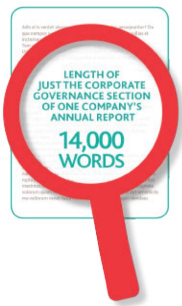
DECEMBER 2013

CORPORATE REPORTING
WHAT GOOD MIGHT LOOK LIKE?



INTRODUCTION

In the summer of 2013 we published a forerunner to this document and were surprised by the strength of the response we received from a broad range of stakeholders affected by the current UK corporate reporting requirements.

This follow-up document draws on those responses (both the positive and the less enthusiastic) to paint a picture of how corporate reporting could evolve over a relatively short period to better meet the needs of its primary users – whilst better engaging with preparers, other stakeholders and providers of assurance.

The fundamental purpose of reporting, and our starting point in this debate, has always been that corporate reporting is a fundamental element of an effective capital market. It should enable the market's participants to make better-informed investment decisions and to understand sufficiently any company's position and performance.

Whilst perhaps old fashioned, the notion of stewardship is central and an expectation that historical performance will somehow inform expectations of future performance is unavoidable. Risk will always be present, but good reporting must reduce it, and thus be of real value to investors and also to companies competing to attract funds.

BDO

THE PROBLEM

There has been a growing crescendo of dissatisfaction with corporate reporting over recent years. This has been exacerbated by the impact of the financial crisis, in that few commentators, investors or analysts appeared to feel adequately informed of the apparent financial frailties of financial service businesses, in particular.

A selection of fairly typical comments gives a consistent flavour to the debate:

There's so much legal disclosure that it's complete rhubarb. It needs to be more transparent, more relevant and to relegate the standardised stuff to the back. We won't get reform by legislation and regulation. Pressure has to come from investors.

Financial Director

It's written for accountants, so it's impenetrable. If it gave an honest appraisal of the business for those that don't have accountancy training and still contained what the accountants want, we'd all be in a better situation.

Non Executive Director

It's too detailed and difficult to see the wood for the trees. Despite the multiple disclosures, one report is far from comparable to another so it's hard to benchmark against competitors. Within accounting policies there is room for interpretation and that can mean different answers to the same question.

Private Equity Investor

...there is increasing pressure on fund managers to engage with companies on the quality of their corporate reporting.

Institutional Investor

If you're not a qualified accountant you can struggle, because even when you're accustomed to reading corporate reports, you just won't know what it is you're looking for.

Analyst

A DIAGNOSIS

Many companies appear confused about the purpose of the annual report today. Some see it as an opportunity to 'sell' the company's story to varied (and varying) stakeholders. Others see it as an arid compliance exercise.

There is confusion about who it's for. The investor community is quite clear that they are the primary audience, but is it relevant to short term investors? Some think not.

WE NEED TO BRING THE WHOLE THING BACK TO THE SHAREHOLDERS AND ENSURE THE ANNUAL ACCOUNTS ACHIEVE WHAT THE MARKETS WANT: THE FACTS AND THE STORY OF THE COMPANY.

Liz Murrall, Investment Management Association

SHORT TERM INVESTORS RELY ON ALGORITHMS AND QUARTERLY RESULTS, NOT THE ANNUAL REPORT AT ALL.

Roland Rott, Governance for Owners

The investor-focussed approach would seem to contrast with the broader stakeholder acknowledgement inherent in the thinking behind the Integrated Reporting initiative. But with some UK annual reports already over 800 pages, is that more holistic reporting ambition entirely realistic? Many doubt it.

The way that the annual report is often produced, through a process of stitching together different sections from different places, is considered a barrier to both adequate planning of the annual report and to it "telling a story".

IN A COMPANY, THE ANNUAL REPORT IS NO-ONE'S 'DAY JOB'.

Sallie Pilot, Black Sun Plc:

It is also suggested that this lack of real ownership leads to a boilerplate and 'safety first' approach from both users and auditors. If everything conceivable is in there the regulator and commentators can't condemn you.

WHAT CAN BE DONE?

We believe that there is much that can be done without additional legislation or regulation (over and above that currently proposed) to improve corporate reporting. To demonstrate that we have created an annual report and amounts for a fictional mid-sized, British based, internationally operating UK company, Terrapinium Group Plc, which incorporates a number of changes which we believe represent a real improvement in the quality of corporate reporting in the UK.

Terrapinium can be found at **www.terrapiniumgroup.com**

These changes may be summarised as follows:

We have expanded the audit committee report to meet the new requirements of the UK Governance Code [1]

The new material refers to audit risks and links these to judgments and uncertainties. It is more granular in terms of describing matters discussed with the external auditor and in dealing with their tenure and relationship. It refers to materiality and to the annual report being "fair, balanced and understandable".

The audit report has been expanded to reflect new requirements.

The FRC has produced revised material on audit reporting that includes reference to specific audit risks, audit materiality and scope and an overt reference to the completeness of the Audit Committee's report.

More prominence has been given to segmental reporting.

Different business segments are likely to have different characteristics and thus be of significant interest to investors. Burying such information in notes to the accounts may therefore be unhelpful, and we have thus treated the disclosures as if they were primary statements. Given their importance, we have also included data relating to the most likely KPIs to be available at segment level.

We have re-shaped the narrative reporting within the annual report to try and tell the story in a concise and cogent manner.

Whilst we have retained a brief Chairman's Statement, we have not included separate reports from the chief executive or the chief financial officer (and so on), but have organised the reporting thematically, in line with the new requirements in respect of the Strategic Report.

We consider this creates a better narrative than overlapping reports from individual executives and that it flows in both a logical manner and one which could give consistency in nature of content between different businesses.

We have included material relating to sustainability.

The Integrated Reporting initiative 2013 consultation draft[2], deals with a number of the principles we have espoused in the material here, but it does introduce the concept of "natural capital", which we have dealt with in the narrative reporting section on corporate responsibility through reference to carbon targets and achievement and waste recycling.

We have co-located accounting policies and analysis.

As the length and number of accounting policy notes has grown over the years, it has become an increasingly indigestible part of corporate reporting. No one in their right mind would read it in one sitting. Most of the policies can be set down next to the analysis of numbers to which they directly relate. If one is interested in say, intangible assets, you can then go the note labelled "intangible assets", read the policy for deriving the numbers and examine the numbers themselves, without having to flick back and forth to work out what they mean.

We have included reference to specific additional assurance work undertaken by the auditors but beyond the scope of statutory audit.

Investors are often surprised that some information in annual reports, even numeric information, is not "audited". We have therefore indicated where the company has sourced additional assurance to give confidence in such areas of content.

We have included audit committee and remuneration committee reports addressed directly by committee chairs.

Our review of audit committee reports, in particular over the last three years, indicates that reports written directly by committee chairs have more impact and speak to the reader more directly than broader descriptions of their activity during the year.

There are other less prominent areas where we have tried to reflect what we regard as best practice but we acknowledge that this is not a "one-size-fits-all" exercise and different companies will be best served by different disclosures and varying formats and content. This is a contribution to the debate.

We have demonstrated that much disclosure can be removed without damaging the integrity of corporate reporting.

We indicate in a number of notes to the financial statements where we believe material that would normally be included in an annual report can justifiably be removed on the grounds of materiality. This view of materiality is directly addressed by the Audit Committee Chair in their report. We do not believe there is anything in the information we suggest excluding which could remotely be of real interest to an investor, nor any other stakeholder.

THE FUTURE

Technology will continue to evolve and it may well be that the days of the printed report are numbered. "Click through" technology may well enable virtually all readers to self-select what becomes almost their personal version of an annual report, with only those areas in which they have a particular interest on display.

In the meantime there is much that can be done as we have demonstrated. It does require a degree of courage from preparers, but also from auditors and regulators. We hope they all rise to the challenge.

We can then hope that global standard setters feel they can take a lead in making the reporting language simpler and in re-establishing principles over detailed rules of application.

James Roberts
BDO LLP

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[1] Financial Reporting Council – The UK Corporate Governance Code, September 2012

[2] The IIRC Consultation Draft, 2013

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