There is some latent support for XBRL but it requires more standardisation.

Figure 4.6: Why do you not currently find the adoption of XBRL to be valuable?



5. Conclusion

Better reporting is essential to the smooth running of the capitalist system. It helps companies attract investment and build deeper relationships with investors, and it allows stakeholders to develop a deeper understanding of a company's strategy and position. Stronger relationships with investors mean that companies have greater financial support and stability.

Clarity and transparency matter. More than two out of three investors said they would apply a bigger discount to a company if its corporate reporting lacked clarity.

Clarity and transparency matter. More than two out of three investors said they would apply a bigger discount to a company if its corporate reporting lacked clarity. Good reporting can also help to strengthen financial markets and ensure that capital flows to where it can be most usefully invested.

The survey reveals a number of clear areas where improvements in reporting are required. Many investors say that there is too much clutter in corporate reporting, and they worry that management has too much discretion is how numbers are reported.

They are also divided over whether the annual report remains a useful document. Although the majority value it, there is a sizable minority that believes it is no longer fit for purpose.

Policymakers and standard setters must give careful consideration to these issues, along with initiatives that are perceived to be improving the reporting framework. Innovations such as integrated reporting find strong support from investors but, against a backdrop in which investors are already overloaded with information, care must be taken that new reporting initiatives provide genuinely useful additional input.

Investors too must seek to find ways to better assimilate a wider range of information. Their ability to analyse increasingly complex and interrelated data, often in real-time, will grow in importance.

Investors and corporates also bear a responsibility. There needs to be constructive engagement on reporting issues from both sides so that the broader financial markets are served effectively. At the same time, investors need to engage more with the regulatory and standard-setting processes, while recognising that some of their demands may be unrealistic.

There is a complex web of relationships between auditors, regulators and companies as well as broader stakeholders. Nevertheless, at its heart, the relationship between company and investor is paramount.

Investors need to engage more with the regulatory and standard-setting processes.

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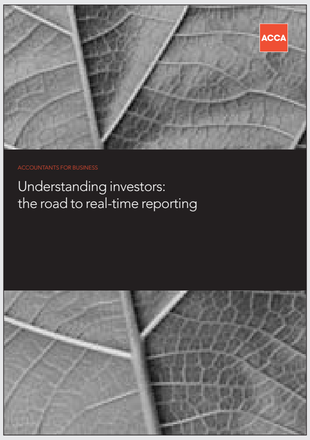
Understanding the investor landscape

ACCA, in collaboration with Longitude Research, has developed a four-stage project examining the changing investor universe, post-global financial crisis, and what investors want from corporate reporting. The project examines how pressure to respond to the needs of investors may change the approach taken by companies in reporting their activities and engaging investor groups.

Recent developments, trends and emerging issues in the investor landscape since the global financial crisis. While it uses the UK and Ireland investor base for its analysis, the trends it identifies have a wide international resonance.

The information investors need to make their decisions, how they now like to receive that information (both the format and the communications channel), and their level of trust in what they receive.



The move towards ‘real-time’ reporting, and how companies are responding to calls to disclose certain information with much more immediacy, rather than at the end of a quarter or year.

How companies are already changing their investor engagement and reporting activities to reflect evolving investor demands, and what this means for the finance function and the CFO.

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