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05 February 2021

Sir Jon Thompson
Chief Executive Officer
Financial Reporting Council
8th Floor,
125 London Wall
London, EC2Y 5AS

Via email: futurereporting@frc.org.uk

Re: Financial Reporting Council's Future of Corporate Reporting Project

Dear Mr. Thompson:

CFA Institute[1] appreciates the opportunity to provide our perspectives on the Financial Reporting Council's (FRC's) Discussion Paper, *A Matter of Principles: The Future of Corporate Reporting* (the Discussion Paper). We have a long history of promoting fair and transparent global capital markets. High-quality corporate reporting that provides investors and other stakeholders with timely, relevant, and reliable information contributes significantly to the well-functioning of and confidence in both developed and developing capital markets across the globe.

CFA Institute lauds the FRC's initiative and efforts at thought leadership regarding the future of corporate reporting and how it "can more effectively meet the information needs of investors and other stakeholders."[2] Herein CFA Institute provides input on several overarching themes of importance to investors – not only in the UK but globally – in reference to the Discussion Paper. CFA Society of the UK (CFA UK), in a separate 5 February 2021 letter to the FRC, provides detailed input on the Discussion Paper and responses to the specific questions posed by the FRC. CFA Institute, as a global investment organization, recognizes that investment choices are global and that information needs are not jurisdictionally specific and that consistent, comparable decision-useful information is not only good for investors but for the functioning of fair and efficient capital markets and the discovery of long-term value creating capabilities of the organizations in which investors provide capital. We provide this letter in support of the FRC's efforts to be a thought leader in the evolution of corporate reporting and CFA UK in its endeavor to provide detailed input on the Discussion Paper.

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[1] CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 77 countries and territories.

[2] See FRC publishes future of corporate reporting discussion paper (*available at* https://www.frc.org.uk/news/october-2020/frc-publishes-future-of-corporate-reporting-discus).

Who is the Audience for the Corporate Report?

Corporate reports are a communication and a central tenant of communication is "know your audience." In many jurisdictions globally, only publicly listed companies prepare annual reports because it is the requirement to have current information for trading of shares that requires the public dissemination of annual reports. The legal requirements of publicly listed companies and the need to disseminate the information to investors determines the location, timing and method of the distribution of such information. Recently, the push toward environmental, social, governance and sustainability initiatives has widened the demand for information. This information is useful to investors as well as for other stakeholders (e.g. employees, suppliers, customers) – as well as "others" without a direct stake in the company. The Discussion Paper seeks to advance corporate reporting to meet the needs of investors and other stakeholders, and some may suggest "others" without a direct stake in the company doing the reporting. The Discussion Paper notes:

> *We believe that accountability is a key concept for corporate reporting but one that is rapidly changing. We believe that demand has shifted from just thinking about a company's financial performance and position, to value creation and the wider impact of the activity of a company on society and the environment. As part of that, we expect there to be a continuing focus on the responsibilities of a board towards its wider stakeholders….*

We are concerned that many, in the spirit of being inclusive of information for a variety of stakeholders, may actually reduce the quality and relevance of corporate reporting by failing to recognize the central tenant of communication is "know you audience". With an increasingly broader groups of stakeholders, who can be mistakenly aggregated, we believe that information quality and relevance may suffer as some information will be targeted toward the wrong audience. Conflation of the information needs of investors with the information needs of a wider group of users may actual reduce the quality of disclosures. For that reason, in our June 2020 comment letter to Accountancy Europe we made the following comment:

> *Having spent many years advocating for the convergence of accounting standards, we recognize that differing or competing objectives will deter convergence. For that reason, we believe, in developing an integrated and global approach for "non-financial information", it is essential to recognize that differing civil society and policy objectives in jurisdictions and differing values may deter progress on convergence. For that reason,* ***we believe that any global approach is best commenced with the financial value creation objectives of investors – in this way jurisdictions don't dismiss the proposals based upon the objectives or audience of the information, or its location****.*
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> ***Again, this is not to say that the information needs of other stakeholders are not important. Investors, in fact, are not a monolith and want to invest, for themselves or for their clients, based upon these civil society and policy objectives.*** *Rather, our point is that in commencing a convergence effort that connects to the existing efforts of the IASB and IFRS Foundation it is more likely to be successful to begin with agreement on the audience for the information (investors) and the communication objective (financial value creation).* ***We believe a focus on investors with an objective of financial value creation could be a catalyst for convergence****.*
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> ***Subsequently layering on disclosures meant to meet the needs of other stakeholders with other objectives – and considering their location – will provide the needed differentiation and discipline necessary to garner support from all stakeholders to accept the disclosures necessary to meet multiple objectives. This ability to layer and distinguish financially value relevant information from values or civil society-based objectives is also very important to investors who want to make – or need to explain to their clients – trade-offs between investment decisions made based-upon financially value relevant information and those based upon values or civil society-based objectives. Professional investors, investing on behalf of others, will want to be able to make such distinctions to act in the best interest of their clients****.*

Said simply, to achieve highly relevant decision-useful information for all stakeholders, the FRC, over the ten-year transition horizon as that proposed in the Discussion Paper, may be best served by adopting an approach that considers the information needs of investors and then layers on the information needs of other stakeholders. That is not to say that the information needs of other stakeholders are not important. This approach simply recognizes that discipline is needed in identify the audiences for corporate reporting and serves the information needs in a layered and integrated approach. We actually see that financial statements and corporate reports may omit value relevant information to investors in their pursuit of discovering long-term value. As an organization founded on the tenants of fundamental valuation, our advocacy efforts are always informed by the need to focus on value creation over current period earnings.

We also believe it is important for the FRC to recognize that corporate reporting may never be able to fully meet the needs of "others" who are not stakeholders due to their heterogeneity.

We recognize the Discussion Paper suggests the development of a network of reports and that may be useful for meeting the needs of different audiences, but we also believe the FRC must think deeply about how this network of reporting presents an integrated view of the company and the audiences for individual and network of corporate reports. Further, we think it is important to recognize that investors – as the residual equity holders of the company – will always be interested in the mosaic of information provided to other stakeholders because they are, in fact, the residual interest owner of the corporation. In such capacity they absorb the residual risks of the enterprise and they are being asked to pay for the information being provided to all stakeholders and others.

We also believe the FRC needs to consider that publicly listed companies, by virtue of having publicly listed equity securities, may have to provide information to a wider group of stakeholders than those companies that are not publicly listed. This may have the impact of deterring companies from seeking capital from the public markets. In such a way, proportionality is important to these disclosures as all companies – no matter their size or their method of ownership (public or private) – have a broad group of stakeholders and an impact on wider society.

Materiality

For the reasons noted above, different stakeholders have different views of what is relevant and decision-useful and it has been our long-standing view that materiality is positional – meaning that it is judged by the audience or user of the information. We have read carefully Section 4 on Materiality in the Discussion Paper. We note the FRC has said it does not seek to develop a different definition of materiality and that materiality should be applied at the report level and that in applying this definition it should consider the objective of the report. While understanding the objective of the report (i.e. communication) can imply this notion we think the audience for each report should be more explicit.

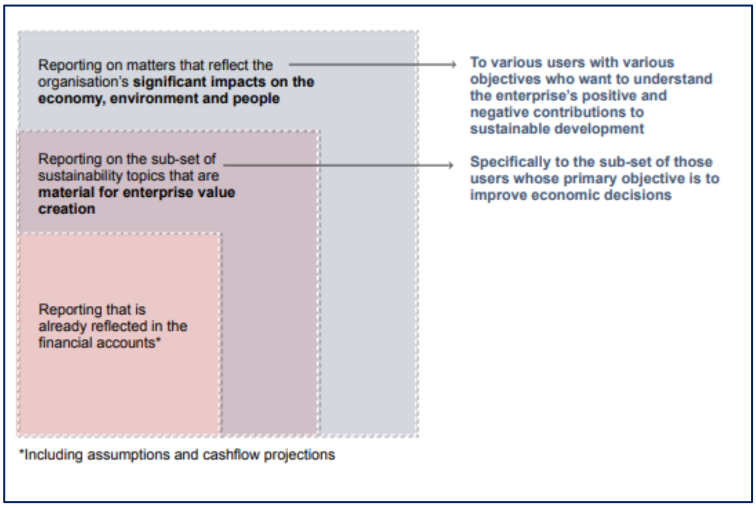
We believe the UK has been a leader in the disclosure of materiality and for that reason we support the information in Sections 4.5 and 4.6 on the disclosure of materiality.

As we have observed the dialogue on materiality over the last year – and the advent of the term "double materiality" – we find that preparers, investors, other stakeholders and "others" may not fully understand the topic of materiality in the financial reporting construct and how that dovetails with this notion of "double materiality." Presently we believe people are talking about materiality but may not be fully understanding how the other party defines the term or applies the concept in practice. We think significant education and dialogue is necessary to reach a common understanding of the notion of materiality. For that reason, we are working on a project to enhance the understanding of materiality. As we understand the Discussion Paper, we do not believe the FRC is promoting the notion of double materiality.

"Non-Financial Information": A Term in Need of Rebranding

The term "non-financial reporting" or "non-financial information" used in the Discussion Paper – as we highlight in our comment letter to Accountancy Europe – needs, in our view rebranding. The term connotes to many that such information has no financial consequence or does not relate to financial value creation. Accordingly, we believe some may perceive "non-financial information" solely relates to public-policy or civil society goals or objectives. Environmental and social factors, however, can have an impact on the financial value of a business – and as it relates to civil society and values-based objectives. Accordingly, information and metrics can demonstrate how such values or risk translate into measurement of financial value creation. Further, the ability to distinguish financially value relevant information from information concerning public interest or civil society-based objectives is also very important to investors who want to make – or need to explain to their clients – trade-offs between investment decisions made based-upon financially value relevant information and those based upon values or civil society-based objectives. Professional investors, investing on behalf of others, will want to be able to make such distinctions to act in the best interest of their clients.

Accordingly, we urge, as we did to Accountancy Europe, the FRC to reconsider, clarify or rebrand the term "non-financial reporting/information". Such information is really additional information provided outside the financial reports. In our view "non-financial" relates to the location of the information (i.e. outside of financial reports or financial statements) but the term is perceived by many to be related to the nature of information provided (i.e. not financial). It can be both. Companies can provide a variety of measures or metrics (non-GAAP, KPIs, APMS, etc.) communicating business objectives or with the objective of improving the transparency of its activities (e.g., sustainability or human capital management). These disclosures may be financial or non-financial in their delivery/communication and have non-financial or financial implications. The proliferation of information outside the financial statements has led many to question regulatory models of corporate reporting and whether they remain fit-for-purpose. The absence of frameworks for consistent and comparable reporting of other information may add to investor, other stakeholders and others confusion about the intended audience and objective. We have strongly supported the *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting* among leading sustainability and integrated reporting organizations—SASB, GRI, IIRC, CDSB and CDP. Greater consistency in the disclosure of such information and the layering approach proposed – as excerpted in the table to the right – is consistent with the views we expressed in our Accountancy Europe comment letter and articulated above regarding the audience for the information.



Impact of Technology

Technology has, and continues to have, a profound impact on the nature, timing, and extent of communications between corporations, investors, and other stakeholders. This has changed dynamics in both the dissemination and consumption of information places challenges on preparers, auditors, and investors. In 2013, frustrated by the narrative of disclosure overload, we highlighted in our paper, *Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust and Volume*, the need to better consider the application of technology in both the creation of corporate reporting and the dissemination of the information. See excerpt below. We encouraged policymakers to incorporate technology in their decision-making. Accordingly, your project to explore ideas to improve the effectiveness of corporate reporting is both necessary and appropriate. The incorporation and advancement of technological tools and methods, such as structured data frameworks, have the potential to reduce preparation burdens and enhance the ability of end-users to obtain and use the information. We think the FRC should think about the use of technology in the construction of corporate reports and their filing with regulatory agencies. While XBRL includes tagging presuming structuring occurs after creation of a paper-based format, the use of XBRL and technology may need to be considered foundational in the creation of corporate reports or databases of information regarding companies.

Technology: Irreversible Trend toward Greater Connectivity and Data in Financial Reporting

The majority of accounting standards and financial reporting regulations were written before there was a computer on every desktop (circa 1990) and a smartphone in the palm of everyone's hand (circa 2010). Prior to the implementation of EDGAR from 1993 to 1996, financial reports of U.S. public companies were not available without a written request to the issuer to mail a copy. EDGAR helped democratize the availability of financial information. Implementation of data tagging using XBRL in 2009–2012 in the United States was an extension of the financial reporting process by allowing data capture at the end of the process, which makes data more flexible and interactive. Similar advancements have been made in jurisdictions outside the United States.

Certainly, significant enhancements have been, or promise to be, made in the delivery of financial reporting information to the investing public. However, when evaluated in the context of the use of technology and the availability of data in other aspects of our lives and in light of the economy, investors see substantial room for innovation and improvement. Consider, for example, the advancement in mapping and direction technology over the same period of time. We have moved from hard copy maps to smartphones that can provide us directions in seconds. Do the reforms in technology related to financial reporting disclosures seem as sweeping?

Where Is the Discussion of Technology in Enhancing Disclosures?

Investors recognize the implementation of technology elsewhere and see the opportunity for better use of technology in financial reporting. The time is fast approaching when companies (preparers) that say, "We can't provide that information; it's too costly to obtain" will be heard by investors as saying, "We can't manage this business" or "We are unwilling to provide the information." Advances in technology and connectivity in the past five years and talk of "big data" have irreversibly changed expectations regarding the extent to which data are available, the speed by which data can be delivered, and the impact data can have on decision making—including investment decision making. Yet, in the dialogue on disclosure reform, there is little discussion about how technology can be used to improve the quantity, quality, and timeliness of information for investors. Rather, at this very time, when expectations regarding the availability of data are increasing, the conversation on disclosure reform is focused on reducing the volume of disclosures. This irony is not lost on investors.

Investors believe the conversation about disclosures specifically and financial reporting more broadly needs to consider the vast changes in technology that have occurred in the past 10–20 years. The conversation needs to consider how technology can be effectively leveraged to provide the information investors need for investment decision making in a globally connected, data-driven economy. Investors do not seek a reduction in data or volume of disclosures as they have the ability to utilize technology to evaluate the data. Identifying ways to effectively capture, manage, analyze, present, and deliver financial data is the reform investors see as necessary. How technology can be harnessed to reform the financial reporting process end to end—not simply in the filing of documents with regulators as in the case of EDGAR and XBRL—is where investors believe the dialogue on disclosure reform should be focused.

Changes in Technology and Connectivity Need to Be Part of Policymakers' Decision-Making Processes

An excerpt from the "Global Agenda Outlook 2013," published by the World Economic Forum, highlights the new reality that technology imposes on business people and policymakers:

> *The boundaries of physical and digital worlds are melting at unprecedented speeds, leaving many of our policy-makers, heads of government and business people unprepared to integrate new concepts into decision-making processes.* Technologies have evolved and continue to do so, while vast amounts of data are sent and received by billions of interconnected devices. As interdependency grows between individuals and the systems they are a part of, what are the issues and opportunities to be grasped? (p. 16)

Recognition by accounting standard setters and policymakers of the changes in technology (i.e., in connectivity and delivery of data) and the bearing such changes have on the perceived quality and relevance of their decisions is essential for the sustainability and relevance of financial reporting and accounting standard setting in the eyes of investors. Investors believe standard setters and policymakers need to integrate into their decisions the effect changes in technology have, or could have, on capturing, managing, analyzing, presenting, and delivering financial data.

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We appreciate the time and attention that the FRC has devoted to the examination of new ideas to improve the effectiveness of corporate reporting. If you or your staff have questions or seek further elaboration of our views, please contact Sandra J. Peters at sandra.peters@cfainstitute.org.

Sincerely,

Sandra J. Peters, CPA, CFA

Senior Head, Global Financial Reporting Policy Advocacy