A COMPANY’S ‘PERFORMANCE’ CAN NO LONGER BE DEPICTED PURELY IN FINANCIAL TERMS

“THE PROPOSED STRATEGY REPORT FOCUSES ATTENTION ON A COMPANY’S LONG-TERM STRATEGY AND MANAGEMENT’S STEWARDSHIP”
EXECUTIVE SUMMARY

Corporate reporting needs a radical overhaul to ensure it remains relevant and capable of adapting to respond to the key challenges facing business today:

- Technological innovation
- Low levels of public trust in business and its role in society
- The need for long-term sustainable business and investment models
- The need to demonstrate value creation to wider stakeholder groups.

In this paper, we propose a ‘strawman’ reporting model for debate by investors and other corporate reporting experts, which sets out a better benchmark against which the directors’ stewardship can be assessed. The proposed structure consists of a ‘strategy’ report, which provides a concise and coherent summary of key information about the company, its business model, values and long-term strategy. More frequent ‘performance’ reports provide more detailed updates about how the company has performed against its planned strategy.

**The benefits of our new model are:**

- Setting more meaningful and comprehensive benchmarks against which the stewardship of directors can be assessed
- Increased efficiencies for companies and investors in providing and accessing relevant information
- Enabling accountability for a broader range of impacts and outcomes
- Providing information about the long-term, future prospects and value drivers
- Improving transparency, in enabling companies to tell their own story about performance
- Providing information relevant to different stakeholder groups.

The model will be more flexible to suit the changing demands of stakeholders and the future opportunities that evolving technologies will offer for corporate communication.

We believe that, in the interests of sustainable corporate and market stewardship, the community of longer-term investors must draw towards a consensus on an improved model for corporate reporting which better responds to their information needs. This will support a programme for change which delivers the major reform which is needed, ultimately helping to build trust in business amongst investors and other stakeholders. The following questions are therefore intended for discussion at a series of Investor Roundtables during the course of 2018 which will then form the basis for a further development of a consensus based on our proposals.

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1 We use the term ‘strategy report’ here as a new concept, distinct from, but building on, the existing UK strategic report.
QUESTIONS FOR DEBATE

1. Do you agree that annual (or periodic) performance reports, in some form, still have relevance? If so, what key elements of information should these communicate?

2. Do you agree that the reporting framework should focus primarily on the needs of longer-term investors, while also being structured to facilitate access to a broader range of users?

3. Do you agree on the need to establish a broad consensus amongst long term investors in order to facilitate change?

4. Do you agree with our approach to improve the structure and accessibility of reporting for a wide range of users, involving a strategy report and performance report(s), as described below?

5. Do you agree with the suggested content of our proposed strategy report – of key strategic and standing information?

6. Do you agree that this strategy report provides a useful and more complete benchmark for directors to be held accountable for their stewardship of the company?

7. How do you see current and new technologies facilitating an appropriate presentation, availability and accessibility of reported information?

8. How should current requirements be evolved to allow and encourage experimentation and development of new ways of reporting including the kind of structures which we advocate?

9. What advantages and disadvantages do you see from the broader strategy and performance reports as described?

10. What levels of assurance and/or audit would you see as being necessary or relevant on the different aspects of the strategy and performance reports?
BACKGROUND

ICAS formed a working group in 2017 to consider the future of corporate reporting and develop a way forward. Key to this initiative is that the Working Group would be dominated by investors and the conclusions would be strongly investor-led. ICAS would like to thank the members of this Working Group, who are listed in the Appendix. Inevitably the Working Group cannot engage every investor or encapsulate the views of all investors. Therefore, this paper is intended to facilitate a broader discussion amongst a range of long-term investor users of annual reports, to seek to gather a consensus for change.

ACHIEVING CHANGE

Few months go by without the issuance of a new commentary proposing changes to financial and/or corporate reporting. Innovation in company reporting is a crowded market, in concept if not in practice, with lots of ideas vying for attention. This may reflect unease that company annual reports are not delivering what the range of users wants, and this is borne out by challenges and comments from stakeholders.

Substantive change, though, is slow to achieve. Incremental improvements are made, but there is often insufficient consensus amongst the user community to take forward initiatives of major change. Users often don’t want to lose the important information they currently receive, even though they may find it hard to extract, and they are not always clear about what additional information they would like to obtain or how it could helpfully be structured. Equally, corporates are perhaps hesitant to innovate or to remove previously reported information given pressure for “full disclosure” even if less but more focussed information would be preferable.

Company websites and other developments in communications technology allow for a variety of approaches to communicating information to company stakeholders. We need to reflect current realities in our proposals but, as it is not clear how these technologies will develop over time, keep a degree of flexibility to allow for further innovation.
PRELIMINARY ANNOUNCEMENTS

Currently preliminary announcements are voluntary, but many companies issue these, and it is the release of these announcements and the summary results they contain which seem to be the main drivers of 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 strategic, governance, financial and stewardship information together with a long form audit report on the financial statements.

ANNUAL REPORTS

Many investors attest that the annual report remains a valuable reference point for them. But over the years, it has become a repository for a multitude of detailed disclosure requirements arising from a wide variety of sources and arguably of differing value to users and investors, resulting in longer reports, repetition, boilerplate disclosures, lack of depth, important information hidden amongst detailed disclosures, and a lack of internal consistency and coherence. It has also become a focus for great change and experimentation, as the strategic report and concepts such as Integrated Reporting have been applied to varying degrees and in different ways.

While the annual report certainly combines many different types of information with varying levels of quality and credibility, it has arguably become excessively detailed, over-complex and multi-focused, making it harder to access key information, to assess its reliability and to pick out from amidst the fog of details the critical messages relevant to a coherent assessment of performance and of the business going forward.

The traditional format of the annual report, much of which is prescribed by statute, constrains experimentation with more user-friendly and accessible ways of reporting. This is going to become more of an issue as technology allows for different and better ways of providing information and enhancing access to different investors and other stakeholders. Some of this communication may be two-way, self-serve or interactive to some degree, such that users will be able to focus on what is important for them without being overwhelmed by huge volumes of less relevant information.

PERFORMANCE AND STEWARDSHIP

As businesses have adapted and made increasing use of intangible assets to generate value for their stakeholders, there is a view that these ‘key value drivers’ are not appropriately accounted for or represented in the financial statements or referenced elsewhere in the annual report, and there is therefore a gap in the information investors and other stakeholders are receiving. There is a growing recognition that a company’s ‘performance’ can no longer be depicted purely in financial terms – other forms of capital, such as environmental and human capital are increasingly important.

In recent years, the concept of accountability has broadened and become more complex – as encapsulated in section 172 of the UK Companies Act. Reporting needs to evolve to enable a more coherent assessment of how directors have discharged these duties in delivering value to a broader range of stakeholders. Whilst we recognise that investors use a wide variety of sources in their investment models, there remains a need for a publicly available periodic report, to demonstrate accountability to investors and other users.
RATIONALE FOR A NEW REPORTING STRUCTURE

We took as a starting point the concept of ‘core and more’ proposed by Accountancy Europe in their 2015 paper ‘The Future of Corporate Reporting – Creating the Dynamics for Change’. Core & more aims to present corporate reporting in a smarter way, organising financial and non-financial information based on the interests of users. The most important information relevant for a wide range of stakeholders would be in the “core” report, akin to an executive summary, and supplementary but possibly expansive details for a more limited audience would form the “more” reports.

ICAS VISION FOR A DIFFERENT TWO-REPORT MODEL

Whilst this was a positive way of moving the debate forward, ICAS is seeking to fundamentally change that ‘core’ and ‘more’ approach in a way that better meets the needs of investors and provides information to support long-term investment decisions. As well as considering the way in which information is presented, we look at what information should be provided to assist the assessment of management stewardship and better decision-making by investors. It is key that a new model of reporting incorporates broader notions of ‘performance’ and ‘value’ – providing information about a range of capitals.

In the information age, we believe that annual (or periodic) reports of some kind remain a key communication tool for companies. With the proliferation of data sources, it is more important than ever that there is a central, credible source of information that can be relied upon. However, we believe that the annual report, in its current format and purpose, has lost much of its relevance, is not valued or trusted by users as a key information source and is not fit for the future.

STRATEGY REPORT

In our new vision, a long-term “strategy report” would provide a concise and coherent summary of key information about the company, including its business model, its long-term strategy, those assets or other aspects of the business which drive the maintenance and creation of value for the different key stakeholders, key governance structures and bases of risk / reward management, and forward-looking information on risks, opportunities and prospects. Much of this will be standing information which would normally be subject only to evolutionary and periodic change. This strategy report should be the entry point for new or potential investors in accessing broader company information and a reference point for existing investors in holding management to account.

In this way, the strategy report would provide the benchmark against which the directors report on their stewardship of the company and against which the investors would hold those directors accountable. Separate “performance report(s)” would provide periodic updates on performance by reference to the benchmarks set in the strategy report.

The strategy report would be a standing report which would remain on a company’s website, but periodic reports would highlight any updates or reconfirm the information which it contained.
PERFORMANCE REPORT

The focus of the regular performance report would be on the short-term performance of the company by reference to the longer term strategy, objectives, expectations, opportunities and risks set out in the strategy report. It would therefore cover financial performance, reports on current corporate governance activities, remuneration outcomes and any developments in key risks. It would also report on the extent to which the company’s key value drivers have been maintained and/or enhanced during the reporting period.

TWO-TIER APPROACH

The two levels of information which we propose will each have their own periodic reporting by directors and each will have its own tailored assurance or ‘audit’ reporting. In our view this will provide for more meaningful and focused stewardship reporting by both the directors and the external assurance providers: it will be tailored to the specific business model, strategy, operational drivers and risks that impact company value; it will provide an effective platform for the evaluation of performance against the company’s forecasts; and it will retain a specific environment for the reporting of historical performance.

In developing our model, we aim to retain some key qualities of the current annual report – namely, its confirmatory value and reliability, which can be attributed to the fact that it is prepared and audited under recognised frameworks of standards – while driving a fundamental improvement in the value, relevance and breadth of information being provided to stakeholders.

CONTENT OF THE STRATEGY REPORT

The innovation of the proposed strategy report, is that it focusses attention on a company’s long-term strategy and management’s stewardship and will create a clearer and more tailored framework for assessing performance. The strategy report will not necessarily be updated as frequently as annually, but will be updated for significant changes and developments in strategy, governance etc. The Board should confirm annually that the strategy remains correct/true and fair, and should highlight any key changes made during the year. The strategy report is prepared in the context of the current/expected market conditions but would be updated to reflect significant changes to external factors.

The content of the strategy report would include:

- Purpose and business model – the company’s higher-level purpose, how the company makes its money and creates value for stakeholders
- Viability statement – the directors’ assertions on the viability of the company’s business model and how the risks to that business model are being mitigated.
- Long-term strategy – how the company will change its business model, commercial strategy and operations over time to continue to maintain or create value for its stakeholders
- Performance measures and time-framed targets adopted for each of the performance objectives
- Value drivers / strategic assets – detailing those company “assets” (whether recognised in the annual report & financial statements or not) which drive the maintenance or creation of value for the stakeholders
- Key corporate governance information, e.g. on how the principles are being followed and the extent to which the code provisions are being complied with
- Key opportunities and how these are intended to be pursued
• Key risks and how these are mitigated
• Other important factors relating to the long-term success of the company, including the desired culture of the company, the desired ethical standards and behaviours, and its views on matters such as diversity and inclusion
• Executive remuneration policy and structure
• Forecasts/planned performance over the next one to five years

The strategy report sets out the long-term view for a company and will incorporate some information that is similar to that already provided in the current Strategic Report and investor/analyst presentations. However, it will also require new thinking about the presentation and disclosure of value creation and strategic assets, as well as the linkage and consistency of content and presentation in the financial and non-financial statements.

CONTENT OF THE PERFORMANCE REPORTS

As the strategy report becomes a more permanent/standing document compared to what we have in the current reporting cycle, the performance report(s) will become the key periodic update(s) on performance against the company’s strategy, objectives, forecasts and expectations established in the strategy report.

The performance report is crucial in differentiating between performance over time and period-to-period changes and shows the links between long-term value creation and shorter-term performance. Short-term signals are important as investors need to assess whether current performance is indicative of what may be coming in the longer term or is just short-term, non-recurring 'noise'. Information about the shorter-term and, in particular, how the drivers of value are being maintained or enhanced provides context to the long-term picture, and a regular flow of information may help alleviate short-termism in the markets by avoiding the need for second-guessing.

The performance reports would include annual and periodic reports, including:

• A single page infographic as the lead communication, including the top ten key performance indicators
• Key financial statement information
• Key performance metrics vs targets
• Commentary on financial performance and other aspects of performance and the extent to which they are achieving the company’s longer-term objectives set out in the strategy report and delivering ‘value’ to the broad range of stakeholders.
• Details on how the company’s value drivers have been maintained or enhanced during the period
• Corporate governance information, including key perspectives on how the code has been implemented during the period, details of any changes, major judgemental issues, and changes during the period in risks and mitigations
• Performance against risks and opportunities – i.e. the extent to which risks have been mitigated as expected and the extent to which opportunities have been pursued
• Information on other important factors relating to the long-term success of the company, including the current culture and ethical standards operated across the company, and performance on matters such as diversity and inclusion
• Executive remuneration awarded
IT IS IMPORTANT THAT THERE IS A CENTRAL, CREDIBLE SOURCE OF INFORMATION THAT CAN BE RELIED UPON
APPENDIX

MEMBERS OF THE ICAS WORKING GROUP

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<tr>
<th>Name</th>
<th>Organisation</th>
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The members of the Working Group were involved in a personal capacity and the views expressed in this report do not necessarily accord with the views of any particular individual or the organisations for which they work.

PROJECT OBJECTIVES

- To engage a broad range of users in discussions on how to improve company annual reports, so as to better meet their information needs.
- To improve accessibility and understandability of company annual reports and better communication of the drivers of long term value.
- To allow for better analysis and better quality usage of the information provided in company annual reports.
- To set an aspiration for company reporting, so as to influence all relevant stakeholders, in particular international bodies such as IASB, IIRC and IOSCo.
- To facilitate debate amongst all stakeholders in corporate reporting.
- ...and ultimately:
- To establish improved corporate reporting which better meets the needs of a wide range of users and in particular long term investors.