



11 August 2016

### **THE FUTURE OF CORPORATE REPORTING – CREATING THE DYNAMICS FOR CHANGE” (OCTOBER 2015)**

#### **FEDERATION OF EUROPEAN ACCOUNTANTS (FEE)**

##### ***BUSINESSEUROPE welcomes the paper***

BUSINESSEUROPE welcomes the FEE Cogito-paper on the Future of Corporate Reporting. We think it is important to challenge whether the current reporting model is fit for purpose or whether there is a need for change. We also think it is important to take a holistic view on corporate reporting, both in terms of the amount and the patchwork of reports, but also the different content elements of reporting. During the last decade, the focus on different aspects of Non-Financial information (NFI) has been increasing. A number of organisations have issued different standards or reporting frameworks and political decisions have pushed more and different reporting into one, common report, making it difficult to focus financial reporting on the primary stakeholders. Even though BUSINESSEUROPE supports the need for a holistic view, BUSINESSEUROPE believes it is important to separate the issues of communication from those of the technical aspects of the reports. These issues should be addressed appropriately.

We comment in more detail below. Even though we agree with some of the concerns expressed by FEE regarding the challenges that current corporate reporting faces, we are not convinced that an integrated approach – such as the one suggested by FEE – is the right way forward overall.

##### ***Difference between market capitalisation and net asset value***

The paper starts out by stating that the growing difference between the market capitalisation and net asset value for leading corporates represents a key rationale for review. BUSINESSEUROPE does not believe that market capitalisation and net asset value should be identical: in practice, there is not a problem with having a difference between the two. Different business models qualify for different multiples when pricing a company, and pricing a company is essentially what financial analysts are doing every day. The important issue is whether the financial statements contain relevant information, presented in a short and concise format. Indeed, at the IFRS conference in Zürich 2016, one investor representative on the panel confirmed that they are in need of more focus on the financial information and less on NFI and other areas. Our conversations with investors confirm this.



### ***Who are the stakeholders? / Broadening the group of stakeholders***

The paper analyses the widening range of stakeholders and their impact on reporting in general. It is true that stakeholder variety and engagement is broadening, in part stimulated by technology. Today, access to information on the internet is a global commodity, and social media allows for new interactions between stakeholders themselves as well as between stakeholders and the companies.

The FEE report expresses similar views to those of parties such as the Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IIRC). On a European level, the need to address the information needs of a wider stakeholder group seems to have been a crucial objective behind the recent change in the accounting directive and the upcoming legal requirements for certain large entities to publish non-financial information.

One of the fundamental questions is whether all these stakeholders should – and can – be served with the same report or with a set of reports.

Different information essentially has different audiences as its target stakeholders. Today, the Investor Relations departments in companies try to address this by having different formats, allowing for tailored reports, or by other means, on the company websites.

We believe that a wide-ranging review of corporate reporting needs to start with the presumption that the range of stakeholders will vary depending on the size and nature of the reporting entity. As the identification of stakeholders is entity specific, a corporate reporting approach based on a coherent definition of stakeholders and their needs may be impossible to achieve.

The information needs of stakeholders other than investors and other financial market actors are of a different character and may not always align fully with the objectives that are the basis of financial information. We believe that the discussion of future corporate reporting needs to take into account the variances in the information needs of different stakeholder groups. The quality of financial information directed towards actors in financial markets is largely dependent on coherent and well-defined concepts such as reporting entity, capital and performance. The information needs of other stakeholder groups should not interfere with the requirements of such concepts.

Further, experience from communications professionals illustrates this. The same information is explained differently in the CEO letter, in the letter to private shareholders and in the internal publications to the employees. These three stakeholder-driven communication channels illustrate the difference in language and granularity needed for different stakeholder groups.

### ***Relevant information should be the criterion***

A key question is whether the annual report of today provides the relevant information to the intended users and whether this information can be clearly presented or is swamped by other information or mandatory disclosures.

As non-financial reporting is spreading, the relative importance of financial statements is diminishing. However, for instance, to enable users to perform basic comparisons



and make fundamental assessments before looking for other relevant information that may drive share prices, such as, for example, customer trends, financial reporting is still the most important piece of information.

Reflecting on the fact that audit firms globally have invested significant resources in promoting non-financial reporting in different forms and shapes, the profession has itself been a strong advocate for shifting the focus. At the same time, the complexity of the financial statements has increased – not necessarily to the benefit of communication between preparers and users. We believe that the move towards more detailed accounting standards and regulatory supervision is the key explanatory factor behind the increasing information content of annual reports. As preparers, we are continually involved in a discussion about how to focus on essential information and how to distinguish immaterial information from material.

In this environment, it may prove more valuable to have a few, but important, elements of key data rather than adding information and broadening the scope to other areas. BUSINESSEUROPE believes that in order to maintain the relevance of reporting it is important to actually focus and develop these aspects.

Experience from Denmark, for instance, demonstrates that innovation in terms of grouping disclosures in accordance with content and relevance comes from preparers in times when the companies are not faced with the implementation of new rules and standards. In addition, recent initiatives from the UK Financial Reporting Lab have illustrated a way to improve financial reporting. These exceptions highlight the fact that there are, in our view, very few initiatives under way to develop better practice. The initiative needs to come from companies who need not only flexibility in the standards, frameworks and legislation, but also general periods of calm from all the different standard setters in order to give them time to develop and innovate reporting. These initiatives should be promoted by, for instance, recognising and rewarding those seen as best practice. We think a fixed CORE & MORE format will not be able to promote this.

### ***Timeliness of the reporting***

Another issue that the FEE report attempts to address is the lack of timeliness of financial information. It is stated that by the time the information reaches the market it has lost some of its relevance. We are aware of the fact that the reporting frequency varies in Europe with bi-annual reporting being the required minimum. Interim reports are typically released approximately 3-6 weeks after the end of the reporting period, and, before the full annual report is published, a summary report is provided to the market. Furthermore, companies are obliged to immediately release significant information to the market. Consequently, it is difficult to see how information could be released earlier than it is already if the quality of the information is to be maintained.

### ***Non-GAAP measures and KPIs***

The FEE paper also discusses the failure of current financial accounting to provide information on key corporate value as well as off-balance sheet exposures, and proposes solutions on how more relevant and user-friendly corporate reporting can be achieved. Some of these themes are discussed in the paper, including the proposals that management commentaries could be integrated in the financial statements, notes



could be restructured and that non-GAAP measures and KPIs could be presented more consistently. Overall, we believe that the ideas expressed in this section are sound. The quality of financial reports would benefit from more flexibility in terms of how different types of information may be presented, but innovation should come from preparers and their dialogue with their stakeholders. KPIs should, however, not be mandated, since different sectors may have completely different business models and business cycles (for example, R&D companies compared with manufacturers).

### ***One or many reports – the convenient placeholder?***

From our point of view, different information being embedded into the annual report by different standard setters, regulators and legislators is counterproductive to the achieving of a targeted level of information to the relevant stakeholder on different topics. One could also challenge whether the different sets of information have the same, logical reporting cycles.

These discussions seem to be absent from the considerations of legislators who view the annual report as a convenient placeholder. Companies may, for instance, update their corporate governance arrangements following their general assembly / shareholder meetings. The appropriate reporting cycles for the report dealing with this would differ according to the specific circumstances, for example when changes occur. Similar considerations could be relevant for the other sections.

An interesting aspect of the layered CORE & MORE approach is that corporate information could be presented with different frequencies and that information can be partly and independently updated. This idea may be initially appealing, as it allows for greater flexibility for companies as some information can be produced faster and more easily than others can. However, it must be weighed against the company's ability to produce reliable information.

Further, we already highlighted the different demands of just a few stakeholders, but looking broadly at NFI it is not possible to serve everyone in one, common report as the result would be to satisfy the lowest common denominator and not make the report relevant for any individual stakeholders.

It is inevitable that the relevance and need for NFI will vary substantially depending on, for example, the size, line of business and market impact of the reporting entity. This makes it difficult to achieve one reporting framework that works for all. We do not believe that an international set of standards of NFI is a feasible aim and we fear that the present efforts to regulate NFI at a European level may obstruct the company-stakeholder dialogue that, according to our experience, evolves well without regulations. Instead, voluntary international common standards in well-defined areas where standardization and comparability of certain key non-financial measures are vital, such as CO2 emissions etc., are most likely the effective way forward.

### ***CORE & MORE or CORE & NO MORE?***

BUSINESSEUROPE does not agree with the CORE & MORE model. It is based on a criticism of the patchwork of reports but the proposed solution is to introduce yet another report on top of this as a type of "executive summary". We think this is not the right answer, but would rather add to the complexity.



Preparers are investing many resources in tying together the different sets of information required in an annual report - even when the information has different audiences, different natural reporting cycles and different levels of materiality. Preparers also target their communication through different channels to the different stakeholders when necessary. Large multinationals have an ongoing dialogue with stakeholders through different media ranging from roadshows and shareholder meetings to interactions through social media. Based on the amount of feedback from the stakeholders they receive from all these sources, preparers regularly optimize their financial and non-financial reporting channels.

Actually, when it comes to the issue of how to restrict the volume of information in annual reports, we question whether the CORE & MORE approach will actually provide companies with the right tools needed to screen and pick the relevant information over the less relevant. On the contrary, we fear that a framework based on layers of information with different status will increase rather than decrease the total amount of information provided and will contribute to the information overflow.

### ***Technology***

We share FEE's view that the presentation of corporate information could benefit from many of the technological facilities that are available today. For instance, we believe that more of the information now required to be published in the annual report could be presented by reference to the company webpage. Web-based information with links from key information to more details could be a way to achieve this. Unfortunately, initiatives by regulators based on, for instance, XBRL – a technology developed 30 years ago – may be good for regulators, but do not support innovation.

What the FEE paper is suggesting already happens to some extent today with dedicated websites, condensed shareholder communications etc. However, the language needed to target different stakeholder groups (investors, NGOs, employees, etc.) varies as indicated above even when one is communicating the same facts, in order to enhance the dialogue with the specific stakeholders.

Preparers are experimenting with new technologies and formats. However, meeting new requirements in financial and non-financial reporting is the priority, and often the same people are required to prepare both financial and NFI. Further, regulators or legislators may impose fixed formats in contrast with the flexibility afforded by IFRS, either for their own information purposes acting as a specific stakeholder or for a broader range of stakeholders, while auditors struggle with dynamic reporting formats, and preparers are trying to make use of the flexibility which is currently available. The FEE proposal does not change this.

One issue is how to identify audited from non-audited information, in case companies would wish to incorporate different information of the same nature. The answer should not be simply to broaden the scope of reporting by adding more specific reports to what is already mandated.

What would be helpful, if a CORE & NO MORE model/thinking were introduced, would be to have the financial statements as the CORE – and the only report subject to statutory audits. This would allow preparers the flexibility to target the reports on the stakeholders and procure assurance services for the areas where this contributes to the value chain and does not impede the reporting format.



### ***Link to Integrated Reporting***

We observe that the ideas presented in the report generally have similarities with the Integrated Reporting (IR) initiative and the CORE & MORE approach to corporate reporting seems to address the principal issues that IR is an attempt to resolve. The IR framework was introduced a few years ago and, although some companies have already integrated sustainability information when relevant within the annual reports, few entities publish full integrated reports according to the framework. We believe that one fixed format will never be appropriate or be able to cater for the different businesses and their different stakeholders. This is why it is important to maintain flexibility, including the issue of separate reports where appropriate. In our view, it would have been beneficial if a more thorough discussion regarding the correspondence between the CORE & MORE approach and other similar initiatives had been included in the report

### ***Do we need a standard setter?***

The FEE paper challenges the current environment where a number of bodies are developing separate standards for reporting NFI.

The question is whether one would need a traditional standard setter at all, or whether one should actually allow non-financial reporting to develop through dialogue between stakeholders and preparers as reporting on NFI is essentially a tool for communication between these two parties.

If we want to drive innovation, we believe it is beneficial to have a variety of input and sources of inspiration, by which preparers can report (or inform on) NFI. Further, we cannot avoid having different standards or requirements not only because of regional/national differences but also the diversity of stakeholders. We therefore think that the idea that there should be one standard-setter for NFI is not the best way forward. On the other hand, the various standard setters or other bodies should challenge the information they are asking for – both compared with other NFI as well as its relevance compared with financial information - and enhance their own framework.

By the way, we note that the FEE paper is based on the view that NFI is to high degree voluntary. Unfortunately, due to regulatory activity, this, however, is from a European point of view already outdated to a large extent.

With the increased legal requirements for mandatory non-financial reporting, country-by-country reporting etc. in the EU, non-financial reporting is rapidly turning into a compliance exercise, as businesses have to report on topics that may not be relevant to their specific business. The patchwork is a result of separate stakeholder groups ensuring that their specific issues are covered by a mandatory report without setting any restrictions in terms of reporting overload, cost or even delays in reporting in order to meet all the requirements. This development is not helpful for innovation and better communication.

A holistic approach at a political level or at a level without the direct involvement of the underlying standard setters (therefore being independent from these) in order to monitor the totality of reporting could play a role in mitigating the negative effects of this development.



In Europe, an organisation like EFRAG or another organisation of international reach that is not involved directly in standard setting could have a role to play in coordinating and challenging different standard setters, regulators and legislators in order for their standards or requirements to respect criteria such as materiality, but also in requiring them to recognise the fact that similar or even identical information requirements – based on different standards and regulations – are already imposed on preparers today.

### ***The environment for corporate reporting policy***

The last section of the report contains a good depiction of the institutional setting for new policy and innovation in the corporate reporting area. We agree with FEE's views on how to create the best environment for innovation and change in corporate reporting. A principle-based approach and giving flexibility for preparers to make their own judgements and assessments are essential for fostering incentives for experiment and change, as we have already addressed and acknowledged in this comment letter.

### ***Conclusion***

BUSINESSEUROPE thinks the FEE report stimulates an important debate. The paper covers a lot of ground touching on a great number of different issues. Technology provides a platform for readily available information that drives demand for more information rather than better and more relevant information. However, we think that by having a broad aim, the report loses focus and clarity. There is a need to reduce and focus financial reporting and to designate the financial statements as the CORE report. Therefore, BUSINESSEUROPE suggests a model named CORE & NO MORE. This would allow the core financial report to provide relevant information to the primary stakeholders concerned. Other stakeholders could then be served with reporting targeted to their special needs while taking into consideration the different, natural reporting cycles of the reporting in question.

To conclude, we welcome FEE stimulating the debate, but we are not convinced that an integrated approach – such as the one suggested by FEE's adding an extra report in the form of an executive summary – is in general the right way forward. Indeed, adding another report will contribute to the existing information overload, and this is not the way to go.

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