ICAS VISION FOR CORPORATE REPORTING

22 June 2017
Introduction

We welcome the opportunity to provide comments on the Financial Reporting Lab’s Framework for Future Digital Reporting and the FRC Discussion Paper on the role of Auditors and Preliminary Announcements. We believe that, rather than considering the auditors’ role in relation to preliminary announcements in isolation, we should take a more holistic approach – first by consideration of the whole of the annual reporting sequence and package, and then to the expression(s) of assurance on this. Our view is that there are synergies which could be obtained for preparers and auditors from rationalising the annual reporting package and utilising technological advancements, and that there are benefits for investors from a more cohesive structure for annual reporting and from clearer expressions of assurance from auditors.

Consequently, in the light of the publication of the Financial Reporting Lab’s Framework and the Discussion Paper on Preliminary Announcements, we hope that it might be helpful to you to set out ICAS’ medium term vision for a framework for corporate reporting. We believe that is important to establish such a vision to provide some direction to the work of the profession and the FRC and our engagement with stakeholders. Consequently, we welcome the publication of the above Discussion paper and Framework, as a trigger for this debate.

Our views are informed by a number of previous ICAS projects, the resulting reports from which are available on the ICAS website:

- [Making Corporate Reports Readable](2010)
- [The Future of Assurance](2010)
- [Making Corporate Reports Relevant](2012)
- [Towards Transparency](2015)

Our views are also informed by our key policy positions as adopted by our Corporate and Financial Reporting Panel and Audit and Assurance Panel. These are set out in Appendix 1.

We acknowledge that the full extent of some of our proposals would require changes to the legislative framework and that this might only be achievable over the medium term. However, we feel that much of the substance of the improved cohesiveness and accessibility of corporate reporting which we are proposing is already reflected in the thinking behind existing FRC guidance, eg on the content of the Strategic Report.

The “Problem”

As noted in the Discussion Paper, preliminary announcements are voluntary but many companies issue these, and it is the release of these announcements and the summary results they contain which drive investor sentiment and share price movements. The subsequent issue of annual reports can often be overlooked by investors despite the fact that these contain critical information together with a long form audit report on the financial statements.

Therefore, investors are potentially making decisions on the basis of an incomplete set of information in the preliminary announcement which is focused more on the short term financial results than on the longer term picture provided by the annual report and, in particular, the Strategic Report which binds all the information together as a coherent whole.

Furthermore, whilst the auditors’ opinion in relation to the financial statements is stated in a clear positive manner, the assurance from the external auditors over the current “front half” of the annual report is not readily understood, based as it is on reporting only by exception against a “fair balanced and understandable” benchmark and an ISA 720 consistency check. Similarly, the ‘assurance’ over the preliminary announcement reflects only the “agreement” of the auditors, which is often not explicit and can be difficult for users to interpret.
Our Vision

Core and More Model

In summary, we call for the restructuring of the annual report package along the lines of a “core and more” model, within the medium term:

- The amalgamation of the Strategic Report into the Preliminary Announcement, together with the inclusion of other key information which is of critical importance to investors and other users. This might be termed the “core” report, as envisioned by the ICAS Making Corporate Reports Readable document from 2010 and the 2015 FEE publication The Future of Corporate Reporting – creating the dynamics for change;
- The other detailed reports which make up the existing annual reporting package (which might be termed the “more” reports under the “core and more” model) – the financial statements; the corporate governance statement; environmental and corporate responsibility reports; and any other reports – should be published on the company’s website ideally at the same time as the publication of the core report. These should be cross referenced to other relevant information within the core report and the other “more” reports, and linked to any underlying further detail which the company wishes to provide. The “more” reports should be fully searchable and thereby provide a referential source of information on the company’s performance and prospects.

Core Report

In essence, the core report would be a short-form summary annual report and results announcement which, in a maximum of, say, 30 pages, would tell management’s “story” of the performance and prospects of the company, whilst avoiding much of the boilerplate and formality of today’s annual report:

- This would encapsulate the content of the current Preliminary Announcement and Strategic Report, i.e. the company’s business model, strategy, risks and mitigations, its viability statement and summarised financial results, whilst also embracing the principles of integrated reporting and focusing on the broader impacts and value drivers for future performance as well as current performance;
- It should include the company’s KPIs and regulatory and other information where this is relevant to the company’s performance “story”;
- Whilst a guidance framework for the preparation of the core report would need to be established, we would advocate a principles-based approach with a high degree of flexibility to be given to management to decide on the appropriate content and allow them to judge what information is of most importance to investors and other users;
- This core report could be published in a more interactive digital manner which provides links to the underlying detail (i.e. to the “more” reports) or in more traditional hard copy or PDF form;
- The key to this report is that it is accessible to the full range of users in the communication medium which they require, and that it directs those who require further detail to where this can be found on the company’s website;
- The core report would be issued as soon as practicable after the year end (ideally at the same time as the “more” reports), and should comply with the principles set out in Appendix 2 to this response;
- Given the importance of the financial statements to the overall annual reporting package, the external auditors’ report on the financial statements (with appropriate contextual narrative) should be included in full in the core report or as an Appendix to it, with a clear link to those financial statements.

We would envisage the core report being the main reporting document which is lodged with Companies House and which is publicised to the full range of users. The availability of the “more” reports on the company website should also be made clear for those users who wish to look at the financial statements or require further detail.

Comparability

Because of the flexibility which we envisage being given to management to enable them to better “tell their story” of the company’s performance and prospects, the core report may not be readily comparable with other companies. In our view, this perceived disadvantage would be outweighed by the improved quality and insight from the core report.
We suggest that further discussion be held with all stakeholders in corporate reporting on the matter of comparability. In a principles-based system, it is inevitable that absolute comparability can never be achieved, but we recognise that this aspect is important to many users. We would suggest that comparability could be more of a focus for the “more” reports.

**Assurance**

The core report should carry a clear indication of the assurance which has been provided on it. Initially and as a transitional step, this could simply make clear the nature and extent of any verification and assurance on each information item or category of items (along the lines of our *Towards Transparency* recommendations). Our preference is that, in due course, this would be superseded by a clear positive opinion from the external auditors that the (whole) core report is “fair, balanced and understandable”. Our consideration of how the external auditor might approach such a report is discussed in our *Balanced & Reasonable* discussion paper, although this would require further debate and development.

The “more” reports should also make clear the assurance which has been provided on each of them. In the case of the financial statements, we would expect an audit report along the lines of today’s long form audit report under ISA 700 (UK & Ireland). At least in the short term, the “other information” covered by ISA 720 and reviewed for consistency by the auditors would need to be reassessed: we envisage that this would include the full extent of the “core” and “more” reporting package. Our preference over time would be to move towards clearer positively-expressed assurance reports being provided in relation to each of the “more” reports on which any assurance is given.

**Practicalities and Timing**

Given the focus on the provision of information which is relevant to long term investors and the longer term performance of the company, we believe that there should be a rebalancing between getting the current year results published as soon as possible after the year end and an improvement in the quality, accessibility and structure of the overall reporting package which provides valuable information on the performance and longer term prospects for the company in a more cohesive manner.

**Link to FRC Framework and Discussion Paper**

This model would address the following issues contained in the FRC’s Discussion Paper and in the Lab’s Framework:

*Discussion Paper on Preliminary Announcements*

Investor value - Paragraph 15 of the Discussion Paper highlights that the preliminary announcement regime has endured because of the value which investors place on it. Paragraph 30 expands on this point based on the FRC’s discussions with stakeholders, the key points being as follows:

- Investors are not homogeneous, with some valuing the information in preliminary announcements more than that in in the statutory financial statements, and others placing greater reliance on the financial statements and detailed disclosures. We *believe that our vision would provide better quality information in a more accessible manner whilst facilitating access to more detailed information if required*;

- Investors generally want information on company performance as soon as possible, but recognise the trade-off between speed and quality. Again, *we believe that our vision would provide better quality information in a more accessible manner - but that this would not require significantly extended timescales*.

- Investors have limited understanding about the role of the auditor in relation to preliminary information and would value a more definitive indication in a preliminary announcement of the status and results of the statutory audit. *By including a clear and positive statement that the core report is “fair, balanced and understandable, and by publishing the full auditors’ report on the financial statements in or as an appendix to the core report, our vision would make this clear on all counts. (Options 5 and 7 in the Discussion Paper move towards this vision.)*
Audit Practicalities – Paragraphs 17 and 31 of the Discussion Paper note that in the vast majority of cases surveyed, auditors’ reports have been signed on or before the date of the preliminary announcements. As is noted, this means that the auditors have already concluded at that stage that they have obtained reasonable assurance that the financial statements are free from material misstatement (or otherwise). Our recommendation for the core report to include or be accompanied by the final auditors’ report would therefore seem to be feasible. Recent anecdotal feedback from investors has suggested that, for many, the main focus is on the preliminary announcement and that when the annual report is issued at a later date, they do not necessarily look at the annual report or the auditors’ report contained therein. Accordingly, many investors have not benefited from the additional information which has been included in the auditors’ reports over the last two to three years. Publishing the auditors’ report with the core report – importantly, with appropriate contextual narrative - would make it much more visible to investors and therefore potentially much more useful, and would hopefully reduce the expectations gap referenced in paragraph 35 of the Discussion Paper.

Non-Statutory Reporting – The Discussion Paper highlights in a number of places that preliminary announcements are “non-statutory accounts” under the Companies Act. Whilst we accept that there needs to be a definitive set of reported information which comprises the annual reporting package of a company, we fear that the current statutory / non-statutory distinction may be a barrier to improvements in corporate reporting especially in adopting the benefits of technological innovations – and we would suggest that this matter be considered further in due course. Our proposals blur the current distinction between statutory and non-statutory, in the interests of seeking a more coherent and accessible structure to corporate reporting, and more effective communication of better quality information to users.

Framework for Future Digital Reporting

We would assess our vision as follows, by reference to the characteristics highlighted in the Framework for Future Digital Reporting:

<table>
<thead>
<tr>
<th>Production</th>
<th>Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost-efficient</td>
<td>Free</td>
</tr>
<tr>
<td>Our proposals should not give rise to additional costs. Indeed, the rationalisation of the annual report package, including the amalgamation of the current Preliminary Announcement and Strategic Report into a new “core” report, may give rise to cost savings.</td>
<td>Our proposals would not necessarily impact on the free access and availability of the annual report package.</td>
</tr>
<tr>
<td>Compatible</td>
<td>Compliant</td>
</tr>
<tr>
<td>Our proposals would require changes to the current reporting systems, to obtain a more cohesive reporting package, but this should better facilitate the efficient use of technology.</td>
<td>Our proposals would not necessarily impact on the compliant distribution and storage of regulated information.</td>
</tr>
<tr>
<td>Easy</td>
<td>Prompt</td>
</tr>
<tr>
<td>Our proposals would not make the production of the annual reporting package any less easy. The preparation of the core report will require quality thinking time from senior management – though we would not underestimate the thinking which goes into today’s Strategic report and other aspects of the “front half” of the annual report.</td>
<td>Our proposals would not significantly lengthen the time taken to publish the annual reporting package. The production of the annual report package in digital form would avoid the delay involved in hard copy printing.</td>
</tr>
<tr>
<td>Timely</td>
<td>Accessible</td>
</tr>
<tr>
<td>Preparation of quality information will always take time. However, we do not envisage that our proposals would significantly lengthen the time taken to publish the annual reporting package.</td>
<td>Our proposals would significantly improve the structure and accessibility of the annual reporting package, and therefore better cater for a wide range of users. The linkages between, and the searchability of, the different aspects of the reporting package would significantly improve accessibility.</td>
</tr>
<tr>
<td>Consumption</td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Contextual</td>
<td>Our proposals would retain the annual reference point context. Furthermore, an explicit statement by the directors that the core report is fair, balanced and understandable, and an explicit opinion from the auditors on this, would make very clear the concepts which underpinned the report.</td>
</tr>
<tr>
<td>Usable</td>
<td>Our proposals would satisfy the characteristics of usability. In particular, our proposed structure is more logical and intuitive, and searchability is a key factor.</td>
</tr>
<tr>
<td>Credible</td>
<td>Our proposals include clear and positive statements on assurance which would be more understandable to users.</td>
</tr>
<tr>
<td>Engaging</td>
<td>A flexible core report will enable management to tell a more engaging story of the company's performance and prospects. Our proposals would facilitate “standardised consumption and utilisation” and “significant freedom to communicate and engage”.</td>
</tr>
</tbody>
</table>

**Engagement and Assistance**

We would be happy to have an informal discussion with FRC staff on the matters raised in this response, if that would be helpful.

We are willing to engage with the Financial Reporting Lab and specific companies to experiment on the extent to which our vision could be adopted within the constraints of the current legislative and reporting frameworks. Similarly, we would be keen to be involved in discussions with the FRC and at UK and international level on how the corporate annual reporting package might evolve, and the role of technology in that evolution.

We would also be willing to engage in discussions on how Companies legislation, the Listing Rules and FRC pronouncements would need to change in the short term to facilitate the longer term vision we have outlined.
ICAS CORPORATE AND FINANCIAL REPORTING PANEL AND AUDIT AND ASSURANCE PANEL: SELECTED KEY POLICY POSITIONS

Corporate and Financial Reporting Panel

- Establishment of an improved model for corporate reporting which reflects:
  - better distinction between compliance information and communication of key messages;
  - better stratification of information for different types of user;
  - better use of web technology, especially for standing, routine or compliance oriented information;
  - better communication of how the company creates value and sustains that value creation over time;
  - the production of an integrated short-form summary document containing all the most important financial and non-financial information on the company's performance and prospects, driven from its strategy and business model.

- Support for the principles of the integrated reporting framework to underpin a summary but holistic narrative report developed under due process and in the public interest, to support transparent and consistent narrative reporting on a global basis.

- Support for IFRS as a single set of high quality international standards developed under due process and in the public interest and adopted in totality, to support transparent and consistent financial reporting on a global basis.

- Proper application of materiality in financial statement disclosures, so that disclosures focus on what is important and are not obscured by irrelevant detail.

Audit and Assurance Panel

- Develop or support the development of an assurance framework which (i) enhances the understanding of the nature and levels of assurance by users (ii) facilitates the clear expression of assurance opinions in a clear and positive manner and (iii) allows for a broader range of assurance services to be provided to meet the needs of users.

- Reduce the "expectation gap" on audit through (i) increasing the assurance provided by auditors (ii) improving the usefulness and clarity of audit reports and the assurance framework and (iii) better communication with users on the scope of an audit.

- Ensure that the auditing profession develops and maintains the necessary skills and competencies to perform quality audits into the future – by (i) promoting the importance of the auditor and the attractiveness of audit as a training vehicle for CAs and for a future career (ii) encourage the inclusion of the three key skills required for future auditors (technology skills; soft skills; and business acumen skills) within the training syllabus and post-qualification training; (iii) encourage the inclusion of wrap-around/post-qualification audit training for non-audit specialists.

- Encourage standard-setters to ensure that auditing standards are principles-based or objectives-based to avoid them lagging behind technology and developments in practice.
THE PRINCIPLES FOR A SHORT FORM REPORT
(FROM MAKING CORPORATE REPORTS RELEVANT, JANUARY 2012)

1. Provide information which is balanced and reasonable and consistent with the full annual report

2. Be consistent with the full financial statements which present a true and fair view.

3. Explain the company’s business model and strategy and its performance against these.

4. Explain the most significant risks to the company’s business model and strategy and how those risks are being mitigated.

5. Deliver a clear message about management’s stewardship of the company’s assets – the past.

6. Deliver a clear message about the company’s current asset-liability mix and liquidity position – the present.

7. Deliver a clear message about where the company is headed – the future.

8. Provide key statistics indicating performance and prospects, drawing from financial, non-financial and regulatory information where appropriate.

9. Use alternative reporting technologies to allow readers to access more detailed information on the company’s website.

10. Report historic cash flow and liquidity information in a way that is meaningful to management and is consistent with the tools used internally to measure performance.

11. Avoid repetition but provide all important information, including information on environmental and social impact in the context in which these are important to the company.

12. Make clear the significant judgements that have been made in the preparation of the Short Form Report and full annual report and financial statements.