ICAEW
FINANCIAL REPORTING FACULTY

What's next for corporate reporting:

TIME TO DECIDE?

ICAEW's influence on the corporate reporting debate

ICAEW operates under a Royal Charter, working in the public interest. It is a professional membership organisation with a truly global reach.

ICAEW's Financial Reporting Faculty influences the international debate over corporate reporting through its programme of thought leadership activities and its close relations with the international accounting academic community. Activity includes a regular series of thought leadership papers published as part of its 'Information for Better Markets' programme. Influential reports have included:

- *Business models in accounting*
- *Measurement in financial reporting*
- *The effects of mandatory IFRS adoption in the EU: a review of empirical research*

More recently, the faculty has been working on a series of shorter public policy papers. These reports are intended to contribute to a better understanding of the role of accounting in society, so that policy making is more soundly-based. The first publication in the series is *SME accounting requirements: basing policy on evidence*. The final publication in the series, due to be published in 2017, is *Growth, development and accounting: seeing the bigger picture*, which will explore the integral link between accounting and economic growth.

ICAEW has been a persistent champion of the creation of a single set of high-quality global accounting standards and their application by publicly-traded and other companies around the world, and the faculty's IFRS-related reports and thought leadership activity have been influential in recent years. ICAEW's expertise in this area was reflected in its selection by the European Commission to deliver a comprehensive study in 2007 covering all aspects of first time application of IFRS by European Union member states. In 2008, ICAEW was commissioned by the United Nations to prepare a follow-up report on the UK experience of IFRS implementation. In 2012, ICAEW published the seminal thought leadership report *The future of IFRS*, which took stock of the progress that had been made in developing a global financial language and identified barriers and challenges that needed to be overcome. The contents of *Moving to IFRS reporting: seven lessons learned from the European experience*, published in 2015, remain highly relevant to those jurisdictions who have recently transitioned to global standards or are looking to do so in the near future.

The faculty is committed to providing its members with the practical help they need in today's complex world of financial reporting. The faculty provides its members around the world with clear and accessible assistance across a spectrum of financial reporting issues, keeping them up to date with changing regulations and standards.

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Introduction

The future of corporate reporting is a subject attracting much attention of late. In this report we take stock of where corporate reporting stands at present and identify the key decisions that need to be taken before a step change in the quality and usefulness of reports can be achieved, with particular reference to non-financial reporting.

The report captures some of the main features of vibrant discussions on this theme with key stakeholders at a number of recent Financial Reporting Faculty roundtables and meetings. Participants were drawn from practice, business, investor organisations, academia and the regulatory and standard-setting communities. Those involved were mainly familiar with the UK reporting regime and with reporting by listed companies, and commented principally on that basis. But many of the comments will have a wider application and a strong global resonance.

We report the points of view that enjoyed substantial support during these recent discussions (the sections entitled 'What we heard'). We also highlight a number of major issues that were singled out as barriers to change in corporate reporting, and in respect of which we think stakeholders need collectively to agree a way forward once and for all if the pace of change is to be accelerated, broadly in one direction. For each of these issues, we identify the principal policy options to be considered (the sections entitled 'Time to decide').

This report is an interim one, a contribution to a complex, multi-faceted debate of considerable importance. It is not presented as another blueprint for change, rather it forms one part of a major, ongoing programme of work by ICAEW in 2017/18 designed to advance and add rigour to the debate about the future of corporate reporting through a number of connected events, publications and research activities. Each will provide an opportunity for reflection by members of the profession and the standard-setting and academic communities on the challenging issues raised in this report. Further details of this programme are given on pages 19-20.

The Financial Reporting Faculty will consider comments on this report and encourage discussion of its findings through digital and other channels. We expect to publish a followup paper in 2018, drawing on these discussions and related outputs and activities. We will also continue to collaborate with other bodies, supporting Accountancy Europe's important efforts in this area and working closely with the Financial Reporting Council (FRC) on the reform of its guidance on the Strategic Review and with its Financial Reporting Lab on its Digital Future series of reports.

The Financial Reporting Faculty will consider comments on this report and encourage discussion of its findings through digital and other channels.

We acknowledge that the scope of this report is limited, and that it only addresses some of the many questions and issues about corporate reporting and barriers to improvement. Reporting by private companies and the improvements needed to relevant international standards and guidance are, for example, topics which are generally outside the scope of this report, although they are likely to be the subject of other Financial Reporting Faculty initiatives in the near future.

Comments on this report are welcome and can be sent to nigel.sleigh-johnson@icaew.com or alison.dundjerovic@icaew.com

Where are we now?

CORPORATE REPORTING QUALITY: AN EVOLVING STORY

Corporate reporting is continually evolving, changing to meet the demands of an ever-widening range of users, as well as responding to external events. Reporting practice is not static; it can always be improved, and needs to adapt to the constantly changing business and regulatory environment. Indeed, many new reporting models for business have been put forward over the years. Some of them have been examined at intervals in the faculty's thought leadership reports, particularly *New Reporting Models for Business* (2003) and *Developments in New Reporting Models* (2009).

Proposed blueprints for possible new models of reporting are typically far more ambitious and radical than any change that follows. But their development and publication are important. They are an integral part of the complex process of reporting evolution, challenging thinking and practice, and stimulating debate.

In the UK in recent years, much of this evolution has involved broadening non-financial disclosure. UK law requires all companies that are not small to provide an overview of their business and risks in a strategic report accompanying the annual financial statements, including non-financial information where necessary to help users understand the prospects and performance of the business. Changes to UK law effective from 1 January 2017, implementing amendments to EU law, require enhanced non-financial disclosure by large public interest companies. There are also several recent examples of new disclosures required from larger companies, under either EU or UK law, not primarily aimed at investors, and not required to be included in the annual report. This intriguing development is discussed in more detail below on page 10.

New reporting requirements and the publication of new frameworks, such as the International Integrated Reporting Council's approach to value creation, reflect both calls for greater transparency and accountability by major organisations and lower barriers to entry for information. This is reinforced by a steady stream of new proposals, such as Accountancy Europe's 2015 report *The Future of Corporate Reporting*. Demand for enhanced and more accessible corporate financial and non-financial information seems only likely to grow, including from stakeholders with limited contractual rights, such as customers and employees, and those with no contractual rights, such as NGOs and society at large.

Do these demands reflect a major failure in corporate reporting, a failure requiring drastic and urgent action?

Some think so. For example, Baruch Lev and Feng Gu, in their recent book *The end of accounting and the path forward for investor and managers [New Jersey: John Wiley and Sons]* go as far as stating in the introduction that 'we grade the ubiquitous corporate current report information as largely unfit for twenty-first-century investments and lending decisions'. But at the same time we have found continued endorsement of current reporting from many users. These users share the view of participants in the IASB's Investors in Financial Reporting programme, set out in a *Statement of Shared Beliefs*, 'that high-quality, transparent financial reporting is fundamental to building trust in the capital markets and to making investment decisions'.

Some important questions emerge from these different perspectives. Firstly, is corporate reporting fit for purpose for investment and lending decisions? And secondly, does a company really have a responsibility to provide information to stakeholder groups beyond its investors? If so, to which stakeholder groups and to what degree does this responsibility extend? Moreover, and importantly, does that mean that current reporting needs to be replaced with something radically different, perhaps by near-term regulatory intervention? Or are reports of the death of the annual report and accounts greatly exaggerated?

NEW BUSINESS MODELS AND NEW PERSPECTIVES

Demand for additional financial and non-financial information is driven not only by societal expectations but also by changes to business activities in the past few decades, which have seen increasing emphasis placed on innovation and knowledge. However strict recognition criteria for internally-generated intangibles mean that the value of some potentially significant assets such as brands, data, domain names, customer relationships and employees often go unrecorded in the financial statements. This gap between the market value of some companies and the accounting book value of their net assets prompts questions from time to time about the credibility of current financial reports. We discuss views on these issues in more detail on pages 14-15.

Since the financial crisis of 2008, there has also been growing recognition in the UK of the importance of the long-term view in business and the financial markets. This view found expression in the *Kay review of the UK equity markets and long-term decision making* and is now supported by the UK Corporate Governance Code via the requirement for inclusion of a 'viability statement' in the annual report. The inclusion of forward-looking indicators is also often suggested as a way of improving the value relevance of the annual report.

Disclosure of such information is not a revolutionary idea. It was first recommended as long ago as 1973 in the Trueblood Study Group's report *Objectives of Financial Statements*, which suggested that financial forecasts should be included in the annual report. However, it is only in more recent years that this has become a common feature of reporting practice. A recent survey by KPMG, *The KMPG Survey of Business Reporting*, reported that 25% of the companies included (270 companies across 16 countries) provide short-term forecasts in their annual reports. This emerging trend adds to the debate on the purpose of the annual report and whether its role is primarily confirmatory or predictive.

> ***The inclusion of forward-looking indicators is also often suggested as a way of improving the value relevance of the annual report.***

INNOVATIVE COMPANIES, INNOVATIVE REGULATORS

Our work in recent months has found that gloomy assessments made by some of the value of current reporting are balanced by widespread agreement that the quality of narrative and non-financial disclosures in the 'front-half' of the annual report has improved significantly in the UK in recent years. Of particular note are improvements in relation to the business model, strategy, non-financial key performance indicators (KPIs) and drivers of long-term value creation.

Those we spoke to tended to agree that there is much still to be done, both by preparers and by standard-setters, to build on the progress made and to ensure that corporate reports are crystal clear about companies' business models and long-term drivers of value. Many agree this process brings with it internal benefits such as better understanding of risks and value, as well as improved external communication. But there is a strong sense that the 'front-half' has continued to evolve remarkably in response to the introduction of the strategic report and changing market expectations, benefiting from the innovative approach of the Financial Reporting Council (FRC) – the key UK regulator – and of many reporters themselves.

Recent initiatives from the FRC highlighted as of relevance include:

- a strong encouragement of 'clear and concise' reporting;
- the introduction of a requirement for those companies within the scope of the Corporate Governance Code to produce annual reports that overall meet a 'fair, balanced and understandable' test; and
- the creation of a highly successful Financial Reporting Lab to foster innovation in corporate reporting by encouraging experimentation, sharing of good practice, and the development of market-based, non-regulatory solutions to investor demands for improved information.

In response to the FRC's initiatives and changing stakeholder demands, there are ample examples of companies producing high quality and highly innovative reports. In the 2016 PwC *Building Public Trust in Corporate Reporting Awards* for 'excellence in reporting' Marks & Spencer won the FTSE 100 award for an 'open and balanced annual report', with commendations for, among others, BT for its forward-facing strategic reporting and clear sustainability targets, and Mondi for 'strong use of the UN's sustainability goals'.

Surveys across the UK listed sector underline that improvement is not confined to a few exemplary reporters at the top end of the FTSE 100: Deloitte's *Annual reports insights 2016* found, for example, that 74% of companies surveyed now disclose non-financial KPIs in their annual reports. Some excellent examples of informative and innovative reports among smaller quoted companies have been highlighted too. Their behaviour is seen as driven not just by changes in regulation but to some degree by a growing realisation that stakeholders other than shareholders are important to long-term value creation and that their information needs should be considered.

Those emphasising the adaptability of UK corporate reporting also point to the response of many major companies to the work of the International Integrated Reporting Council (IIRC) in developing its Integrated Reporting (<IR>) framework. The majority of the FTSE 350 are covering many of the key content elements of the <IR> framework and reporting in a broadly integrated manner. While in the UK the strategic report is the key vehicle for improvements in reporting, many agreed that the voluntary adoption of a more integrated approach is likely to continue to grow as learning and experience of applying the principles of the <IR> framework deepen.

TECHNOLOGY

No discussion of the current condition of reporting and the likely future direction of travel would be complete without reference to the ever-increasing role of technology in the corporate world.

ICAEW's IT Faculty's 2015 thought leadership paper *Providing leadership in a digital world* highlights how digital technology is transforming business, economies and societies. Consideration of the medium and longer term impacts of new technologies on business decision-making and management practice is, however, at an early stage, and is a subject that many suggested now requires greater attention from the profession and other constituents.

In the context of corporate reporting there is an abundance of financial and non-financial data that could be made available to the user, yet despite access to seemingly limitless data, we found wide agreement that there has been little progress so far in the use of technology as a corporate reporting tool. Reference was made by academics to ICAEW's far-sighted 1975 paper *The Corporate Report* (hereafter, 'our 1975 report'), which anticipated a move away from paper-based reporting, noting that 'it is likely that new means of communication will become a practical alternative in the future'. This prediction has only been partially realised over 40 years later.

Part of the debate about future corporate reporting therefore involves consideration of the reasons for this lack of progress and how to make better use of new and emerging technologies. We summarise recent discussion of these issues on pages 16–18.

OVERVIEW: CHANGE AND CONTINUITY

Overall, we found that the conditions for radical change exist, with significant and growing demand for better financial, and in particular non-financial, information from capital providers and other stakeholder groups alike. But alongside this analysis contributors emphasised the willingness of many UK companies to try to meet these demands and the signs of remarkable innovation and adaptability in UK reporting. This, it was felt, is a good news story which rarely makes the headlines.

As our discussions moved on from an assessment of current conditions, questions considered included the following:

- What are the objectives of corporate reporting?
- How and to what extent should companies meet the demands of diverse stakeholder groups?
- How can we achieve consistency and credibility in corporate reporting as it continues to evolve?
- What should be done about the 'intangibles problem'?
- How and to what extent can data and technology realistically improve the quality of corporate communications?

We will explore these questions in more detail in the next section.

Some key issues and challenges

OBJECTIVES OF CORPORATE REPORTING: WHO IS THE USER?

The uncertain definition of 'corporate reporting', together with the variety of views on what it encompasses and who its users are, was a recurrent issue raised during discussion.

Traditionally, corporate reporting has been viewed as a crucial form of communication between business and capital market participants. The information needs of investors and other current and potential providers of financial capital (hereafter, 'investors') have long been seen as enjoying primacy. Other stakeholders might disagree with this view, claiming that their capital is just as much at risk as that of investors. Suppliers, for example, might postulate that they provide credit, which is a form of financial capital, as would a customer paying in advance. Employees arguably invest 'human capital' in a company and bear risk in the form of their future livelihoods, the risk of redundancies and uncertainties in pension values. From this perspective, the capital they invest and their contribution to value creation entitles these stakeholders to relevant information from the business.

This view was advanced in our 1975 report, in which users are defined as 'those having a reasonable right to information concerning the reporting entity'. The authors considered that rights to communication 'arise from the public accountability of the entity whether or not supported by legally enforceable powers to demand information'. Employees, customers and suppliers, among other stakeholder groups, are cited in the report as valid users of corporate reports.

ONE REPORT OR MANY? THE NEEDS OF INVESTORS V OTHER STAKEHOLDER GROUPS

In considering the accountability of businesses in the 21st century, it is generally agreed that policymakers should look beyond financial reporting to corporate communication in the round, and its future development. However, most of those we spoke to agreed strongly that we must not lose sight of the enduring importance of the annual report and the need for it to focus primarily on reporting to investors.

The annual report remains the cornerstone of the corporate reporting process, underpinning investor trust and confidence. It continues to play a critical role in allowing investors to monitor management efficiency and make informed decisions about where to invest. This may of course change in time, but the confirmatory role of the annual report seems likely to remain very important in the medium-term at least. It pulls together the information that is made public at various times during the reporting year. Investors can therefore have more confidence in this information, knowing that they will be able to confirm later on that it is reflected in the annual report and audited financial statements.

It was recognised that the focus on reporting to investors has potential downsides. For example, some argue that it can reinforce short-termism which, in turn, can temper innovation and development. Nonetheless, if this focus was lost, and the annual report were required to meet the information needs of an even wider variety of stakeholders than at present, it would make the report more diffuse and less useful. Users may overlook important insights if more and more information of questionable relevance is required on a mandatory basis and boards will find it more difficult to tell a coherent story in the annual report about the performance and prospects of the business. The conclusion in our 1975 report was highlighted, stating: 'Corporate reports cannot satisfy all the imaginable information needs of the public'.

> ***What we heard:* 'The UK government should relocate detailed information required by law to be included in the annual report, notably much of the information on directors' remuneration and on greenhouse gas emissions, with clear links provided to more detailed information located elsewhere.'**

Investors and other stakeholders often have much in common and on some issues information primarily of interest to other stakeholders will also be material to investors and should be reported to them. But if an annual report focused on investors is to remain the cornerstone of the corporate reporting process, what of the information needs of other stakeholders? A number of themes emerged here, summarised below.

The duty of a director, as set out in section 172 of the 2006 Companies Act, is to:

'act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

a. the likely consequences of any decision in the long term;

b. the interests of the company's employees;

c. the need to foster the company's business relationships with suppliers, customers and others;

d. the impact of the company's operations on the community and the environment;

e. the desirability of the company maintaining a reputation for high standards of business conduct; and

f. the need to act fairly as between members of the company.'

The purpose of the strategic report is to inform members of the company and help them to assess how the directors have performed their duty under section 172. Directors are explicitly required to take these interests and issues into account in the way the business is run, albeit this does not imply any specific duties to those other stakeholder groups.

These requirements were seen as providing the context for reporting on a broader range of factors. Indeed, it was noted that the reports of listed companies increasingly make at least some reference to the interests of wider stakeholders. Of the listed companies whose annual reports were surveyed for Deloitte's *Annual reports insights 2016*, 33% sought to explain how they create value for stakeholders other than shareholders and 93% at least referred to stakeholders other than shareholders.

But it was also widely agreed that there is room for improvement, leading to ICAEW suggesting that the FRC incorporates a specific reference to the needs of other stakeholders in the requirements of the strategic report (*ICAEW REP 23/17*) and that the FRC undertakes research on how the strategic report could be better used to demonstrate whether directors have fulfilled their duties under section 172 (*ICAEW REP 39/17*).

> ***What we heard:*** ***'Listed companies should disclose in a clear and concise way who they think their key stakeholder groups are, how the company stays up-to-date about changing stakeholder priorities and how the company seeks to balance their different interests. They should also report how they have responded to stakeholders and make sure that their voice is heard in the boardroom.'***

Some of those we spoke to felt, nonetheless, that the diverse information needs of stakeholders makes it increasingly difficult to provide a single report that can adequately meet those needs.

> ***What we heard:*** ***'Producing separate reports for other stakeholders is a sensible part of the solution, as long as the information disclosed and broader messages conveyed are, where relevant, consistent with the annual report.'***

Many reporters in the UK have already embraced alternative forms of reporting, particularly sustainability reporting. This responds to growing demands for transparency in these areas, which is highlighted in PwC's recent report *It's not just about the financials: The widening variety of factors used in investment decision making*. The report explains that many investors now believe that such information captures important aspects of corporate performance.

Indeed, it was pointed out that ICAEW has consistently supported a trend for UK and EU policymakers to require companies to publish on designated websites information not primarily aimed at investors, sometimes on the company website supplemented by links to a government-sponsored website. There are several very recent examples of new disclosures under EU or UK law being channelled to interested stakeholders in ways other than the annual report, as illustrated in Table 1 below.

TABLE 1: RECENT EXAMPLES OF DISCLOSURES REQUIRED OTHER THAN IN THE ANNUAL REPORT

TOPIC	LEGISLATION	REQUIREMENTS	WHERE DISCLOSED
Country-by-country reporting	EU Accounting Directive 2013	Requires large companies in certain sectors to disclose payments to governments and related information on a country-by-country basis.	Reports must be filed annually with the tax authorities of the member state where the reporting entity is resident.
Non-financial information	EU Non-Financial Reporting Directive 2014	Requires large public interest entities to report on the impact their operations and policies have on the environment, human rights, society and employees, boardroom diversity, and tackling bribery and corruption.	The directive permits member states to report the required disclosures separately on a company's website, not necessarily at the same time as the annual report is produced. The UK has opted for disclosure in the annual report.
Trafficking and slavery	UK Modern Slavery Act 2015	Requires larger businesses to publicly report steps they have taken to ensure their operations and supply chains are free of trafficking and slavery.	The report must be prepared each financial year and published prominently on the organisation's website.
Gender pay gap	UK gender pay gap regulations	Larger UK companies are, from April 2017, required to publish details about their gender pay and gender bonus pay gaps.	Companies are required to publish information annually on their websites, supplemented by links to information provided on a government-sponsored website.
Payments to suppliers	UK regulations on payment practice	From April 2017, larger UK companies are required to report publicly on their payment practices and performance, including the average time taken to pay supplier invoices.	Companies are required to report twice a year via a UK government-sponsored website.

It was highlighted during our discussions that consultation about proposals for these new reports often falls short of best practice. Public consultations proposing new special purpose reports by companies are variable in standard and often don't allow sufficient opportunity to comment.

> ***What we heard:* 'The creation of a set of high level due process principles to underpin consultative processes, based on international best practice, might help, perhaps involving the Corporate Reporting Dialogue.'**

It was also recognised that the increasing plurality of reports brought with it risks and challenges, with no consistent approach taken when devising requirements to disclose information on regulatory and social issues other than through the annual report (for example on company websites or via a central registry). Variations in scope, reporting method and the means by which the information is made public were seen as inefficient and causing confusion.

> ***What we heard:* 'The UK government should adopt a consistent approach to new reporting requirements. This should include the development of principles for measurement objectives, updating, organisational boundaries and assurance as well as the style, presentation and placement of information. The appointment of a designated 'gatekeeper' to assess all suggestions for new legal requirements for corporate disclosure in the annual report and to ensure a more uniform approach is taken to other disclosure requirements in terms of scope and method of disclosure might be a useful step forward.'**

It was also emphasised that, if the trend in the UK and elsewhere for distinct and separate reports to be produced for capital market audiences and for non-capital market audiences continues, the linkage between the reports and the use of consistent underlying information sources will become increasingly important. A number of examples were given. With respect to tax fairness, a company's annual report might set out what its tax strategy is and then refer users to its country-by-country report for more details. Although this is prepared for a different stakeholder group, the detail should nonetheless be consistent with, and provide evidence to back up, the claims made in the annual report. On greenhouse gases, the annual report could include environmental metrics to the extent that they are non-financial KPIs, but more detailed emission data reported separately elsewhere should be referred to (but not replicated).

Time to decide?

Should the trend for separate reporting outside of the annual report be encouraged, with appropriate safeguards, to minimise the risk of undermining the usefulness of the annual report to investors?	***or***	**Are the advantages of a single, comprehensive and trusted vehicle for corporate communication with a wide range of stakeholders more important?**

CONSISTENCY, CREDIBILITY AND THE PACE OF CHANGE

During recent discussions some expressed frustration with the limited progress made to date in achieving what they saw as the need for radical change in corporate reporting. But others pointed to the importance of achieving effective and sustainable change in corporate reporting, recalling that the International Accounting Standards Committee (IASC) was formed in 1973 with the intention of creating a single set of high-quality global accounting standards, but those standards were not widely or rigorously applied until the EU and other jurisdictions adopted them from 2005.

Those content to accept a more measured pace of change focused on the importance of embedding experimentation into the process, rather than seeking standardisation at an early stage in the evolution of non-financial reporting practices. This allows evidence to be gathered on the usefulness of the innovation before reporters generally are required to adopt it, rather than afterwards.

Any confusion caused by the existence of many viewpoints, ideas and initiatives was seen as a necessary confusion in the evolution of ideas. It was acknowledged nonetheless that experimentation involves costs for those that undertake it and that preparers will need to be convinced that the potential benefits outweigh these costs. Innovators are also always likely to be a minority, especially in a field such as corporate reporting where the financial benefits of improvement may not always be obvious.

> ***What we heard:* 'What we need is evolution not revolution. Those seeking effective and sustainable improvement in corporate reporting should acknowledge that the pace and nature of change must provide for innovation and experimentation over time as a vital part of the process. Policymakers should actively promote experimentation with the aim of capturing best practice and gradually standardising that practice as appropriate over time.'**

There are lessons to be learnt from the UK, where there is already a considerable amount of innovation. The FRC's Financial Reporting Lab is an example of a forum that has been created to provide an environment where investors and companies can come together to develop pragmatic solutions to reporting needs. At an international level, the Financial Stability Board's Enhanced Disclosure Task Force, which made authoritative recommendations on ways of improving disclosures by banks in the wake of the financial crisis, provides a good example of how progress can be made by bringing together stakeholders under a regulatory umbrella. The recent work of the Taskforce on Climate-related Financial Disclosures (TCFD), also set up by the Financial Stability Board, similarly illustrates this approach to improving reporting practice in an internationally-coordinated way.

In our February 2017 comments on the TCFD's proposals (*ICAEW REP 21/17*), we acknowledged both the strengths and possible shortcomings of the voluntary approach:

'We strongly support the proposed voluntary approach to implementation of the guidelines. Thinking and practice regarding the assessment of climate change risk are at a very early stage. Companies and other organisations are still experimenting with what to disclose and how to disclose it. We believe that it is right that a period of experimentation should continue for some time yet and that practices should continue to be allowed to evolve in response to market demands for information. We acknowledge that a voluntary approach tends to lead in practice to diversity in the quality and style of disclosure ... We suggest that the success of the proposed approach should be monitored closely for an agreed period of time with a view to reviewing the case for taking steps in the direction of a mandatory approach.'

A contrary and common view expressed about the confusion caused by the current and growing diversity of guidelines, frameworks, ideas and initiatives was that it is likely to undermine the usefulness and credibility of non-financial reporting. Proponents of this view recognised that there was little realistic possibility of a single reporting model emerging to provide a detailed blueprint for all non-financial reporting, accepting that the information that different businesses disclose is simply too diverse to be captured by such a model. They advocated instead the development of a new principles-based framework to provide direction on non-financial reporting. Such a framework would be used as a basis for a common language and consistent measurement bases, with perhaps detailed practical guidance on a sector-by-sector basis on common KPIs and their link to strategy and performance. The example of material produced by the Sustainability Accounting Standards Board (SASB) was referred to.

It was suggested that for companies choosing to publish, for example, employee survey results, a single method could be agreed for measuring employee satisfaction and how to best disclose the results to the user. This, it was felt, would represent a leap forward in non-financial reporting, providing guidance for the preparer on measurement and disclosure and improving comparability for users. It would draw on existing frameworks where appropriate and could perhaps also provide a template for the possible future development of non-financial reporting standards.

> ***What we heard:* 'The updating and effective promotion of the IASB's guidance on management commentary might be a key catalyst for improvement in non-financial reporting.'**

Those advocating such an approach went on to argue that this proposal should encompass all forms of non-financial reporting and would necessitate the creation of an authoritative, independent, internationally-recognised umbrella body, supported by relevant organisations in each jurisdiction, to coordinate activities globally and help cement a common viewpoint on the desired direction of travel.

The International Organization of Securities Commissions (IOSCO) or the IFRS Foundation were seen as well placed to oversee the establishment and operation of this over-arching international body. It was recognised that this initiative would require continuous dialogue between preparers, investors, regulators and other stakeholders in the coming years. A role for the Corporate Reporting Dialogue convened by the IIRC was suggested.

Time to decide?

Is a concerted international effort needed to encourage adoption of a consistent approach to non-financial reporting, perhaps through a high-level framework, developed and coordinated internationally by a global umbrella organisation?

or

Should we accept that, with non-financial reporting practice still emerging and evolving, initiatives designed to increase standardisation may at this stage inhibit all-important experimentation and innovation?

THE INTANGIBLES PROBLEM

In this short report we have focused on improvements to non-financial reporting, the 'front-half' of the annual report, rather than the quality of the financial statements themselves. In this section, we make an exception. We reflect on the diverse views we heard about what some – often commentators not close to the financial reporting debate – regard as the Achilles' heel of financial reporting, namely the accounting and reporting of intangible assets.

Before its 2015 agenda consultation, the IASB's research programme included an inactive project encompassing intangible assets, research and development and the activities of the extractives sector, but little progress was made. In view of the growing debate about the financial reporting of climate change and other environmental issues, the IASB has now included a project on extractive activities in its research pipeline. But any reference to intangible assets was removed on the basis that 'any attempt to address recognition and measurement of intangible assets… would require significant resources, with very uncertain prospects for any significant improvement in financial reporting'.

A separate IASB research project, already underway, will consider just one aspect of accounting in this area, the extent to which other intangible assets should be separated from goodwill.

While it is was acknowledged that previous attempts to move things forward in this area of standard-setting have not been very successful, and it is undoubtedly a difficult and complex area where investor views vary, some we spoke to were adamant that more ambition is needed. Few intangibles meet the criteria for recognition on company balance sheets, except in the context of the acquisition of a business, and those we spoke to argued that this weakens the extent to which financial reporting can provide a clear picture of a company's resources to investors and other users of financial reports.

It was pointed out that this concern is only set to increase as more businesses – including the likes of Google and Facebook – are driven by internally-generated intangible assets that cannot be recognised in the financial statements. Accordingly, the time was seen as ripe for further research and debate about the current inconsistent accounting treatment of intangibles. It was noted that in January 2016 ICAEW wrote to the IASB arguing that work to resolve the inconsistency in financial reporting between the treatment of acquired intangible assets and internally-generated intangible assets, was of high importance (*ICAEW 04/16*). In March 2017 we wrote to the FRC with the same message (*ICAEW 39/17*).

> ***What we heard:* 'Reporting of intangibles is a key constraint on corporate reporting and raises questions about comparability and continued relevance. The inconsistent accounting treatment of intangibles needs to be looked at again. The IASB and other policy makers need to advance thinking and practice in this area, and sooner rather than later.'**

The view that we should look at incorporating fully the existing difference between market value and the present balance sheet net asset value of companies by recognising all those intangible factors was a minority one. Others suggested that, with far-reaching changes to IFRS unlikely, the focus should be firmly on ensuring that listed companies in the UK and internationally better address this gap through their front-half reporting, by providing clear, consistent and relevant information to investors seeking alternative means of understanding how the business creates value over time. It was noted that ICAEW's March 2017 letter had also called for the FRC 'to consider the wider debate surrounding the reporting of intangible assets, including better use of the front-half of the annual report and the use of narratives to describe expenditure on assets that are not recognised in the balance sheet'.

> ***What we heard:* 'The objective for the next few years should be to improve understanding about how value is created by the business and to highlight good disclosure practice, encouraging businesses to follow that practice in disclosing their drivers of value alongside the financial statements.'**

The guidance on the strategic report published by the FRC – which calls for information on 'the entity's key strengths and tangible and intangible resources', including 'items that are not reflected in the financial statements' – was seen as relevant here. The IIRC's work in recent years in underlining the importance of such disclosures was also referred to.

Time to decide?

Is it time for standard-setters, with the support and active assistance of other stakeholders, to rise to the challenge and prioritise ways and means of bringing a much wider range of intangibles onto the balance sheet?

or

Should it be finally accepted that the intangibles question will not be resolved through financial reporting change, with attention firmly focused instead on a broader approach to reporting that looks beyond historical financial performance?

DATA AND TECHNOLOGY

In our 1975 report, we noted the need for 'legal reporting requirements and accounting practices' to catch-up with recent 'technological innovation and change'. As we approach the third decade of the 21st century, a key theme of our discussions was agreement that one of the key challenges involved in advancing corporate reporting remains how to take advantage of new technologies, at a time when traditional paper-based reporting is still perceived by many as the principal form of communication.

A recent study by the FRC's Financial Reporting Lab *Digital present: Current use of digital media in corporate reporting* (part of the Financial Reporting Lab's project Corporate reporting in a digital world which has been followed by their latest publication, issued in May 2017: *Digital Future. A framework for future digital reporting*) notes that many consider the UK legal requirement to 'make available a hard copy of the annual report when requested' may be a reason that a paper format continues to be seen as of high importance. The report suggests that 'accounts should be capable of being printed on to paper (something that most web pages are) but do not have to be prepared with a printed page in mind. The law in this respect does not constrain innovation, but rather seeks to guarantee access for all'.

We found wide support for this view that innovation should not be constrained by what would be possible in a paper format if there is a better way to communicate. Although caution will be needed to ensure that the quality of information provided is not compromised, some of the emerging technologies explored on the following pages offer the ability to improve communication with investors by accelerating reporting timetables. This might help address the criticisms of some investors that the financial statements are inadequate for decision making purposes due to lengthy filing deadlines, while recognising that investors now use multiple sources of information to heir investments, much of which is generated outside of the company.

However, in a more fundamental sense, some think that the law does constrain innovation in corporate reporting because it demarcates the boundaries between different reports within the annual report, including between audited and unaudited information. These barriers may need to be broken down to make technology really valuable to the user. It may be difficult to provide technology that combines audited and unaudited information without resolving how to provide clarity on the differing levels of assurance.

> ***What we heard:* 'In the medium term a wider review of fragmented legal and regulatory UK frameworks should be undertaken to identify barriers to optimal use of technology in reporting, and to innovation and good communication generally.'**

Our discussions did not cover all possible technologies of relevance to corporate reporting. There are complex phenomena at play here, often still evolving and not always well understood. It was widely agreed that for progress to be made in the near future there would need to be greater analysis of the likely impact of digitalisation in both theory and practice in this area, requiring more extensive collaboration between IT specialists, the academic community and standard-setters. The analysis would need to draw on IT expertise and relevant research to improve understanding of the possible implications for business and reporting of emerging technologies such as data analytics and blockchain technology. This would help to ensure that the profession is at least able to frame the appropriate questions that need to be addressed.

> ***What we heard:* 'Further academic research into the application of technologies in the corporate reporting process may be helpful. Of particular relevance would be case studies that consider what drives and hinders the use of technology, to enable an assessment of how best to facilitate change. Better collaboration between accounting and IT academic and non-academic communities will be required for progress to be effective.'**

There was wide agreement that collaboration at a practical level between standard-setters and IT specialists will be required in due course. As new reporting initiatives emerge, it will be necessary to consider how technology can assist preparers in implementing these changes. A recent report by The <IR> *Technology Initiative Technology for Integrated Reporting, A CFO guide for driving multi-capital thinking*, is an illustration of this.

> ***What we heard:* 'Bringing technology specialists and "disrupters" into general discussions about corporate reporting will be necessary to understand the opportunities and "mainstream" technology considerations for the reporting process.'**

Raw data and structured data provide examples of the use of technology that were mentioned by our stakeholders as warranting further discussion in this context. We have summarised below conversations about how they could be used to improve corporate communication, the challenges they raise, and existing publications on this topic.

RAW DATA

One vision for the future of corporate communication is providing the user with raw data. This would not only allow the user to manipulate the data as they wish, it would also sidestep the issue of trying to meet the diverse information needs of all stakeholders. A move towards this form of communication may however overlook the importance that management's judgement plays in interpreting data to make it understandable to the user.

There are also numerous obstacles to overcome before this outcome could be achieved:

- In the absence of a clear framework to guide preparers, there is currently no consistency in the data collected or quality of systems used by businesses, making comparison difficult.
- Even if consistency could be achieved, whether providing the raw data would benefit the user would be open to question. The ability to download an almost endless amount of data may overload the user, leading to confusion and an inability to identify material issues.
- Raw data without context may also lead to erroneous conclusions being drawn, as is seen when users equate tax divided by sales as a measure of whether or not a company is paying enough tax.
- Even if the information can be disseminated, it may not always be understood by the user in its raw form, reducing its value.

STRUCTURED DATA

Another option, and perhaps a more realistic one, is the use of structured data such as XBRL, which is already used in capital markets to electronically tag financial reporting data.

This topic was considered in an earlier ICAEW report, *Digital Reporting: A progress report (2004)*. Rather than burden the stakeholder with excessive information in its raw form, it should be possible for users to access specific tagged information and then manipulate it as required. Its use could also be extended to incorporate additional financial and non-financial data.

This option forms part of the recommendations in the CFA Institute's *Data and Technology: Transforming the financial information landscape* (2016) which argues that structured data is not currently being used to its full effect. The report suggests that electronic tagging of values beyond the face of the financial statements would be 'extremely valuable to investors' and that this could be extended further through the incorporation of text block tagging to facilitate text analysis of management commentaries, disclosure notes and accounting policies. The challenges faced include developing a strong taxonomy that is consistent with other countries and thereby instils trust in the user. The CFA Institute also recognise that the use of structured data is currently seen as a compliance exercise, with tagging done after the financial statements are produced. It suggests that companies need to use structured data earlier in the process if it is to be timely and useful to the user.

If the use of XBRL is to be extended, however, it may first be necessary to address concerns about what has been described as the 'trust gap' between the audited annual financial reports of companies and the currently unaudited digital versions of those documents. The risk is that users do not differentiate between the two formats, assuming that they will be identical, when in fact they are often prepared using very different processes. This highlights perhaps a need to develop consistent and coherent standards for providing assurance over digital reporting.

As technology continues to evolve, it will be important that decisions about the reform of corporate reporting reflect these sorts of impacts, and are not be taken in isolation. It is also clear from these examples that there will be many challenges in incorporating them into the corporate reporting and assurance process and ensuring that the potential benefits to the business and its communications are properly explored and understood.

Time to decide?

Should we accept that the pace of progress in the use of technology as a corporate reporting tool is likely to remain very slow, with no real impetus to change when investors already manipulate data using their own software and analyse data from a variety of sources?

or

Should stakeholders make a concerted effort to accelerate and coordinate progress, necessitating a new depth and breadth of collaboration between technology specialists and those with an interest in better corporate reporting?

Conclusions and next steps

While in many respects there is agreement about the preferred future direction of corporate reporting, our discussions have highlighted a number of critical policy questions that stakeholders need to address collectively before substantial progress can be achieved:

THE NEEDS OF INVESTORS V OTHER STAKEHOLDER GROUPS

Should the trend for separate reporting outside of the annual report be encouraged, with appropriate safeguards, to minimise the risk of undermining the usefulness of the annual report to investors? Or are the advantages of a single, comprehensive and trusted vehicle for corporate communication with a wide range of stakeholders more important?

CONSISTENCY, CREDIBILITY AND THE PACE OF CHANGE

Is a concerted international effort needed to encourage adoption of a consistent global approach to non-financial reporting, perhaps through a high-level framework, developed and coordinated internationally by a global umbrella organisation? Or should we accept that, with non-financial reporting practice still emerging and evolving, initiatives designed to increase standardisation may at this stage inhibit all-important experimentation and innovation?

THE INTANGIBLES PROBLEM

Is it time for standard setters, with the support and active assistance of other stakeholders, to rise to the challenge and prioritise ways and means of bringing a much wider range of intangibles onto the balance sheet? Or should it be finally accepted that the intangibles question will not be resolved through financial reporting change, with attention firmly focused instead on a broader approach to reporting that looks beyond historical financial performance?

DATA AND TECHNOLOGY

Should we accept that the pace of progress in the use of technology as a corporate reporting tool is likely to remain very slow, with no real impetus to change when investors already manipulate data using their own software and analyse data from a variety of sources? Or should stakeholders make a concerted effort to accelerate and co-ordinate progress, requiring a new depth and breadth of collaboration between technology specialists and those with an interest in better corporate reporting?

ICAEW has a programme of publications and events planned for 2017/18 designed to advance the debate and explore possible solutions to these important questions. Details of these activities are provided below.

AUDITFUTURES INITIATIVE

A new initiative from ICAEW's AuditFutures thought leadership programme aims to reimagine the future of accounting and how both current and future businesses can engage and communicate with their stakeholders, building on the recommendations of the 2016 Audit Insights report *Corporate reporting. Improving annual reports of listed companies*.

As part of the initiative, facilitated jointly by ICAEW and the FRC, an innovation summit is planned for July 2017 at which radical ideas can be explored and developed into forward-thinking solutions. The output will be presented at an event later in 2017 where stakeholders will have the opportunity to discuss the new ideas. AuditFutures plans to turn some of the ideas from the events into follow-up projects.

INFORMATION FOR BETTER MARKETS CONFERENCE

In December 2017, the Financial Reporting Faculty's Information for Better Markets (IFBM) thought leadership conference will ask whether corporate reporting is heading in the right direction. It will provide an opportunity to bring together the academic and non-academic communities to debate the issues, and in particular the findings of four academic research papers specifically commissioned by the faculty for the event.

The four papers are as follows:

- *Financial reporting for investors: do the financial statements give them what they need?* Baruch Lev, NYU Stern
- *Reporting on business's external impacts: do we know enough about them?* Jeffery Unerman, Royal Holloway University of London
- *The non-financial reporting explosion: who benefits?* Hervé Stolowy, HEC Paris,
- *Is corporate reporting information being communicated successfully?* Niamh Brennan, University College Dublin.

A response to each paper will be provided by a non-academic before question and answer sessions take place with the conference delegates. The papers will be published in 2018 in a special edition of *Accounting and Business Research*, along with the transcripts of the responses to each paper delivered at the conference.

INFORMATION FOR BETTER MARKETS PUBLICATIONS

A number of IFBM thought leadership publications planned by the Financial Reporting Faculty for 2017/18 have been influenced by the discussions that underpin this report. These publications are likely to explore:

- how we report on the future, with a particular focus on to the use of prospective financial information in corporate reporting;
- the role of regulation in redesigning the financial statements; and
- how successful the profession is at evaluating the impacts of financial reporting changes.

TECHNOLOGY INITIATIVES

ICAEW's IT Faculty supports the Financial Reporting Faculty on technology-related matters. The faculty has a number of projects underway that consider the impact of technology on the accounting profession in general, following its recent work on big data and analytics. It is focusing in 2017/18 on two main technology developments - artificial intelligence and blockchain - and plans to publish short reports on their potential impact on the profession, including, where applicable, in relation to auditing and reporting.

CORPORATE GOVERNANCE FORUM

ICAEW's corporate governance initiative, *Connect and reflect*, encourages members and others to contribute to the wider corporate governance debate by giving their views on difficult questions facing business and society. The initiative, which includes a series of papers on controversial issues, calls for companies to connect with the public by providing open channels of communication.

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