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Via email: futurereporting@frc.org.uk

Discussion Paper: A matter of principles - The Future of Corporate Reporting

CPA Australia represents the diverse interests of more than 166,000 members working in over 100 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia welcomes the Discussion Paper that presents a number of interesting and innovative proposals that could contribute to improvements in the systems and fundamentals that underpin corporate reporting. We have provided our overall comments below in response to the proposals rather than responding to the specific questions raised in the Discussion Paper.

Alignment with other developments in Corporate Reporting

We expect the Financial Reporting Council and its Future of Corporate Reporting Advisory Group considered other developments on corporate reporting, notably the Integrated Reporting Framework <IR>, in developing the Discussion Paper. We note there are some differences between these proposals and <IR>. For example, <IR> espouses a single report whilst the Discussion Paper proposes a disaggregated network of corporate reports. We also note similarities such as a focus on non-financial reporting. It would be helpful for stakeholders with an interest in the future of corporate reporting to understand how the proposals contained in this Discussion Paper will interact and align with other reporting frameworks such as <IR>.

Other important developments such as the establishment of the Value Reporting Foundation, and the proposal from the International Financial Reporting Standards (IFRS) Foundation to create a Sustainability Standards Board alongside the International Accounting Standards Board (IASB), could also have a bearing on the future of corporate reporting.

In developing its proposals further, we suggest the FRC considers existing initiatives, including those described above, to ensure that it leverages existing developments to achieve efficient, effective and globally consistent outcomes. It may also be helpful to both the FRC and other stakeholders interested in these developments if a comparative analysis is undertaken as to how the FRC's proposals align with other developments in this space.

Broader consideration of corporate communications

The Discussion Paper proposes the establishment of a framework based on three broad themes for corporate reports that are objective-driven, communication-focused and based on one common set of principles. It is noted that along with annual reports that are considered the 'set piece' of corporate reporting by many, companies communicate with stakeholders about their activities through numerous other reports. Notably, companies also employ other modes of communication such as social media channels to communicate with their stakeholders. Whilst these digital communications may not take the form of reports (e.g. a tweet or a LinkedIn post), these communications nevertheless play an important role in companies communicating information to stakeholders.

The Discussion Paper notes in the footnote on page 11 that stakeholders rely on the company website as a preferred source of information about a company, followed by media coverage in news outlets, magazines and journals. Presumably, information obtained through these sources may not always take the form of reports.

We suggest that consideration is given to how the three broad themes of corporate reporting would apply to all forms of communication that companies employ, and not just corporate communications that take the form of reports.

Three broad themes for corporate reporting (Objective-driven, communication-focused and one set of principles)

The Discussion Paper proposes a shift from "user focused" reporting to "objective-driven" reporting. Whilst we agree with the assertion that corporate reporting is based on the perceived needs of a single set of primary users in the case of financial reporting, we are not entirely clear how this same assertion is valid for all forms of corporate reporting. Further, the focus on providing financial information to primary users is also the key objective of financial reporting. Nevertheless, we support the proposal that multiple information objectives could be established for different reports that form part of corporate reporting.

Communication-focused corporate reporting should be an underlying theme for any reporting model to deliver meaningful and useful information that stakeholders can rely on. We agree with the need to shift away from treating corporate reports as a compliance exercise and enable them to become effective communication tools. It will also be important to ensure that communication-focused corporate reporting remains a fundamental theme regardless of whether reports are prepared as part of a compliance exercise.

We agree with the proposals to introduce one set of principles that includes system level attributes and report level attributes. We make the following observations in respect of report level attributes:

- We agree that the "true and fair" attribute is important for financial reports, and indeed this is a well-established feature of financial reporting enshrined in corporate law and financial reporting requirements globally. However, not all corporate reports required by statute are subject to the true and fair requirement or subject to external audit for independent verification of this attribute. This includes information contained within the annual report (e.g. the directors report) and other corporate reports such as an annual modern slavery statement.
- Many corporate reports are voluntarily prepared, and in some cases, as highlighted above, corporate communications may not take the form of a report.

Further consideration needs to be given to how the true and fair attribute can be applied to all forms of corporate reporting.

The Reporting Network

The outlined approach is highly commendable both as a framework for discussion amongst the now significantly widening community of interest in the future of corporate reporting, and indeed, as a possible way forward in understanding the overall "architecture" of interconnected reporting components and frameworks. Nevertheless, assumptions that can be made about the threshold and interactions between the three components of the Reporting Network introduced on page 3 of the Discussion Paper, and elaborated in Section 5, are critical matters in any sought after design of a corporate reporting system – be it only at an abstract level. Therefore, we believe that too rigid an approach may mask the inherent complexities in financial and non-financial information and metrics which, whilst distinct, are at the same time symbiotic. These sensitives are highly relevant to the qualitative characteristics of both Financial Statements and Public Interest Reports within the proposed Reporting Network, and at the same time, are critical to the form and content of the central Business Report. The following elaboration illustrates our concerns.

The FRC will no doubt be aware of the release in June 2017 of the FSB's Taskforce on Climate-related Financial Disclosures (TCFD) Recommendations. These recommendations suggested three disclosures for Metrics and Targets, alongside—within Strategy disclosures—a description of organisational resilience against climate-related scenarios, including 2°C of global warming. Subsequently, the TCFD released *Guidance on Scenario Analysis for Non-Financial Companies* and is consulting with stakeholders on *Forward-Looking Financial Sector Metrics* (both October 2020). Elsewhere in the TCFD Recommendation is a compelling illustration (Figure 1, page 8) of the financial impact of climate-related risks and opportunities, and how they are ultimately being reflected in financial information and financial statements. The TCFD Recommendations are by no means unique in seeking depth, rigor and mainstreaming of sustainability-related information, with organisations such as the GRI having operated in this realm for more than two decades. What is dramatic about these reporting developments is the scale and speed of interest across a wide spectrum of parties, including institutional investors, corporate and securities market regulators, central banks, governments, and relevant to the FRC's considerations, financial and non-financial reporting standard setters and framework developers. For example, both the public commentary and guidance issued by the IFRS Foundation/ IASB on the effect of climate-related matters on financial statements and the in-depth technical resource developed by the Climate Disclosure Standards Board (CDSB) in its 'Accounting for climate'.

Four noteworthy factors arise in relation to these developments which we believe are highly pertinent to the matters canvassed in the Discussion Paper:

- Firstly, measurement considerations with respect to financial and non-financial information do not occur in a vacuum or in isolation. This has never been the case. However, the implications of climate change compel increased harmonisation in approach in terms of factors which impinge on climate-related risk assessments. They include the necessity to more effectively address time horizons and the progression towards monetisation of externalities, each of which affects accounting assumptions and triggers recognition, measurement and disclosure considerations. As the Discussion Paper notes, the arguments for elevating non-financial reporting to a level of discipline and acceptance comparable to that of financial reporting are compelling. There is widespread acceptance of this point. Additional to the matters identified in the Discussion Paper around coherence and rationalisation, this evolution of non-financial reporting must address, at the same time, the interactions with information presented in financial statements.

- Secondly, as noted in the TCFD Recommendations, one of the sources of climate-related transition risk is litigation or legal risk. Understanding the character of this source of risk has developed further in the short period since 2017, with growing awareness of the extent to which litigation exposure from a multitude of sources is impacting disclosure choices. In its 2019 report on liability risks across four common law jurisdictions the Commonwealth Climate Law Initiative (CCLI) noted:
  - Directors and fiduciaries must now approach their governance of climate change in the same way as they would any other matter. The only safeguard against liability exposure will be a proactive, dynamic and considered approach to the impact of climate change on strategy, risk management oversight and reporting.

    More recently Professor Pamela Hanrahan observed that:

    > The next regulatory challenge for corporate law will be policing the quality of the ever-increasing volume of disclosure about non-financial matters, including ESG disclosure, where the impact of

misleading silence on the value of the disclosing corporation's securities may be less readily observable.[1]

Therefore, whilst there might be conceptual appeal in unbundling and reconfiguring corporate reporting into a network of relatively discrete building blocks, this should not be at the expense of losing sight of how, when and where disclosure choices are made that can both create and negate litigation risk.

- Thirdly, with respect to Public Interest Report (refer to discussion in paragraphs 6.1 to 6.21 of the Discussion Paper), we urge the need to be sensitive to the character of the underlying information and associated corporate behaviours. We note the reference in paragraph 6.6 to misnomers with respect to the limited extent to which non-financial attributes impact the viability of a company's business model. The discussion goes on to refer to the implications of accountability to external stakeholders for such viability. Set in the context of our foregoing observations regarding litigation risk, we believe it crucial to acknowledge the extent to which non-financial disclosures reflect regulatory obligations spanning both environmental and social spheres, notwithstanding the voluntary character of the framework through which the associated corporate disclosures are made. Developments such as those outlined in the Discussion Paper warrant greater recognition that sustainability reporting has moved beyond processes of reputation management. It serves as a tool for both managing and communicating governance practices with consequences for both preserving enterprise value and negating litigation risk. As such, we believe the Discussion Paper could be strengthened in these regards.

- Fourthly, in terms of the interconnection and consistency across the three elements in the Reporting Network, we believe that those items identified on page 21 of the Discussion Paper that would form the basis of a Business Report would be widely endorsed. Such content aligns well with both the TCFD recommended Governance and Strategy disclosures and the improvements in quality and breadth of director narrative analysis occurring both in the UK and elsewhere. Nevertheless, what seems to be lacking is a sufficient reference to how a conceptual framework might drive the type of alignment identified as essential in the final dot point of paragraph 5.7 of the Discussion Paper. We believe that <IR> and the formation of the Value Reporting Foundation offer the most reliable conceptual basis for both aggregated narrative disclosures and driving coherence within the totality of corporate reporting.

Other matters

We agree with the proposal to apply materiality to the network of corporate reports as a whole and to establish materiality for each corporate report based on its communication objective.

Major steps have been taken in developing reporting principles for non-financial reporting through other initiatives such as <IR> referred to above. We do not believe the proposals in the Discussion Paper are sufficiently advanced in comparison to existing developments in this space. As stated previously, we suggest the FRC incorporates existing developments and thinking on non-financial reporting in developing its proposals further.

We agree with the proposal that technology should be a supporting pillar to corporate reporting and "digital by default" should be the approach to all forms of corporate reporting. Whilst the Discussion Paper explores technology from the preparers' and users' perspectives, it is necessary to consider the role of technology also from a regulatory and standard-setting perspective. Regulatory and standard-setting activities, including requirements for financial and other corporate reporting, traditionally focus on corporate reports that are paper-based. For example, XBRL tagging is used to convert conventional financial reports into digitally enabled reports, but the

[1] "Core Issues in the Regulation of Misleading Silence in Corporate Law" in *Misleading Silence* Elise Bant & Marie Paterson (ed), Hart Publishing 2020, pp 307 – 330.

underlying standard-setting focus remains on paper-based financial reporting. Consideration needs to be given to how regulators and standard setters develop reporting requirements that result in digitally enabled reports.

We hope our comments can contribute to the ongoing conversation around the future of corporate reporting and we look forward to continuing engagement in developments that seek to improve corporate reporting.

If you require further information on the views expressed in this submission, please contact Dr John Purcell, Policy Advisor – Environmental, Social and Governance on +61 3 9606 9826/john.purcell@cpaaustralia.com.au or Ram Subramanian, Policy Advisor – Reporting, on +61 3 9606 9755/ram.subramanian@cpaaustralia.com.au.

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