WHAT IS PERFORMANCE?

An ICAS discussion paper and call for research
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It should be noted that the members of the Working Group and Critical Review Group were acting in their personal capacity and were not representing the organisations for which they work.
FOREWORD

This discussion paper addresses the concept of corporate performance and how it is reported, raising questions for debate and future research. The paper is not intended to offer solutions or to be a comprehensive review of all the issues surrounding performance. It focuses primarily on listed corporate entities that are subject to applying International Financial Reporting Standards (IFRS), although the discussion and issues may be relevant to other entities.

The paper starts with a brief introduction and some context before turning to the key issues around performance. At ICAS, we believe that a more holistic approach to the concept of performance and its reporting is needed. Current practice, through the use of narrative reporting and other corporate communications, already suggests that financial reporting alone cannot convey the full picture of an entity’s performance. There is also a recognised proliferation of alternative performance measures (APMs, such as non-IFRS information) as entities look for financial metrics that they believe better explain the performance of their business model. This is underscored by a widely held perception that the corporate report is diminishing in its relevance to some investors as they rely on other sources of information. Therefore, a key objective of this paper is to consider the ‘notion’ of performance and how it should be reported. Can we improve corporate reporting to better reflect a holistic rather than financial view of performance? Can and should financial and non-financial performance measures be encapsulated in the corporate report? Are the initiatives which are currently taking place, either nationally or internationally, addressing the needs of stakeholders with regard to performance?

This in turn raises the question of assurance. How can a board obtain sufficient assurance, whether internal or external, on an entity’s wider performance measures and disclosures to the market? Is there any demand from investors for external assurance on such information? This is addressed in the penultimate section of the paper.

ICAS believes that policy making should be evidence-based and we therefore fund policy-relevant research in the wider public interest. We conclude this paper with ideas for future research and we call for applications to undertake research on performance. Applications are welcome from around the world and should be submitted by 30 September 2016.

We encourage the profession and corporate reporting stakeholders to engage in a debate on performance, what it means and how it should be reported in order to advance the current model of corporate reporting. We also hope that researchers will undertake research in the areas identified in the final section of this report to provide the evidence needed for the evolution of corporate reporting. We welcome any feedback on the paper and your views on the questions raised in this document to help inform our programme of work in this area – please contact research@icas.com with any thoughts. We look forward to hearing your views.

The Working Group
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1. INTRODUCTION

The objective of this paper is to frame and move the debate on performance forward rather than to seek to answer or resolve the issues. The central argument is that we need to take a more holistic view of performance and look at how financial and non-financial information can be joined together more effectively.

Understanding an entity’s past performance and having an insight into its future performance is key to investors’ decision making and the effective operation of the capital markets. But does our current framework of corporate reporting meet investors’ and other stakeholders’ needs? The economic environment, business models and the demands of stakeholders continue to change, raising the question of whether the traditional model for corporate reporting can meet all these demands for the reporting of performance. Do we even know what we mean when we talk about performance and is that meaning shared by others?

This paper seeks to address two distinct elements:

• The concept of ‘performance’ itself: what it means to management and stakeholders; the extent to which non-financial factors should be considered part of performance; and indeed whether an agreed definition of performance can be arrived at.
• How performance is reported: including who performance is reported to; how it is measured; and the most appropriate channels of communication.

An entity communicates its performance with investors through a wide variety of media, including investor presentations, preliminary announcements and investor meetings. The corporate report is only one piece of this jigsaw, and it highlights the inherent trade-off between timeliness and having financial statements that have been prepared on a standardised basis and independently audited. The content of the corporate report, in turn, forms the basis of many of the other communications that are part of the reporting cycle. It is also the document that is available to all shareholders, irrespective of size, and other stakeholders. In this paper we focus primarily on the corporate report but recognise that investors often use other sources of information to triangulate and update their assessment of an entity’s performance. Irrespective of the medium used to report an entity’s performance we believe that it is important to understand the notion of performance and how it can be measured and what level of verification or assurance is needed.

Such an approach requires consideration of the following overarching fundamental questions:

• Is the current reporting model broken? Initial conversations with investors indicate that we do not need a revolutionary change. So, can the current reporting model be used as the basis for progress, rather than proposing an entirely new model?
• Can one reporting model meet the needs of different user groups? It could be argued that there is significant overlap of needs and that transparency is the key consideration. By meeting investors needs can we meet other stakeholders’ needs?

We recognise that these two questions need to be debated and wider views are sought to inform this debate.

To help frame the debate, this paper discusses broader concepts of performance and the specifics of reporting performance in the financial statements, and asks how these ideas could be developed, including topics we believe would benefit from research. We recognise that there are a number of bodies working on corporate reporting initiatives that either explicitly or implicitly, consider the issue of ‘performance’.

ICAS does not intend to add ‘noise’ to the marketplace, but rather to bring some coherence and consistency in how we understand performance, with the intention of making a positive contribution to those initiatives to the extent that they are aimed at ‘general purpose’ reporting. There are a number of bodies working on corporate reporting-related initiatives. Section 4 of this paper provides some background information on their activities in this area, although it is not intended to be an exhaustive list.

Section 5 of this paper discusses whether assurance may or may not be needed on performance reporting outside the traditional financial statements.

We think the issues raised in this paper have applicability globally and can potentially inform many current developments in corporate reporting and corporate communications, such as the use of alternative performance measures (APMs) and non-financial reporting. We hope, therefore, that this paper will be of interest to all of those in the corporate reporting supply chain – including standard-setters, regulators, preparers, investors and other stakeholder groups.
Throughout this paper we use terminology that may have different meanings to different people, especially in an international context. To avoid confusion we explain our use of some of these terms below:

- **Corporate report** – this refers to an entity’s annual report which generally comprises management commentary and financial statements.

- **Non-financial information** – this refers to information which is included in the corporate report other than information in the financial statements. Accordingly, it does not mean that such information is inherently non-financial in nature. Examples include information relating to strategy, governance, culture, environmental impact, employee relations and customer satisfaction. Despite not being included in the financial statements such information has the potential to have a financial impact. Such non-financial information could also be referred to as narrative information, management’s discussion and analysis or management commentary.

- **Investors** – a broad definition of investors is used in this paper to incorporate both the current and prospective capital providers and asset owners of an entity (the equity shareholders and bondholders) and their advisors and intermediaries (such as fund managers and analysts). The term ‘investors’ is used interchangeably with ‘users of company reports’ throughout this paper.

- **Stakeholders** – Stakeholders are wide ranging and include, amongst others, investors, employees, suppliers, society and general public, local communities, customers, business partners, government, regulators, lenders and competitors.

- **Income statement** – as defined in IFRS and in some jurisdictions referred to as the profit and loss account.
2. CONTEXT

Attempting to define and report on corporate performance continues to exercise the minds of standard setters, regulators, preparers and users of corporate reports. Performance has traditionally been seen as ‘financial performance’, represented by the income statement. But as business structures, transactions and financial reporting standards (including the use of a mixed measurement model) have become more complex, the notion of ‘performance’ has become more difficult to define and assess. It has also called into question whether performance can really be captured in a single figure or even in the financial statements alone.

The environment in which businesses operate has changed considerably in the last decade, creating implications for notions of performance. Increased globalisation, technological advances, the prevalence of cybersecurity risks, the threat of terrorism, and the impact of climate change are all reshaping business activities. The economic fundamentals have also changed and business models have had to evolve. Consequently, an increasing proportion of an entity’s value drivers and risks to value creation are typically not recognised in the balance sheet (such as human resources, intellectual capital, customer relationships and efforts to minimise harm to the environment). If ‘assets’ and ‘liabilities’ are not measured and presented in an appropriate way, or not recognised at all, can we really assess the performance of an entity? Improved reporting of broader concepts of value could assist entities in managing their sources of value and risk, and enable them to communicate these aspects more effectively to their stakeholders.

The sources used to assess performance are expanding. The array of information for assessing performance includes the corporate report, whose contents are highly regulated and standardised, along with preliminary announcements, websites, social media, quarterly reports, analyst presentations, meetings with board members and sustainability reports. This means that entities can communicate on aspects of their performance in ‘real-time’ which enables capital markets to respond to information almost instantly.

To make progress in this area, we think two fundamental issues need to be addressed:

- the audience and the perspective from which ‘performance’ is being assessed; and
- the scope of performance reporting and whether to take a narrow or broad view of what should be included.

its governance, and its wider social and environmental impact. All of these factors are considered important when assessing the long-term viability and prospects of an entity. But they are not all widely reported and so their use (and understanding) varies greatly. This has been coupled with a renewed focus on the use of non-IFRS and non-financial measures as corporates rely on alternative means of communicating their performance and ‘telling their story’. Does all of this mean that financial statements are no longer fit for purpose? Or is it a sign that the world is changing and market participants are suggesting that reporting needs to change with it?
3. CORPORATE PERFORMANCE

Whilst some academic research\footnote{1} argues that corporate performance is too context- and user-specific to be defined meaningfully, we think that debate around the following themes would be helpful.

**For whom should performance be defined?**

At the most basic level, performance is about how successful a business is in generating and sustaining value, but stakeholders have different views about what this means in practice. For example, investors want to assess an entity’s financial performance in order to gauge its future prospects but increasingly they will price in broader aspects if they believe it will impact future returns. Financial statements are an important part of this assessment but they only provide information about past performance, and investors use a range of sources including qualitative as well as quantitative information. For instance, research shows that an entity’s corporate governance and quality of management are important factors in assessing the representational faithfulness of financial information.\footnote{2}

Internally, senior management measure and monitor various elements of performance but there is a perception that there is a disconnect between information used internally and that which is reported under IFRS, with IFRS financial statements sometimes referred to as mainly a compliance exercise. There seem to be two main reasons for this:

- IFRS financial statements are limited to financial information. By only covering financial information in a world in which stakeholders are becoming increasingly interested in a wider range of factors, IFRS financial statements risk losing their status as the primary source of performance information.
- IFRS financial statements are for general purpose reporting and are designed to be applicable to a wide range of entities across different jurisdictions, and to enhance consistency and comparability between different entities. Therefore, the ability of entities to fully reflect their specific business model through the financial statements may be constrained.

These factors may lie behind the increase in reporting of non-IFRS measures, as entities seek different ways of ‘telling the story’ of their business, and explaining their performance through the eyes of management in a simple and understandable way. There is, therefore, something of a conflict between an entity-specific view of performance, and an approach that provides consistency, comparability, verifiability and reliability – characteristics that investors seek. The IASB has noted that preparers prefer to report performance based on their business model, while investors have concerns about the scope for management manipulation of results.

Therefore, it is worth considering to what extent consistency and comparability are desirable and indeed achievable in reporting performance? What ‘performance’ means and whether it is a broad or narrow concept varies across different jurisdictions, industry sectors and even within groups with disparate activities. An interesting question is therefore the extent to which external performance reporting should mirror internal measurement and presentation techniques raising issues about the appropriate trade-off between consistency and comparability on the one hand, and aligning with the perspective of management on the other. If management take a narrow view of performance is that problematic if it fails to align with the views of the entity’s stakeholders? It is for that reason that some have suggested that entities should be explicit about the intended audience for the corporate report and how they have identified material matters\footnote{3} in the context of that identified user group.

A further influencing factor on our ideas of performance is the debate about whether corporate reports should be targeted primarily at investors, or at a broader user group (and is that broader user group in fact a user of company reports?). Moreover, if the focus is on investors, to what extent does the same information also meet the needs of other stakeholders? One argument is that reporting should be in the wider public interest. Increased globalisation, financial crises and technological developments mean that corporate information, such as that contained in corporate reports, is available to a much wider audience and therefore subject to greater public and media scrutiny. Increased debate on the role of business in society, including the headline-grabbing topics of executive remuneration, corporate tax avoidance and cyber security, translates into increasing pressure on business to report to a wider stakeholder audience on a wider range of topics related to performance. This wider set of information in a changing environment may also be part of what’s contributing to the complexity of corporate reporting. Are corporate reports trying to be all things to all people and to solve too many problems at one time?

The increased scrutiny and expectations of business performance may have contributed to a broader view of performance, as there now seems to be more interest in an entity’s non-financial impacts (for example, its environmental impact). It is interesting to note, however, that despite the existence of very diverse stakeholder groups there may be significant overlap or convergence of information needs. Diagram 1 portrays stakeholders and their information needs.
Diagram 1  Stakeholders and their information needs

- Do we have all the information segments?
- Which stakeholders need which information?

Notes:
1. Information needs are listed at a high level and could be disaggregated (for example: tax strategy vs tax rate; environmental risk management strategy vs carbon emissions; particular financial information) and many risks and threats are not listed here.
2. Stakeholders also could be disaggregated (for example: prudential regulators vs securities regulators; type or level of employee; taxpayers vs wider society).
3. Proxy advisors (including analysts) are included separately because they play a role in the investment chain and it is useful to see whether their information needs differ from those of shareholders and bondholders.
4. Other stakeholders not listed:
   - Media
   - NGOs/trade bodies
Can performance be measured over both the short-term and long-term?

A strong theme arising in the debate about the role of business is the notion of the sustainability of business models, and the development of a longer-term perspective in business and the financial markets. This concept of long-termism was expressed in the Kay Review of the UK equity markets commissioned by the UK government in the wake of the 2008 financial crisis and is also being considered in other economies.

The longer-term view is often accompanied by a broader focus by entities — both in terms of the range of stakeholders to which they are accountable and the range of issues on which they report. In the UK, this is given statutory force by the Companies Act 2006 requirements for directors’ duties which require them to have regard to factors such as the long-term impact of decisions, environment and community, and employee relations. This is mirrored in other jurisdictions where directors’ obligations are to the long-term success of the entity and not the shareholders.

It is argued that addressing these duties may contribute to an entity’s success and that demonstrating how they are being met is necessary to gain public trust. The consideration of a wider concept of stakeholder needs leads to reporting on a wider range of issues such as environmental impact, diversity, and governance matters. These issues are also relevant for investors because — as recent events have shown in the automotive and banking industries — they may have a significant financial impact in the future.

For entities to be able to provide a longer-term view of performance, we need to develop appropriate long-term metrics, and to be able to differentiate between performance over time and period-to-period changes. It is important to show the links between the long-term value creation and shorter-term performance. However, short-term signals are still important as investors need to assess whether current performance is indicative of what may be coming in the longer term or is just ‘noise’. Information about the shorter-term provides context to the long-term picture, and a steady flow of information may help alleviate short-termism in the markets by avoiding the need for second-guessing. Developments in reporting technology may also assist by providing the right information at the right time.

It is worth noting that for the notion of long-term performance to take hold, there are complex behavioural factors that need to be addressed. Incentives for many market participants, including company directors, fund managers and analysts, remain structured around a traditional view of financial performance, and many will have a short-term investment horizon. Therefore, how performance is reported is only one element of a complex picture.

What are the different elements of performance?

It is clear that our notions of corporate performance have widened in recent years beyond the traditional focus on the financial statements. There are many reasons for that, some of which are:

- IFRS have developed to account for changing transactions and business models, but in some cases they may not have developed quickly enough (for example, the lack of internally-generated intangible assets recognised in an economy that is increasingly technological and service (rather than product) driven).
- Developments in technology mean that users can obtain more data more quickly and many are still working out what to do with all this information.
- Science has evolved so that we know more about how our actions impact the environment, meaning that policy makers, entities and others are trying to figure out what to do about it and how to do it cost-effectively (for both investors and taxpayers).

Does this mean that corporate performance is something broader than financial performance, or does the concept of financial performance itself need to expand and evolve? Although the IFRS literature uses the term ‘financial performance’, it defines it only indirectly and does not address the measurement of performance. Without this, it is difficult to reach agreement on which particular items of income and expense should be included or excluded in assessing corporate performance (via earnings or income), and indeed how assets and liabilities are measured in the balance sheet is a crucial consideration in the performance debate as changes in value impact the income statement. The mixed measurement model adds to complexity by effectively combining incomparable items (‘apples and pears’).

There is also the increasing global trend for more ‘non-financial’ reporting in addition to the financial statements. This information can be separated into two broad categories:

- Information that provides context to, or enhances confidence in, the information in the financial statements, for example, narrative commentary on financial results, information about the business model, strategy and the quality of governance arrangements.
- Information about topics that are not necessarily within the scope of the financial statements, such as corporate social responsibility (CSR) and diversity information.

There seems to be growing support for the idea that this more holistic view of an entity’s activities is relevant to assessing its performance (particularly in the context of thinking about the viability or longevity of its business model). But the various elements are still rather disparate and lacking consistency. Without a recognised framework
such as IFRS, there is a lack of clarity as to the process for recording, measuring and presenting these non-financial items.

Whilst the information currently provided is useful in terms of providing context about an entity and its financial results, it could be argued that this ‘non-financial’ information could be much more useful if it could be linked more directly and robustly to financial performance. This information should certainly be relevant for investors, particularly as they may have a financial impact in the future, and therefore an impact on the value of the business. Perhaps a solution is that these broader types of information should be included in the financial statements as either ‘assets’ or ‘liabilities’, so their potential financial impact can be assessed. Arguably, the inclusion of ‘contingent assets’ and ‘contingent liabilities’ under IAS 37 is already a partial step in this direction. Could these help investors obtain a more rounded and informed view of an entity’s financial performance?

**Who defines performance?**

As investors and other stakeholders use such a variety of sources to assess an entity’s performance, it would be difficult to identify a single party to be responsible for defining it.

However, the lack of consistency in ‘non-financial’ reporting seems to be a natural consequence of the sheer number of international and national bodies issuing guidance on a wide range of topics in this area. The result is that no single global body has jurisdiction for non-financial reporting, in the way that IASB has for financial reporting, and no single body has jurisdiction for corporate reporting overall.

Whilst in many ways a market-led solution, without the requirement for mandatory guidance, is desirable, the involvement of so many different groupings with different perspectives creates a risk that the debate does not progress, and that the two strands of financial and non-financial reporting diverge further.

Section 4 summarises the current activities being undertaken by various bodies as they relate to reporting of corporate performance.

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### KEY QUESTIONS ON CORPORATE PERFORMANCE

- How do entities manage and report on performance internally?
- How does this compare with what is reported externally? If they differ, does this mean there is not a single figure for performance?
- To what extent would a ‘through the eyes of management’ approach work for reporting performance?
- Is the concept of performance perceived differently across different jurisdictions?
- How do investors perceive corporate performance and how do they want it reported?
- Should standard metrics be established for reporting performance? If so should they be regulated? Is performance comparable across entities and sectors?
- How can performance be reported to cover both long-term and short-term issues?
- Is the annual change in the difference between the book value of the entity and market capitalisation ‘performance’ or something else?
- How should we present performance in the income statement? What subtotals are relevant before we get to comprehensive income?
- What other non-financial information is needed to understand performance?
Many bodies are undertaking initiatives to improve the reporting of corporate performance - whether financial or non-financial - to give stakeholders a more comprehensive picture.

Aside from issuing a (non-mandatory) Practice Statement on management commentary, the IASB has not addressed narrative, or non-financial reporting. However, the IFRS Foundation Trustees recently asked stakeholders whether the IASB should become more active in this area. Indeed, if we restrict ourselves to the existing paradigm of the financial statements, is it possible to capture a holistic view of performance?

Requirements and guidance for non-financial reporting currently come from a variety of sources including legislation, regulatory bodies at a national and international level, and non-governmental bodies. Therefore, currently the two strands of reporting - financial and non-financial - are developing separately, with the risk that the overall picture becomes confused and contradictory. If we are to have consistent and comparable reporting on performance is a more integrated approach and a link between financial and wider corporate reporting needed?

International Accounting Standards Board (IASB)

In its analysis of comment letters on the 2015 Exposure Draft of the Conceptual Framework for financial reporting, the IASB noted that many commentators disagreed with some or all of the proposals on ‘reporting financial performance’. Many requested the IASB to undertake more conceptual work on performance reporting, including determining whether definitions can be developed for terms such as ‘financial performance’, and ‘operating profit’, and working on principles to determine what items should be reported in other comprehensive income (OCI).

The IASB has re-commenced a research project on performance reporting, now titled ‘Primary Financial Statements’, representing a shift in focus to look at the placement of information within the financial statements. This proposes to look at the structure of the income statement and OCI, considering issues such as the level of disaggregation, identification of totals and subtotals, and analysis of components of OCI.

Potential areas for research identified by the IASB include:
- whether the income statement can be disaggregated on the basis of recurrence, management control, re-measurement etc.;
- whether it is realistic to be able to define a single performance measure such as operating profit;
- whether investors would prefer raw data to subtotals; and whether there is a method of disaggregation which would preclude the need for OCI (which links to the role that technology can play in improving reporting).

Research in this area in the past has found that it can be very difficult to identify robust principles for determining an appropriate basis for disaggregation, for example, what is operating for one entity may be non-operating for another (this is particularly an issue in comparing, for example, financial services companies with industrial companies).

The IASB project is at an early stage – and time will tell whether it will meet the needs of those demanding more clarity around financial performance. From what we know of the project so far, it seems that there are a number of aspects of performance that the IASB is not proposing to address. These can be summarised as follows:

- The link between performance and the objective(s) of financial reporting.
  - Whilst the 2015 Exposure Draft of the Conceptual Framework has re-introduced stewardship as part of the objective of financial reporting, a number of respondents (including ICAS) argued that the IASB should go further and frame stewardship as a separate objective, instead of as a sub-set of decision-usefulness.
  - This is supported by the recent ICAS/EFRA study on professional investors and the decision usefulness of financial reporting, which found that the objective of investors (valuation or stewardship) does matter. Different information may be necessary to enable an assessment of the performance of an entity’s management as opposed to the performance of the entity itself.
  - The focus has tended to be on an ‘earnings concept’ – aiming to help assess the entity’s future cash flows, whereas stewardship may require information that centres only on performance that is within management’s control.

- Reporting of alternative performance measures – whilst this is not within the remit of the IASB, it could be argued that the design of IFRS makes it necessary for entities to report non-IFRS information.
- Segment reporting is critical to understanding performance especially as many groups are made up of disparate activities or operate across different geographical areas. In these types of groups, the income statement may not give a meaningful view of performance, and therefore disclosures are an important element.
Other bodies and initiatives

Overall, whilst there are fewer mandatory requirements for non-financial reporting, there are an ever-growing number of bodies at a national and international level, covering various aspects of the measurement and reporting of non-financial factors.

Many jurisdictions have legislation or regulation around traditional management commentary or narrative reporting, but there is now a trend towards widening the scope of this reporting such as the strategic report mandated under the UK Companies Act and the EU Non-Financial Reporting Directive, which member states must implement by the end of 2016.

Much activity is focused on the area of environmental reporting, which has become common practice amongst larger entities. Some of the bodies issuing standards and guidance on the measurement and reporting of non-financial factors include:

- Accounting for Sustainability (A4S)
- Carbon Disclosure Project
- Climate Disclosure Standards Board
- Financial Stability Board Task Force on Climate-related Disclosures
- Global Reporting Initiative
- International Integrated Reporting Council
- Principles for Responsible Investment
- Sustainability Accounting Standards Board
- World Intellectual Capital Initiative

This list is not intended to be exhaustive, but it highlights the level of activity in this area. Many of these initiatives address reporting and disclosure rather than recognition and measurement, perhaps reflecting the relatively early stage of development of this topic compared to financial reporting. The Climate Disclosure Standards Board and Corporate Reporting Dialogue have both undertaken mapping exercises to look at the level of alignment in reporting approaches – these provide further information about the various initiatives.

Sustainability reporting currently tends to be provided as a discrete element of the reporting cycle, published separately from information on financial performance. Is this an effective model, or should sustainability information be better integrated with financial reporting? One body advocating such an approach is the International Integrated Reporting Council, which proposes an integrated reporting model incorporating various capitals such as human, social and environmental, as well as financial capital. The model does not include guidance on how to measure the different capitals, focusing purely on reporting.

There is a need for continued debate about how these various reporting models fit together and the extent to which frameworks (or a single framework) for the measurement of non-financial elements are required.

KEY QUESTIONS ON CURRENT INITIATIVES

- Should the IASB consider wider corporate reporting issues?

- Should the IASB consider requiring the recognition and measurement (or at least disclosure) of a broader range of resources and obligations (such as intangible assets and climate-related risks) and consider whether more of these sources of and encumbrances on value should be recognised in the financial statements?

- Is a single model for corporate reporting, incorporating financial and non-financial reporting, desirable? If so, who should lead this?

- Is there a demand for non-financial factors to be measured as well as reported?

- Who should determine which non-financial items should be measured, and how they should be measured?
5. ASSURANCE ON PERFORMANCE

A key consideration in reporting a broader view of performance is the reliability of the information being reported. Financial statements are produced under a consistent set of standards and are verified by the independent auditor, as explained in the auditor’s report. The level of assurance over information in the management commentary is not the same. There is not a single global framework governing the information, giving assurance over the way that the information is compiled and it is not subject to the same level of independent verification.

The International Auditing and Assurance Standards Board (IAASB) has revised ISA 720 The auditor’s responsibilities relating to other information (effective for accounting periods ending on or after 16 December 2016) and this will require the auditor to carry out an ‘intelligent read’ of an annual report in the context of the knowledge obtained in the audit and perform certain procedures to ensure that the annual report is not materially inconsistent with the audited financial statements. The auditor will also be required to articulate their responsibilities in relation to the work done on this other information, including the fact that the audit opinion does not cover this other information.

The board of directors is responsible for publishing corporate information, including the corporate report. With a broader concept of performance – how will a board gain comfort on the entity’s performance disclosures? If some form of assurance is required to provide this comfort, will it be internal or external assurance? A recent practical guide produced by ICAS13 provides an assurance matrix to help boards identify the most appropriate source of assurance over key performance indicators, which could also be used for other narrative reporting.

In the UK, corporate boards are now required to confirm that their corporate report as a whole, including the management commentary, is fair, balanced and understandable and external auditors are required to report by exception on this. A recent ICAS research report found that this was a positive innovation, but called for research on investors’ views of the current assurance provided and whether there was demand for more positive assurance.14

If there is found to be a demand for wider external assurance, is a new assurance framework required and does the audit profession have the requisite skills to meet such a challenge?

The IAASB has established an Integrated Reporting Working Group and the remit of this working group has been extended to cover emerging external reporting (EER) in recognition of the number of alternative reporting frameworks currently being developed. The Integrated Reporting Working Group is gathering information on the demand for assurance, the scope of assurance, the key assurance issues and considering how it should respond.

Recent ICAS and FRC research suggests that audit teams and audit skills will need to evolve to meet the demands of the audit of the future.15

**KEY QUESTIONS ON ASSURANCE**

- Is there a demand for assurance on wider measures of performance?
- Is there a demand for assurance on other corporate communications?
- Who should provide such assurance? If it is external assurance by an audit firm, is an alternative assurance model required?
- What other types of organisations may be engaged by boards to provide such assurance?
- What level of assurance could be provided? To what extent would auditors be liable for this?
- To what extent does assurance constrain innovation in corporate reporting?
6. AREAS FOR FUTURE RESEARCH

The ideas and key questions in this paper highlight a number of issues for further research, including:

- The need to review existing literature, particularly taking account of the recent changes to the business and reporting environment which entities operate in.
- What are the different perceptions of corporate performance by different stakeholder groups?
- How do managers measure and manage performance and is there a disconnect with external reporting?
- The need to review current reporting to establish some principles of best practice. Do any entities currently do a particularly good job of this?
- What longer-term performance measures may be useful and their link to short-term performance?
- Is there a demand for assurance on wider/alternative measures of performance, including non-financial and non-IFRS measures?
- What do investors want to see and how do they want to see it? Can preparers deliver this vision, should it be audited and if so can auditors audit it, and can regulators regulate it?
- How do banks and investment firms’ models depict corporate performance?
- Does the wider ‘user’ community actually read the corporate report in its current form, and if so, how? If they don’t, why not?

CALL FOR RESEARCH ON PERFORMANCE

The ICAS Research Centre provides research funding for policy-relevant impactful research. For further details please visit icas.com and search for research funding.

The Research Centre calls for applications for projects addressing the issues around performance. Proposals must address the public interest and may include, but not be confined to, any of the above issues. Grant funding is available up to a maximum of £25,000 per project.

The final research report (maximum 10,000 words) arising from each project should draw conclusions and implications for policy makers, the accounting profession, regulators, investors and business. ICAS will use the reports to inform public debate and policy development and the projects will therefore be high profile. A final draft of the report arising from the project is to be delivered by 31 October 2017 and authors will be required to make short presentations of interim and key findings to ICAS. A presentation of findings at ICAS sponsored events may also be required. Draft reports will be reviewed using practitioner and academic reviewers, with a view to publication and use by ICAS and to influence policy makers and practice. Publication in academic journals, following submission of the final report, is also encouraged.

If you are interested in undertaking a project in this area, please email research@icas.com attaching a call for research application form (available at icas.com) and a proposal together with summary CVs by 30 September 2016. The Guidance Notes for Research Applicants (available at icas.com) explains what should be included in the proposal. Applications are not restricted to the academic community and are accepted from around the globe.

The applications will be considered by the ‘What is performance?’ working group to arrive at a final decision. Applicants will be advised of the decision by 31 October 2016.

For further information about this funding opportunity or any queries please contact the ICAS Research Centre at research@icas.com.
ENDNOTES

1 For example, Lee (2014) likens questions of performance reporting to Alice in Wonderland asking the Cheshire Cat which way to proceed, and the cat answers ‘That depends a good deal on where you want to get to’. Young (2014) also notes that different pressures on a ‘one-size-fits-all’ financial reporting regime have resulted in a demand for customised performance reporting.


2 For example, see Armstrong et al. (2010) for a survey of the literature on the links between corporate governance and financial reporting information.


5 See, for example:
https://hbr.org/2014/01/focusing-capital-on-the-long-term/ar/1

6 See the legal opinions at the American Bar Association about the obligations of directors in jurisdictions around the world: http://www.americanbar.org/groups/leadership/office_of_the_president/sustainable_development_task_force.html.


12 Climate Disclosure Standards Board http://www.cdsb.net/sites/cdsbnet/files/cdsb_making_the_connections.pdf


15 Recent ICAS research suggests that changes to the competencies and skills of audit teams will be required if the scope of audit is to widen:


Please help inform our work on performance and provide your views on the questions raised in this paper and/or apply for funding to undertake research in this area.

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