FRC Future of Corporate Reporting Discussion Paper

https://www.frc.org.uk/news/october-2020/frc-publishes-future-of-corporate-reporting-discus

1.Would you like your response to be kept private?
No

2.Which type of stakeholder group do you represent (pick all that apply)?
Academic/student

3.Name of your organisation:
University of Glasgow

4.Contact details - if you would like to be contacted about the consultation in future please include details below.
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Invitation to comment questions
Comments are most helpful if they indicate the specific section to which they relate, contain a clear rationale and, where applicable, suggest an alternative approach.

5.What are your views on our proposals as a whole? Are there elements that you prefer over others?
We welcome the comprehensive review of corporate reporting as our ongoing research on the role of wider stakeholders within a company (Esser, I.-M. , MacNeil, I. and Chalaczkiewicz-Ladna, K. (2018) Engaging stakeholders in corporate decision-making through strategic reporting: an empirical study of FTSE 100 companies. *European Business Law Review*, 29(5), pp. 729-772 and Part 2 in *European Business Law Review*, 31(2), pp. 209-242), reveals that there is too much focus on the quantity rather than quality of disclosure. To sum up our findings, Part 1 of the empirical project on strategic reporting demonstrated that companies are producing a vast amount of non-financial information, amounting even to super or over-compliance. Part 2 indicated that while the strategic report is improving practice regarding non-financial disclosure, stakeholders perceive that it does not meet their needs for relevant and high-quality information. In other words, statutory compliance does not necessarily result in quality reporting. Part 2 also suggested that disclosure, on its own, is not a sufficient tool, and that stakeholder engagement or participation mechanisms are required (this aspect falls outside the scope of the *Discussion Paper* as it relates to engagement mechanisms such as

Provision 5 in the CGC or procedural ways to deal with stakeholder engagement like specific board committees). A simpler reporting framework, integrating financial and non-financial information, should assist in ensuring better quality information. The focus on wider stakeholders and the long-term is crucial in this regard. This is also an improvement to the current strategic report where the report is aimed at the shareholders. The definition provided of 'corporate reporting' (paras 1.5 and 1.6) is good in this regard.

We support the introduction of a regulatory framework of corporate reporting, with a long-term view. The *Discussion Paper* could have been clearer on the implementation of the framework. It also lacks specification regarding the link with s 172 of the CA2006 and the strategic reporting requirements, especially for companies other than listed companies.

The *Discussion Paper* suggests an in-depth reform of corporate reporting and contains detailed provisions in this regard. The *Discussion Paper* lacks detail when it comes to the current legal framework and how the new, proposed reporting framework will operate in relation to what is currently in place (this is dealt with to some extent in Section 8, under 'Proportionality'). This is especially the case with regards to companies not included under the new, proposed framework, but currently included under the strategic reporting requirements and the s 172 statement. It is also unclear whether the 'comply or explain' dimension, currently embedded in parts of the strategic report, will be carried over or whether the new framework is fully mandatory (this is touched upon in paras 3.1 and 3.5). Reference to the Corporate Governance Code in this regard and the recommendations on disclosure would be useful too.

We are also of the view that the focus on reporting as 'communication' is problematic, as it is our view that reporting should rather be framed in the first instance as an accountability mechanism. Rather like Marshal McLuhan's famous 1964 claim that 'The Medium is the Message', a focus on communication prioritises the 'how' over the 'what', whereas an accountability frame of reference inverts that paradigm. Referring to reporting as a 'narrative', or 'telling of a story' complicates this even further and distances reporting from its traditional link to objective and verifiable information. That in turn opens up uncertainty as to 'what' should be disclosed and as well as the risk of liability due to non-disclosure. (See, especially pages 4, 9, 11 and 18).

On page 11 reference is made to 'transparency', focussing on the 'how', but whether or not a system is transparent is based on the 'what' and less so the 'how', i.e. it is about contents not technique.

6.Implementation: What do you see as the key practical challenges of implementing our proposals?

First, the linkage to continuous disclosure has not been adequately considered throughout the report (material disclosure across any of the reports or documents in the proposed network can trigger the market abuse regime, especially in the context of listed companies, and this should be dealt with). Secondly, it is an ambitious project and requires intervention on many levels (legal, auditing rules and company reporting practices, for instance). Many companies would need to change their reporting style completely and it is likely to be a cumbersome and cost-intensive process. This would be justified if the new framework produces better quality information, which is well organised and structured.

7.Implementation: Do you have any suggestions on how the above could be overcome?

It is our view that the *Discussion Paper* does not adequately deal with implementation. It is firstly not clear how this new framework would be implemented. The relationship between 'comply or explain' and 'mandatory' compliance is also not sufficiently clear. It should be clarified whether disclosure is mandatory with regards to all issues or whether some issues will be disclosed on the basis of 'comply or explain'.

8.Implementation: What do you see as the costs and benefits of the new model?

9.Objective-driven: Do you agree that corporate reporting should focus on a wider group of stakeholders?

The current strategic report is focused on the shareholders, although it is also of use and value to a wider range of stakeholders. We are in agreement that the new framework should focus on a wider group of stakeholders and not merely the shareholders (para 3.9).

The *Discussion Paper* refers to an 'objective-driven approach' to encourage dialogue between companies and their stakeholders. In our view, the first step in recognising the importance of wider stakeholders within a company is for the businesses to identify the key stakeholders. Our ongoing research on the role of wider stakeholders in corporate governance shows only limited evidence that companies are diligent in doing this.

10.Objective-driven: Do you agree that reports should be driven by their objective instead of a primary user-focused approach?

In principle, we support a move towards an objective-driven reporting framework around principles of effective communication as a move away from the distinction between different user groups and their

needs (but see our earlier comments on the focus of reporting as 'communication' rather than linking it to accountability).

11.One set of principles: Do you consider the principles of good reporting would be helpful in improving the quality of corporate reporting?

Yes, one set of principles of good reporting would help to improve transparency and comparability of reporting, but the fact that different types of companies might need to produce different reports should be taken into account (the point made in para 6.4 that too many standards are confusing is a well-made point). Importantly, the various stakeholder groups should have an impact on the development of these principles too (this also came from our interviews with various stakeholder groups).

12.Reporting network: Do you agree with our approach to improving the relevance and accessibility of information, involving more concise reports distributed across a reporting network?

Creation of a well-functioning network of interconnected reports is challenging. It will be difficult to ensure that companies adopt a cohesive approach and produce concise reports (it is likely the reports will grow over the years too). Over-reporting, and repetition seem likely and is a risk in the context of the recommendations. The "holistic" approach mentioned as an objective would be hard to achieve. However, paragraph 2.4 refers to 'unbundling' of reports, which can work well if the reports are linked together and it is clear what must be dealt with under which report, to avoid repetition. With reference to the use of more than one report Part 1 of our non-financial reporting study (Esser et al., 2018, pages 760-762) scrutinised, among other things, transparency of non-financial reporting – i.e. links between annual reports and other voluntary CSR/sustainability reports published by companies. Our research showed examples of good practice regarding transparency of non-financial reporting:

- in 2015, 46 out of 73 FTSE100 companies that produced additional sustainability reports (also highlighting that not all companies produced additional reports); and
- in 2016, 56 out of 75 companies

made in their strategic reports, clear connections to the other reports disclosing non-financial information. Many companies made several links to various websites or additional reports. As a consequence, the additional reports were on many occasions well integrated in the strategic reports. On the other hand, although some companies were extremely diligent regarding non-financial reporting, production of several additional reports or very long sustainability reports (100 pp and more), was often counter-productive.

Finally, it is unclear to us why it is necessary to have a 'business report' and a 'public interest report'. If reports are to be neutral as to stakeholder and materiality is to span all types reporting it would seem more appropriate to combine the business report and public interest report, also to recognise that the boundary between financial and non-financial reporting will recede over time.

13.Materiality: We are proposing that there should no longer be a single test for materiality that is based on accounting standards. Do you agree with this approach?

In the *Discussion Paper* materiality is linked to communication and we see this as problematic as materiality then loses its conventional link to objective reality with such linkage. That poses a problem for capital market efficiency in terms of securities valuation as well as for compliance and the risk of liability.

14.Non-financial reporting: Do you agree that there is a need for regulatory standards for non-financial reporting?

We strongly support the introduction of regulatory standards for non-financial reporting. In Part 2 of our non-financial reporting study (Esser et al., 2020), we conducted twelve interviews with a diverse group of stakeholders. Our interviewees generally opted for a more standardised non-financial reporting framework

15.Non-financial reporting: What do you consider the scope of information that should be covered by those standards?

Our interviewees were very much in favour of creating sector-specific non-financial reporting standards. In their view for the reporting to be successful, the non-financial actors should reach an agreement first, on *how to measure* the non-financial information in a given area. Companies should report on targets that are based on objective measures, as the descriptive reporting – on how the company is doing – is not meaningful. Secondly, the *metrics* should be established – i.e. the areas that everyone thinks are important and not only the information that is financially important for shareholders should be disclosed, thirdly, the *format of disclosure* must be set up to allow comparability. This evidence supports our comments above that 'communication' is overly prioritised in the proposals over objective and verifiable information.

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16.Non-financial reporting: Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest?

Yes

17.Non-financial reporting: Do you consider that reporting by a company in respect to the public interest should be dealt with through a public interest report?

We were unclear about the need for a business report as well as a public interest report.

18.Non-financial reporting: Do you agree with the suggested content of the public interest report?

See before.

19.Technology: Do you see any other ways that current and new technology could be used to facilitate the proposed model and support the overall attributes of corporate reporting?

The suggested changes regarding technology are of good standard. If an approach of interconnected reports is adopted, tagging of all reports in the reporting network will be crucial. To better connect various reports and to make them more user-friendly, hyperlinks should be widely used too, transferring the reader instantly to the relevant part of the other report.

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

We are in favour of the suggested approach, but subject to the comments made in this document.

21.Other: What other areas do you see as necessary or relevant to the development of corporate reporting that is fit for the future?

22.Other: Do you have any other comments?