The Financial reporting backcloth

Once again, financial reporting and corporate reporting will no doubt have fundamental changes. Pre-pandemic the environmental concerns were taking shape but post-pandemic there will be other concerns – perhaps focusing on survival?

The pace of change

This has been and will continue to be hectic. Among the recent and current changes, include: Starting with the crisis facing Carillion and its collapse, there is a timeline which leads up to the CMA review, the Kingman review, the Brydon review and then other recent failures (such as Patisserie Valerie and Thomas Cook but in total about 40 cases[1]) which resulted in a fundamental reappraisal of reporting and auditing. This is shown in detail in Box 4.1 – showing many of the changes ton rules and regulations for financial reporting and auditing,

[1] See our site (updated regularly): https://www.fin-rep.org/which-book/financial-failures-scandals-from-enron-to-carillion/post-publication-discussion/

Box 4.1 The timeline of recent, current and future changes to reports & websites

January 2015	Audit tendering process (CMA for FTSE 350), New UK GAAP, ESMA APMs guidelines
	Trafficking and Slavery Act – website only
January 2016	New accounting regulations (FRC)
	Changes to new UK GAAP
	Slavery and trafficking statement
June 2016	ARD – new audit rules and code including auditor rotation, non-audit work limits, and black list of work.
	Expanded role for Audit Committee
July 2016	Guidelines on alterative performance measures
January 2017	EU non-financial reporting (NFR) directive
	New IAS 7 Statement of Cash Flows disclosure
April 2017	UK regulations on payment practice for financial years beginning on or after 6 April 2017. Twice a year via a government website
January 2018	IFRS 15 – new for revenue recognition
	IFRS 9 – new for financial instruments
April 2018	Gender pay gap – website only and every year from then onwards
	Amendments to several existing IFRS (1, 2, 4, 8, 28, 40)
2018/2019	Amended Governance Code together with a stewardship code, with additional disclosures.
	Additional non-financial information requirements
May 2018	The EU General Data Protection Regulation (GDPR)
	GDPR will apply from 25 May 2018, when it supersedes the UK Data Protection Act 1998.
June 2018	Proposal for governance code to be extended to all companies, including private , with 2,000 employees or £200m revenue globally and a balance sheet of over £2 billion globally.
January 2019	New expanded governance code & guidance on board effectiveness
	(Expansion of Section 172)
	IFRS 16 – new for leases
	Amendments to several existing IFRS (3, 9, 11) and IAS (12, 19, 23, 28)
	The Companies (Miscellaneous reporting) Regulation 2018
From 2019	IASB and IFRS revised conceptual framework
January 2020+	EU electronic reporting format in which issuers should prepare their annual financial reports from 1 January 2020 (RTS).
	Brexit new regulations and changes to existing EU regulations
	Country-by-country reporting
	Amended Governance Code.
January 2021	IFRS 17 on insurance contracts.
From 2021 onwards*	Possible changes to UK GAAP and Governance Code as a result of Brexit and possible divergence (after transition period which may be extended so timing may be delayed). More on supply chain.
From 2025 onwards*	Regulations concerning the use reporting and auditing of systems relying on blockchains and multiple entry accounting systems
	Plus changes to UK GAAP and Governance Code.
From 2030 onwards*	Regulations relating to artificial intelligent systems in accounting, information, reporting and auditing systems

* speculative

Disruption in reporting timeline

Basically the newly beefed up FRC wants the breakup of the Big Four and now the Big Four are pushing back and say it is the fault of the FRC. Others are saying breakup the FRC and perhaps the Financial Conduct Authority (FCA) and the Pensions Regulator. Box 4.2 shows a heavily populated timeline from 2015 to 2020 and it is by no means finished

The timeline of the debate and current dispute is summarised (as per Chapter 8):

Box 4.2 Disruption in reporting timeline

15 January 2018	Carillion goes into Administration
24 January 2018	Parliamentary joint select committees (Pensions & Business) investigate and takes evidence
2 February 2018	Bill Mitchell's letter to the select committee in defence of KPMG the auditors to Carillon.
17 March 2018	The Financial Reporting Council (FRC) has called for an inquiry into the case for breaking up the Big Four accountancy firms into separate parts. Big Four softly counter-attack blaming FRC for being too weak.
Later in March	Backlash: the FRC is accused of being weak and employing too many former Big Four personnel. Greg Clark, business minister says he wants a review into the FRC. FRC counter by now wanting to be involved in the recruitment of potential candidates for senior positions at the largest accountancy firms.
29 March 2018	Conviviality goes into Administration
April 2018	The government launched an independent review of the FRC.
May 2018	SC report on Carillion. CMA taking an interest in the audit market
June to November 2018	A number of financial scandals including Patisserie Valerie.
December 2018	Above report concluded chaired by Sir John Kingman. But we think this may be delayed (for collection of evidence). CMA update report
2019-2020	Possible consultation Politics and Brexit strategy may delay/postpone/change FRC's replacement ARGA.
April 2019	CMA final report
2020	Brydon review on auditing
2020-2023	Possible new powers for ARGA and other regulatory bodies Though the current feeling is that this will be rolled back in a new spirit of deregulation but because of continuing failures. A Brexit with low-cost and low-regulation may foil any attempt at greater regulation

Even though we may be heading for a lower regulation economy, there are trends and events that have already shaped tighter regulations in some shape or form. ARGA will certainly tighten up regulations and be a beefed up and stronger version of the FRC.

Pandemic special issues

The Economist[2] highlighted three threats to going back to normal. The first was follow-up waves of infection. The second is dealt with below and concerns this book. This was a political backcloth as the effects of the ensuing recession would hit workers and small firms to a greater extent. The second threat concerns us more directly and the Economist reckons that the pandemic recession will expose accounting wrongdoing and frauds.

> A second hazard to reckon with is fraud. Extended booms tend to encourage shifty behaviour, and the expansion before the COVID-19 crash was the longest on record. Years of cheap money and financial engineering mean that accounting shenanigans may now be laid bare. Already there have been two notable scandals in Asia in recent weeks, at Luckin Coffee, a Chinese Starbucks wannabe, and Hin Leong, a Singaporean energy trader that has been hiding giant losses. A big fraud or corporate collapse in America could rock the markets' confidence, much as the demise of Enron shredded investors' nerves in 2001 and Lehman Brothers led the stockmarket down in 2008.

The two cases mentioned in the above article are discussed in: https://www.fin-rep.org
Both of these are clear cases of deliberately falsifying accounts and will lead to court cases. The UK is not alone, and in our site above we have over 100 such cases of accounting errors found in UK companies (deliberate or not - spreadsheet erros being one cause of non-deliberate errors).
The FT[3] also opined the same:

> The reputation of Britain's accountancy firms has been damaged in recent years by a string of corporate collapses they didn't see coming. Now auditors say that they have been thrown into the most challenging working environment of their careers as they attempt to spot potential fraud and calculate the likelihood of businesses surviving the crisis — all while in lockdown and under increased regulatory scrutiny.
> "The risks are not different from those you would normally find as an auditor but the risk is turbo-heightened and more pronounced than it's ever been around going concern," said Stephen Griggs, 55, who is overseeing Deloitte's audit work in 27 countries from his kitchen.

So expect a few more accounting errors and fraud to crop up post-pandemic crisis. Especially during the crisis the risk of fraud is heightened. Directors could be tempted to tweak accounts

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[2] Leader, A dangerous gap: The market v the real economy, *Economist*, 7 May 2020.
Available at:
https://www.economist.com/leaders/2020/05/07/the-market-v-the-real-economy
Accessed: May 2020.
[3] Clarence-Smith, L., Auditors face biggest challenge yet with reputation on the line, *The Times*, 13 May 2020.
Available at:
https://www.thetimes.co.uk/article/auditors-face-biggest-challenge-yet-with-reputation-on-the-line-v882jtswk
Accessed: May 2020.

to improve their chances of survival. Auditors also have to be wary of directors using the crisis to try to flush out bad news on their balance sheets by falsely attributing it to COVID-19. And this applies as much in the front end as the back end of the annual report. Not being able to make site visits to watch stock counts, review documents and attend board meetings increases the risk of fraud.

The Major Players in Reporting

The chief executive (CEO) and the chief financial officer or financials director (CFO) are probably the two most important people on the board of directors along with an executive or non-executive Chairperson. The role of executive chairman seems to be waning though there a few notable exceptions. The non-executive directors (NEDs) have an important role to play but often come from important jobs in the FTSE 100[4]or FTSE 350[5] and often do not have much time, in our research, to spend on being a NED.

The other formal stakeholders are, of course, the shareholders, sometimes composed of investment funds or even hedge funds. Predator hedge funds have become increasingly important especially after MiFID II has cut down the used-to-be free analysts' opinions. Also the proxy advisers, acting on behalf of shareholders, have become increasingly important. Whether the city has 'equivalence' or not with the EU and MFID II, some of these are bound to stick. Muddy Waters (Research) LLC is a major –player in reporting fraud, accounting and other issues. They are constantly in the news.

The main method of reporting is the annual report which is ever expanding with financial and non-financial information. The financial information is often collected together under the umbrella of 'financial statements'.

The external auditors, often just called auditors here, are the main external check and balance for all companies over a certain size, many smaller than a PIE, and they extend into private and non-listed organisation. The internal audit function is usually an internal managerial function but can also be augmented or performed by an external accountant. Increasingly the watchdog FRC/ARGA has become more proactive. Another active check, though with little real teeth apart from public interest, PR and impact on politicians, is the House of Commons, Business, Energy and Industrial Strategy and Work and Pensions Committees. The chairperson at the time of the former in 2019 was the now famous Rachel Reeves.

[4] The FTSE 100 is the top 100 listed companies on the FTSE, the Financial Times Stock Exchange.
[5] FTSE 350. The top 350 companies listed on the FTSE, the Financial Times Stock Exchange 350 index – that is the top 350 companies by market capitalisation. Most of these are classified by as Public Interest Entities which means they have the highest level of reporting and external audit requirements. The FTSE 100 is the top 100 listed companies. The FTSE 250 is the 101st to the 350th top listed company.

Change in relative importance of the principal players

Board

So far the CEO and his board of directors have little scope of control by any regulator. They can be censored by the FRC but at the moment he possibility of sanctions ad fines against them are lax. This may change as the overriding concerns of the various reports were to rectify the difference between auditors and the board being audited – to make the directors more responsible backed by suitable sanctions and fines. This may be rolled out in 2020 or 2021 and may require some legislation – if not rolled up into the formation of ARGA.

The growing importance of the Audit Committee

Preparers should be mindful of the new Audit Committee report disclosures effective from June 2016[6]. In recent times, the role of the audit committee has been enhanced. The primary purpose of an audit committee is to provide oversight of the financial reporting process, the audit process, the system of internal controls and compliance with laws and regulations. This is now laid down by the FRC[7].

Non-executive directors (NEDs)

The board of directors has the overall responsibility. It delegates audit matters and dealing with the external auditors and monitor internal audit function. It appoints Non Executive Directors (NEDs). The NEDs should have involvement 2 or 3 independent NEDs on the audit committee. The role of the shareholder has been strengthened but this body has shown signs of more criticism of its Board but has never had the power to outvote proxy shares (usually held by the Board). Again this may change with greater responsibility and sanctions on NEDs.

Shareholders

The day-to-day management of the company is the responsibility of the company's board of directors, the shareholders may exert a significant indirect influence by exercising the rights and powers available to them. Such as passing resolutions at shareholder meetings (usually at the AGM). This is a simplification[8]. Shareholders came in for their own criticism from the Carillion joint select committees:" Big shareholders were not inquisitive[9]". Even when there

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[6] FRC, Guidance on Audit Committees. FRC, April 2016
Available at:
https://www.frc.org.uk/getattachment/b34eb292-f875-4d00-b46c-665b8d88b12b/Guidance-on-Audit-Committees-FINAL-DRAFT.pdf
Accessed May 2020.
[7] FRC, Guidance on Audit Committees. FRC, September 2012
Available at:
https://www.frc.org.uk/getattachment/9ac07916-ea56-4027-864a-11ef9bfa24e4/Guidance-on-Audit-Committees-(September-2012).pdf
Accessed May 2020.
[8] See for example:
https://www.shareholderrights.co.uk/shareholders-meetings
Accessed May 2020.
[9] Pratley N., Entire system failed Carillion, not just directors at the top, *The Guardian*, 16 May 2018.
Available at:

is a dispute, the board usually has the proxy votes from the big institutional shareholders and so they always usually win (in 99% of the time in Krish's subjective view). And this was the case with Unsilver pay award in the Table 4.1 below.

Unsilver, Inmarsat, Pendragon, Ocado and Rio Tinto all had minor revolts over their directors' remuneration repeat in 2019/2020.

However, every now and again, the shareholders do have a revolt – usually about excessive pay awards for the board. Remuneration committees select consultants to help them judge appropriate pay awards and overall remuneration. It is a cosy club and it seems these awards always spiral upwards regardless of economic conditions or actual company performance. The Unilever action had one third of the shareholders voting against the resolution but it was not enough and the proxy votes won. With Persimmon the bonus of £100m was reduced to £75m voluntarily and then forced through.

Table 4.1 Selected Shareholder revolts over CEO pay deals in 2018/2019

Company/ Group	**Date of AGM**	**CEO**	**Possible overall pay £m**
Astra Zeneca	18-May-2018	Pascal Soiret	£9.4m
Aviva	10-May-2018	Mark Wilson	£4.3m
Direct Line	10-May-2018	Paul Geddes	£4.3m
Dixons Carphone	6-Sep-2019	Alec Baldock	£2.3+m
Kier	15-Nov-2019	Haydn Mursell	£2.6m
Melrose*	10-May-2018	Simon Peckham	£42.8m
Persimmon	4-Oct-2019	Jeff Fairburn	£100m down to £75m
Purplebricks	09-May-2018	Michael Bruce	<£1m
Redrow	09-May-2018	Steve Morgan	Role & pay
Ryan Air	19-Sep-2019	Michael O'Leary	£99m
Rentokil	09-May-2018	Andy Ransom	£4.4m
St. Life Aberdeen	14-May-2018	Stephanie Bruce (CFO)	<£1m
Unilever	02-May-2018	Paul Polam	£11.3m
* Melrose took over GKN in 2018			

There are some share action groups, including Share Action, ISS, PIRC and Glass Lewis which can help to mobilise the power of shareholders. But in general, unless there are institutional shareholders with a large stake, they are more or less ignored and powerless. That may change with the forthcoming new governance code.

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https://www.theguardian.com/business/nils-pratley-on-finance/2018/may/16/entire-system-failed-carillion-not-just-directors-at-the-top
Accessed May 2020.

In *Financial Failures & Scandals: From Enron to Carillion*[10] (Chapter 6) the buildings group SIG's failure is examined. Deloitte was the external auditor. The shareholders at its annual general meeting (AGM) voted by a large majority against the reappointment of Deloitte, and against the board advice, following the discovery earlier this year of profit overstatements.

The BEIS Select Committee

As we have seen, of all the watchdogs, the new parliamentary phenomenon has proved the most influential. They do not pull their punches. They are now fast and hard-hitting, but try to ascertain the facts and do not suffer fools gladly. The chairs of (the majority of) select committees have been elected by the house as a whole since June 2010 and that has made them much more efficient. Rachael Reeves was the current chairperson of BEIS and she has made a considerable name for herself – the press coverage and reports on Carillion, BHS, Thomas Cook and others have made quite an impact and have influenced government policy.

Reports: The annual report

Up to now we have been referring to financial and corporate reports as if it was a fixed item. It isn't. It is a living organism which is constantly evolving and changing. Many would view the annual report as the principal company report.

The components of the current annual report

We make these distinctions in this book: hard, soft, strategic, sustainable, non-financial, forward-looking and hybrid; and one that might not be immediately obvious: entropic. The US has much less soft information that is mandatory. The UK probably has more than any other country in the EU.

The current report requirements are constantly being added to but currently stand as the headings discussed in the appendices below, based partly on FRC regulations and partly on statutory instruments from Parliament.

Reports follow along similar lines although there may be wide country differences especially for smaller companies and organisations. A typical list of headings is shown in Appendix 3.04.2 The components of the Annual Report, of course, may change as regulations changes over time arising partly from the various government and other guidance notes and in part from an examination of a number of companies. See also the Excel sheet shown in Appendix 3.04.3 (Excel table) entitled 'Alternative layouts of annual reports'. This shows a comparison of some actual recent annual reports and both can be found in www.fin-rep.org.

[10] Bhaskar, K., and Flower, J., *Financial Failures & Scandals: From Enron to Carillion*, Routledge, April 2019.

Differences between UK and US Annual Reports

Box 4.3 show the major differences between the UK and US Annual Reports. The US has much less soft information that is mandatory. The UK probably has more than any other country in the EU.

Box 4.3 Comparison of UK and US reports

UK	**US**
Typical annual reports used to include: General corporate information Operating and financial review Director's report Corporate governance information Chairperson’s statement CEO review Auditor's report Contents: non-audited information Financial statements, including balance sheet also known as Statement of Financial Position Income statement also profit and loss statement. Statement of changes in equity Cash flow statement Notes to the financial statements Accounting policies Other features	Typical annual reports will include: Financial highlights Letter to the shareholders Narrative text, graphics and photos Extended PR information and simulacra Management's discussion and analysis Financial statements Notes to financial statements Auditor's report Summary financial data Corporate information

However, this is too simplistic. All sorts of items and reports are now added which we will investigate in greater detail. One additional item is the comprehensive income statement which consists of the sum of net income and other items that must bypass the income statement because they have not been realised, including items like an unrealised holding gain or loss from available for sale securities and foreign currency translation gains or losses.

This may become more important with any future UK-US trade deal. The UK tends to have more narrative information at the front-half. This has now been taken to be boilerplate statements, PR for the management and often studded with fake-news or information lacking objectivity. In contrast, we found some of the narrative sections of private non-PIE companies are brief and much more salient and objective,

Financial statement components
The financial element is usually split by group for the consolidated statements and the principal company. Does not make sense

The consolidated statements could typically look like that also shown in Appendix 3.04.2 called 'The components of the Annual Report' (discussed previously). This carries the same caveat: that this may change as regulations changes over time.

The consolidated statement of comprehensive income is the sum of net income and other items that must bypass the income statement because they have not been realised, including items such as an unrealised holding gain or loss from sale of securities or foreign currency translation gains or losses. As we noted with WeWork in Chapter 1, increasingly new definitions are being used, to suit the purposes of management or to hide the loss making situation – as with WeWork, a chronic loss making situation. .

Increasingly the annual report might be split into a number of reports. Sometimes these are named:

Strategic report
Transparency report
Sustainability report

The annual report has its own set of standards under the voluntary Global Reporting Initiative (GRI)[11]. The GRI is an international independent standards organisation that helps businesses, governments and other organisations understand and communicate their impacts on issues such as climate change, human rights and corruption.

The Regulators and Watchdogs
These are the policemen, judges and jury in the financial world. Our main concern in this book is with he top two regulators, FRC and ARGA – the second one (ARGA) might replace the FRC. Or there may be a stronger more proactive FRC. But there will not be both.

In summary, we have the following watchdogs now in the UK:

FRC/ARGA – annual reports and auditing
FCA – listed companies and markets
Pensions – The Pensions Regulator
The Equality and Human Rights Commission – Gender pay gap
PRA – Prudential Regulation Authority for banks and lenders
Department of business (BEIS) – payments practices, and directors' conduct
Insolvency Service – may get enhanced powers to pursue directors, currently takes to court around 1,200 directors
SFO – pursuing fraud in such cases but its reputation is that it takes too long (e.g. Tesco case) and that its conviction rate is too low. Though they seem to keep on failing the

[11] See the GRI website:
https://www.globalreporting.org/Pages/default.aspx
Accessed May 2020.

latest is with Barclays Bank on their Qatari funding which might have been a round trip type of manoeuvre.
Select Committees – all areas, fast and hard hitting but with no power or teeth

When presented like this, we think this is too fragmented and split between too many agencies. And we agree that there are insufficient sanctions against management of the companies making inaccurate, false, or misleading reports.

Disruption in reporting - a final word
Basically the FRC wants the breakup of the Big Four and now the Big Four are pushing back and say it is the fault of the FRC. Others are saying breakup the FRC and perhaps the FCA and the Pensions Regulator.

The Narrative section

The sections in the annual report have been divided into hard (numbers) and soft (mainly words and/or analysis of numbers). The narrative section includes such elements as:

Strategic (soft)

This tends to be soft and as the FRC defines it: 'The overriding objective of the strategic report is to provide information for shareholders that will enable them to assess how the directors have performed their duty to promote the success of the company. It should reflect the directors' view of the company and provide context for the related financial statements. In meeting the needs of shareholders, the information in the annual report may also be of interest to other stakeholders. This should include the principal risks and uncertainties facing the company.

The annual report should not, however, be seen as a replacement for other forms of reporting addressed to other stakeholders. Source: GRI[12]

Viability (over 12 months)/Going-concern (under 12 months) [soft-ish]

Usually the accounting basis is that the business will continue. As such the going concern is a business that functions without the threat of liquidation for the foreseeable future, usually regarded as at least within 12 months from date of signing the accounts. Now recently expanded to be between 2 to 5 years. But the directors have to justify that the firm will continue for the period they have chosen. This is never straightforward. The auditor has a weaker test for anything beyond the next 12 months. Recently tightened up by the FRC in their series *Reporting in times of uncertainty*[13].

Forward-looking/Resilience (Brydon) [soft but may include some hard information]

This includes the current controversy about whether a firm is a going concern and asking the board of directors to provide a forecast as to how long the firm might remain a going concern. As we will see, it also encompasses forecasts, long-term forecasts and sensitivity analysis on, for example, exchange rates, interest rates and other major economic variables.

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[12] Global Reporting Initiative GRI. Develops and disseminates globally applicable "Sustainability Reporting Guidelines" for voluntary use by organisations. GRI's Sustainability Reporting Framework is a reporting system that enables all companies and organisations to measure, understand and communicate this information. GRI's mission is to make sustainability reporting standard practice; one which helps to promote and manage change towards a sustainable global economy.

[13] FRC, COVID-19 - Going concern, risk and viability, June 2020.
Available at:
https://www.frc.org.uk/getattachment/ef564f3f-d37b-4469-aa30-cc36f0343708/COVID-19-Going-concern-risk-and-viabilityFinal.pdf
Accessed July 2020.
And FRC, COVID-19 – Resources, action, the future, June 2020.
Available at:
https://www.frc.org.uk/getattachment/9fff0029-9be2-4cf8-8f9d-932c3689e99e/COVID-19-Resources-action-the-future_Final.pdf
Accessed July 2020.

The Brydon review also contains new requirements for disclosures in company accounts: the “going concern” statement should be expanded into a “resilience statement” reviewing not only the near-term viability of the company but also including a wider stress test and statements regarding the long-term threats to the business. The report recommends replacing the existing going concern and viability statements with a resilience statement that incorporates a going concern opinion for the short term, a statement of resilience in the medium term, and a consideration of risks to resilience in the long term, such as climate change.

Sustainable (soft)

A sustainability report is a type of corporate or organisational report. It conveys sustainability-related information in a way that is comparable with financial reporting.

Non-financial (tends to be soft but with some numbers)

Recent regulations make additional non-financial information compulsory for larger firms and bodies. These may be separate or contained within the main report.

Interim statements:Importance of Quarterly and Half-yearly reports

Real-time reporting

Several partners at the Big Four are in favour of reporting on a continual basis in more or less real-time. For example daily or weekly of like-for-like retail sales. That might work in the retail arena. But in general we found there were a variety of views. PwC's views on real-time reporting were documented in a PwC paper[14]. Though that paper is no longer available online. In general in our interviews we found that with real-time data, there was only some limited support in certain sectors and certain types of companies, real-time sales data may be relevant and a useful indicator. But it does not replace or supplant annual reports. It would be an addition.

More frequent reporting than annual

One study's findings[15] suggest that frequent reporting can impose significant costs by inducing myopic behaviour, and distorting managerial investment decisions. The empirical results in the paper suggest that firms significantly reduce investments following an increase in reporting frequency. Specifically, firms that increase their reporting frequency reduce investments in fixed assets by 1.7% of total assets. This is an economically significant decline, as it is equivalent to a 22% decline from the mean level of investments. The reduction in investments is persistent up to at least 5 years, and is robust for a range of alternative proxies for investment opportunities. And they also conclude:

> We contribute to the literature on managerial myopia. Prior studies identify different sources of capital market pressures that can induce myopia. We suggest that frequent financial reporting is another mechanism that can encourage myopic managerial behavior. Our findings offer a starting point to evaluate this cost-benefit tradeoff by highlighting a significant cost of frequent reporting apart from the myriad benefits reported in prior research.

Another study in the Accounting Review examined the question of whether frequent financial reporting led to better or worse managerial decisions. Estimates indicate that increased reporting frequency is associated with an economically large decline in investments. Additional analyses reveal that the decline in investments is most consistent with frequent financial reporting inducing myopic management behaviour[16].

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[14] Audit of the future, James Chalmers, PwC, around 2013.
[15] Real Effects of Frequent Financial Reporting
Posted by R. Christopher Small, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Friday, September 19, 2014
[16] Arthur G. Kraft, Rahul Vashishtha, and Mohan Venkatachalam (*2018*) Frequent Financial Reporting and Managerial Myopia. The Accounting Review: March 2018, Vol. 93, No. 2, pp. 249-275. https://doi.org/10.2308/accr-51838

Our conclusions from our evidence

This summarises what we found in our interviews and written evidence. This is not a proper sample or statistical study but more a large collection of anecdotal evidence:

> Annual – everyone agreed that there should be a core annual report.
>
> Quarterly reports – interestingly we found that of the people and users we discussed this report with, universally did not like this report. Myopia or short-termism was a common complaint reinforcing the academic research in the previous section. On the other hand, it did remind management of the need to make profit and other warnings to the market in a timely fashion. But as the studies above show it develops a short-termism which limits shareholder value in the medium and longer term.
>
> Half-yearly reporting – Difficult to summarise. Interviewees were slightly pro to neutral, and a few strongly against. Rod is especially keen on this report. John is against. If there has to be a choice between half-yearly or more forecasts, Krish would prefer more on forecasts.
>
> Real-time data – Some agreed with PwC's assessment that in certain sectors and certain types of companies, real-time sales data may be relevant and a useful indicator.

Mary Barth, in an article The Future of Financial Reporting: Insights from Research[17] asked the question:

> … what does the future of financial reporting look like if we incorporate insights from research? I envision more fair value; a performance statement designed to highlight the information embedded in changes in fair value; information to help investors assess the value of intangible assets; more specific information about risk and uncertainty; information that is unbiased, rather than conservative; acceptance of a degree of earnings management together with a determination of how much earnings management is acceptable; and a financial reporting package that is purposefully designed to convey information users need, which presumably is broader than today's financial statements.

Our version of this is provided in Chapter 9.

[17] Barth Mary E.
The Future of Financial Reporting: Insights from Research
Abacus, Journal of Accounting, Finance, and Business Studies
Volume 54, Issue 1, February 2018.
https://onlinelibrary.wiley.com/doi/abs/10.1111/abac.12124

New types of information

There is a range of new types of information being required by UK companies. Some of these are UK specific and go further than the EU rules. Most of these are unlikely to be rolled back in a low regulation environment post-Brexit. They are here to stay either because companies have become used to these measures or they have become industry specific or market demanded as standard. More rules and regulations will come. There maybe some easing back by the low regulation of the Boris Johnson government.

Alternative performance measures (APMs) and Key Performance Indicators (KPIs)
APMs are financial oriented whilst KPIs tend to be volume or quantity or percentage oriented – such as occupancy rates and so on. APMs have become almost mandatory and are financial. In June 2015, ESMA (European Securities and Markets Authority) published Guidelines on APMs (Alternative Performance Measures) for the purpose of promoting their usefulness and transparency in prospectuses or regulated information, including annual reports and interim statements. The goal is improved comparability, reliability and comprehensibility of APMs. We also add that non-financial Key Performance Indicators (KPIs) are if anything of even more importance[18].

Annual slavery and trafficking statement under The Modern Slavery Act
Companies from 2016 are required to publish an annual slavery and trafficking statement in a prominent place on their website[19]. We have not found much evidence that firms are actually complying with the spirit of this regulations. Some are. In general, it is a boilerplate response. And we see no reason to suspect that this will change in a low regulation post-Brexit environment.

New non-financial disclosures required
From 2017, the government published new regulations implementing the European Union Directive on disclosure of non-financial and diversity information (the 'Non-Financial Reporting Directive'). The regulations amend the Companies Act 2006 requirements for the Strategic Report and include diversity requirements in the Disclosure and Transparency Rules (DTR). We suspect that will continue whether we move to a low regulation environment or not.

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[18] ESMA Guidelines on Alternative Performance Measures, 5 October 2015.
Available at:
https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf
Accessed May 2020.
[19] Statutory guidance: Slavery and human trafficking in supply chains: guidance for businesses, UK Government, 20 April 2020
Available at:
https://www.gov.uk/government/publications/transparency-in-supply-chains-a-practical-guide
Accessed May 2020.
See who is required to comply? in Transparency in Supply Chains etc. A practical guide. A Hoe Office publication, Guidance issued under section 54(9) of the Modern Slavery Act 2015.
Available at:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/649906/Transparency_in_Supply_Chains_A_Practical_Guide_2017.pdf
Accessed October 2019.

The test is for larger quoted and/or traded[20] companies, partnerships with more than 500 employees, all banks and insurance companies. The additional information includes in the strategic report the non-financial key performance indicators.

The European Directive has also led to changes to the Disclosure and Transparency Rules which require listed companies to disclose the following in their corporate governance statement in respect of diversity

- The diversity policy applied to the company's administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds;
- The objectives of the diversity policy;
- How the diversity policy has been implemented; and
- The results in the reporting period.

For those companies within the scope of the new regulations there are some additional requirements. All quoted companies are already required to provide some information on environmental, employee, social, community and human rights matters in their Strategic Report. Similar to the pre-existing requirements, disclosures relating to most of these requirements are only required when the information would be material. See Appendix 3.04.4 on Non-Financial Reporting Requirements.

Government BEIS Website reporting

Gender pay gap and supplier payment information is now mandatory. See Appendix 3.04.5 'New methods of reporting' for further details. This is likely to be the trend with self reporting under guidelines as to non-financial information and/or policy. Now that we are in a possibly low regularity environment, nothing may be added for sometime. But there are other measures such as 'how good is it to work in your company' as per The Sunday Times survey[21].

[20] Slight difference. You will need to see the FRC paper. But a traded company includes those with debt securities on a regulated market. AIM listed companies are excluded from both quoted or traded.
FRC, Frequently Asked Questions on Non-Financial Reporting.
Available at:
https://www.frc.org.uk/getattachment/c3b4e267-ef24-4c91-8427-4aa18b697c25/FAQs-on-non-financial-reporting.pdf
Accessed July 2018.

[21] Available at:
https://www.b.co.uk/the-lists/

Climate change disclosures

In the world of climate change and post the development of Integrated Reporting (now nearly defunct in our view), the watchdogs themselves will push for greater disclosures. Hence UK-listed companies will face greater and often compulsory climate disclosures on climate change over the next few years. Initially, and surprisingly it is the FC

A (Financial Conduct Authority) who is reported to be bringing forward proposals to help investors and support the transition to a low carbon economy[22]: Under these proposals all companies that have their main listing in London must make climate-related disclosures as prescribed by the Financial Stability Board's Taskforce [TCFD])on Climate-related Financial Disclosures — or explain why they cannot[23].

[22] Kinder, T., UK-listed companies face compulsory climate disclosures, Financial Times,
Available at:
https://www.ft.com/content/de915fb4-5f9e-11ea-b0ab-339c2307bcd4
Accessed March 2020

[23] FCA, FCA announces proposals to improve climate-related disclosures by listed companies, 6 March 2020.
Available at:
https://www.fca.org.uk/news/press-releases/fca-announces-proposals-improve-climate-related-disclosures-listed-companies
Accessed March 2020

Performance indicators and reporting – hard and soft
We have made these distinctions in this book: hard, soft, strategic, sustainable, non-financial, forward-looking and hybrid; and one that might not be immediately obvious, entropic. Hard information tends to be figures whether arbitrary or not. Soft tends to be narrative or opinion such as a business review or description of the business model.

Sustainable reports are defined by the GRI[24]

A sustainability report is a type of corporate or organizational report which conveys sustainability-related information in a way that is comparable with financial reporting. Partly soft but can include some hard data.

KPIs

Can include financial but more importantly non-financial such as occupancy rates and benchmarks, competitive position, capacity utilisation measures, physical measures of performance split by product line/by region/outlet, market shares, productivity measures, things gone wrong, quality measures and customer satisfaction indices. Mainly hard.

Non-financial

Recent regulations make additional non-financial information compulsory for larger firms and bodies. These may be separate or contained within the main report. They may overlap with the KPIs above. Hard.

APMs

Alternative Performance Measures. Mainly financial. WeWork from Chapter 1 is an example. Hard.

Hard information is easier to audit to provide a view as to whether they represent a true and fair view (among many views). In the case of forecasts, at least the numerical accuracy can be checked (that would have helped Conviviality) if not an assessment of the model and the assumptions – something that might be challenged but not necessarily replicated in any detail currently by auditors. However, we think this should change.

Size and Reporting Definitions

This list includes everyday companies such as Boots, John Lewis, JCB, Arcadia (Sir Philip Green), Virgin Atlantic, Dixons, Wilko, Thames Water, Specsavers, Anglian Water, Clarks, Matalan, Gala Coral, Dyson, Formula One, House of Fraser, Spire HealthCare, Monsoon, Poundland, Welcome Break, Harrods and many construction companies. There is only a voluntary requirement for private companies in 2018 but this may change.

Size of company: micro, small and medium companies

There are many conditions but roughly the main principles dealing with definitions, reporting requirements and audit exemptions are shown below. Roughly speaking, if a shareholder holding more than 10% of the nominal value demands an audit, then an audit must be performed regardless of size. See Appendix 3.04.6 Size and reporting requirements.

Public Interest Entities

Any public interest entity has to comply in the UK with the new Audit Regulation and Directive (ARD) as well as increasingly new and tighter governance codes. And the full range of prohibitions applies: the NAS (non-audit services) prohibitions, the NAS fee cap and the requirement for Audit Committee approval will also impact parent undertakings and controlled undertakings of the PIE, with some territorial limitations.

Private companies

The larger UK private companies employ more than 400,000 employees directly – this excludes the online disruptive companies (though such companies as Uber and Airbnb are not reported on in the UK). We think that private companies of a certain size (e.g. Boots, John Lewis, Arcadia etc.) and some privately owned utility companies should be defined as a PIE. This might very well come about. Any new governance code will apply to the larger private companies except for controls and reporting on the remuneration of directors.

However, the FRC/ARGA seem to be of the same opinion and it seems that there is a move to hold unlisted businesses to the same standard as public listed companies[25]. That would certainly level the playing field and meet with out approval. But how far is the watchdogs prepared to go?

[25] Kinder, T., UK's big private companies brace for audit scrutiny, Financial Times, 24 January 2020. Available at:
https://www.ft.com/content/679a8f7c-3dc8-11ea-a01a-bae547046735
Accessed January 2020

UK GAAP (Generally accepted accounting practice)

Generally Accepted Accounting Practice in the UK (UK GAAP) is the body of accounting standards and other guidance published by the UK's FRC (to be replaced by ARGA). The financial reporting framework in the UK is effective from 1 January 2015 and has had small incremental revisions more or less continuously since then. For a more complete description see Appendix 3.04.7 UK GAAP[26]. However, these standards are the subject of new exposure drafts and are being revised by the FRC. We expect these to continuously evolve through time.

Smaller entities have a choice between IFRS (International Financial Reporting Standards) and three core UK GAAP regimes subject to meeting relevant criteria (FRS 101, FRS 102 and FRS 105 where FRS stands for financial reporting standard). See the above appendix (Appendix 3.04.7) for more detailed explanations.

The EU Accounting Directive

This is provided verbatim in Appendix 3.04.8 found in www.fin-rep.org. And Appendix 3.04.9 on EU Non-financial reporting. This EU non-financial directive has not been fully adopted into UK reporting requirements. This is one of the problems of EU's harmonisation process. It works but has many deviations, exceptions, and variations.

UK versus EU-Continental reporting

Post Brexit this has become less important but see Appendix 3.04.10 UK versus EU-Continental reporting.

Measuring different criteria

Will there a difference in the UK versus the continental Europe? Perhaps the great divide in current approaches to financial reporting is essentially between those who emphasise 'shareholder value' and those who favour a much broader concept of the function of the business enterprise, such as 'stakeholder value' or 'value for the community'. However, the UK and most of the larger listed groups on the continent are beating to the same drumbeat of shareholder value and are often listed on the London, New York as well as European and sometimes even Asian markets as well.

[26] Also see the ICAEW documentation.
Available at:
https://www.icaew.com/technical/financial-reporting/uk-gaap
Accessed July 2020.

Annual reporting: Core/More = Hybrid

Investors and other stakeholders often have much in common and on some issues information primarily of interest to other stakeholders will also be material to investors and should be reported to them. But if an annual report focused on investors is to remain the cornerstone of the corporate reporting process, what of the information needs of other stakeholders?

So we postulate a hybrid system (several parallel reports) with a core report and then, emanating from and consistent with that core, a number of more detailed reports geared to the needs of each type of user or stakeholder. This is also more likely to require self-service for those classes of users catered for. This hybrid reporting system is in sharp contrast to 'integrated reporting' where there is a single all-encompassing report. There is a growing need not to put everything in one report. A summary of the remuneration report on one or two pages could then link to the detailed report which may run into 20 or more pages by 2020.

Several senior partners at the Big Four, when confronted with the concept, felt that a hybrid system could well be the right way for companies to experiment with a new style of reporting.

> 'And I think the increments should be added depending on the needs of the stakeholders in that particular company. So, the hybrid reporting might evolve differently for different companies.'

It will not give a perfect answer straight away – but neither will any of the other solutions. The hybrid solution will give a company a relatively low cost/low risk way of starting to make change. Companies will look at what others are doing, and the next year's reporting will reflect what they have learnt.

The need for hybrid reporting emanated from ever expanding annual reports. For example, the HSBC Annual Report of 2014 had grown to 598 pages (322 pages in 2018); RBS's Annual Report at the end of 2013 was 564 pages (267 pages in 2018). In both cases, much is unintelligible to anyone not trained in a) accounting and finance or b) as a banker and c) specify jargon relating to HSBC or RBS. Rod, Krish and John, all of whom are skilled at reading annual reports and financial statements, including those of banks, found many pages in both reports difficult to read and understand.

Hence the set of Annual or Quarterly information is sometimes, and may increasingly be, contained within a number of distinct reports; and these reports may combine several different elements.

Hence Hybrid reporting

Investors and other stakeholders often have much in common and on some issues information primarily of interest to other stakeholders will also be material to investors and should be reported to them. But if an annual report focused on investors is to remain the cornerstone of the corporate reporting process, what of the information needs of other stakeholders? A number of themes have emerged here, summarised below.

Though several senior partners at the Big Four, when confronted with the concept, felt that a hybrid system could well be the right way for companies to experiment with a new style of reporting.

> 'And I think the increments should be added depending on the needs of the stakeholders in that particular company. So, the hybrid reporting might evolve differently for different companies.'

It won't give a perfect answer straight away – but neither will any of the other solutions. The hybrid solution will give a company a relatively low cost/low risk way of starting to make change. Companies will look at what others are doing, and the next year's reporting will reflect what they have learnt. The full plethora of reports under Hybrid is shown in Table 4.2. The CORE and MORE is extended by tailored and self-service reports allowed by direct access to the raw or semi-structured data.

Table 4.2 Hybrid Reporting covers:

External	CORE & MORE reports
	Standard reports for stakeholders
	Tailored reports for different classes of stakeholders
	Self-service reports for stakeholders with suitable privileges
	CORE & MORE for shareholders
	CORE & MORE for professions investors
	CORE & MORE reports for employees
Internal	CORE & MORE for different classes of management and employees
	Self-service reports for internal stakeholders with suitable privileges e.g. employees
	Management standard reports
	Self-service reports for management with suitable permissions
	Self-service reports for employees with suitable permissions
	Operational standard reports
	Self-service reports for operations

More frequent communications between company and the public

The annual report is the main corporate report for many readers but there are other equally important communications (as judged by our and other empirical evidence). As one senior partner of the Big Four proclaimed:

> The other observation I have about today's corporate reporting is that whilst the "official" annual report & accounts is released annually, companies actually communicate with their stakeholders much more frequently, almost on a real-time basis. This means that the weighty, complex and retrospective set of historical financial statements is at risk of becoming irrelevant.

Now our evidence indicates that this is not true. But the intermediate forms of communication or messaging, half-year reports aside, are becoming important for the professional investor, analyst, investment banker, institutional investor an hedge fund operator.

At the moment the official communications with professional investors include:

- Interim statements (quarterly [US] or often half-yearly [UK]) but we have discussed these previously and their usefulness is questionable.
- Pre-closing statements.
- The website (becoming increasingly important with some mandatory information being required on a website only basis) and for additional information but still biased and too much simulacra at the moment.
- Preliminary results announcements and then the AGM and annual report – already discussed.
- Analysts' presentations (made frequently throughout the year).
- Professional investors' presentations if different from the above.
- Shareholder and other stakeholder presentations.
- One-to-one meetings with executives (more important than you might imagine though less important than it used to be but care has to be taken not to be accused of insider trading).

Stakeholders also rely on other sources of data. These include:

- Press coverage, radio and TV coverage, especially the business sections from the UK broadsheets. Online news.
- Specialist financial press (Financial Times, City Am and the Wall Street Journal).Online specialist sites [those of the papers and magazines plus other sites such as Moneywise]).
- Accountancy, Accountancy Age, Economia, Economist, Financial Director, Investors Chronicle and so on. Other informed business commentary in specialised magazines and journals.
- Reports by analysts, equity research and advice prepared by broker-dealers; now since MFiD II might have to be paid for separately and that will place a damper on such demand.
- Third party reports on such areas as employee welfare, sustainability etc.

- Social media comments and channels including those on Twitter, Facebook, LinkedIn, YouTube and other social media sites.
- Comments, complaints on Google and other search engines not part of the above
- Third-party evaluation reports (consumer, supplier, etc.).
- It would be good to know the extent to which the shares of the company are being shorted. This is easier in the US than the UK[27].

As noted previously, the quarterly (especially) or half-yearly reports are not something that we would actively support.

1) They are unaudited.(though may be reviewed by the external auditors)
2) They take the focus away from the annual report.
3) They could encourage decisions that may be short-termism by nature that respond to the quarterly or half-yearly report, rather than the longer run performance.

Now, the number of communications that occur throughout the year for major companies are many. Take BMW for example. There is a presentation or investors/analysts meeting every few months. In total there are over 70 documents or presentations issued to the public, usually to an invited set of professional investors and/or shareholders. But all these documents are available on their web and can be downloaded or accessed by anyone. And BMW is a company primarily owned by the Quandt family (46.6%)[28].

These presentations include profit forecasts, changes in forecast profits (but not quite a profits warning), product plans, new technology and so on. For the analyst they are very informative and provide a glimpse and insight to the way the company is operating, performing and what the future holds. Krish has used this information in detailed financial forecasts for a time horizon of 10 to 15 years. He feels without these he would be significantly handicapped. EY in the next section has some comments on analysts' presentations.

Of course meetings with executives are not public so those executives have to be careful of breaking market rules and of creating a situation which might be termed insider trading. That said management seemed to be blissfully unconcerned about privileged information leaking out. We found much evidence that it did leak – but not for anything major such as a merger or takeover bid or a major profits warning.

The empirical work undertaken by EY[29] shows that active professional investors use different information depending on where they are in their purchase of shares or their own investment cycle.

[27] For general shorting information such as the short interest ratio, which is the short interest divided by the average daily volume, you can usually go to any website that features a stock quotes service. For example, you can find this information on the Yahoo Finance website in Key Statistics under Share Statistics. The New York Stock Exchange also calculates its own short interest ratio for the entire exchange, which can be a useful metric for determining overall market sentiment. See https://www.investopedia.com/ask/answers/06/shortedstock.asp
[28] As at 2019,
[29] EY Annual Reporting in 2017/17: broad perspective, clear focus, September 2017,
Available at:
http://www.ey.com/Publication/vwLUAssets/EY_-_Annual_Reporting_in_2016-17/$FILE/ey-annual-reporting-in-2016-17.pdf

> Our research has shown us that the value placed by investors on different sources of information varies with the stage in the investment cycle. From a small sample of investors we surveyed separately within investment institutions and conversations we have had with some others, it seems that for portfolio managers and others involved in the investment decision, the annual report is a primary source of research material when making a first time investment decision - although used alongside analyst presentations and meetings with executives, which are also ranked highly.
>
> Once the initial investment has been made, annual reports, although remaining important, lose prominence. Meetings with executives become the primary source of information, while analyst presentations and preliminary announcements gain importance. As might be expected, the smaller the investor and the less the resource available, the more likely they are to rely on third parties for analysis and recommendations.

EY feel that this should not undermine the importance of annual reports. They go on to say:

> Although share prices are perceived to move more on preliminary announcements, this simply reflects that they are the first insight into the company's performance, not the best. Rather, within a wider set of sources used by a range of stakeholders, annual reports retain primacy. They are the most read and disseminated document, are assured, are more detailed and holistic, and are the only source for many kinds of information (e.g., governance, business model and risks). The main challenge for companies is to ensure the consistency and balance of messaging across all corporate communications, especially as boards are required to present a fair, balanced, and understandable assessment of the company's position and prospects in not only the annual report, but also interim and other price-sensitive reports[30].

Accessed December 2019

[30] EY Is your Is your non-financial performance revealing the true value of your business to investors?, 2017. Available at:
https://www.ey.com/Publication/vwLUAssets/EY_-_Nonfinancial_performance_may_influence_investors/$FILE/ey-nonfinancial-performance-may-influence-investors.pdf
Accessed December 2019

Analysts' presentations versus meetings with executives

EY put some store into preliminary announcements. We could not duplicate their findings in all the interviews and evidence we collected. On the other hand, we found that analysts' presentations had much greater importance. However, EY found that meetings with executives become of greater importance for active professional investors. Our evidence confirmed this. Although this was certainly mentioned in our interviews, it was not something that interviewees drew a lot of attention to – maybe afraid of being tainted with an implication of receiving privileged information ahead of the market? But more likely they did not wholly believe the information that was given to them – believing it to be filtered and biased in some way. But we believe that the EY conclusions are correct – for active professional investors. Meetings with executives would not occur with a wider set of smaller investors or other stakeholders (except perhaps for those few shareholders who choose to attend an AGM)

Box 4.4 Selected EY Comments on Analysts' Presentations[31]

All companies we reviewed publish their presentations for analysts and investors on their websites.

The vast majority of analyst presentations contain disclosures on strategy and priorities for the future, but only half articulate the company's strategy in a way consistent with the annual report — and sometimes this information isn't clearly labelled as the company's strategy (with other priorities getting more prominence). Conversely, a few companies provide clearer narrative and graphics to articulate their strategy in their analysts' presentations than in their annual report.

A significant proportion of analyst presentations convey messages that are inconsistent with those disclosed in the annual report.

Some presentations focus on different aspects of the company's activities to those highlighted most prominently in the annual report, while others portray a more positive and less balanced picture.

[31] EY Center for Board Matters, 2019
Available at:
http://www.ey.com/uk/en/issues/governance-and-reporting/corporate-governance/ey-annual-reporting-in-2016-17-broad-perspective-clear-focus
Accessed December 2019

Profit warnings

A profit warning is more formal. It is a warning or declaration issued by a listed company to investors and shareholders. It warns investors that the profit of the company in the coming quarter/half-year/year will significantly decline when compared with market expectations and analysts' predictions. Sometimes it is a guide for analysts to reduce their expectations of profitability. Meeting analysts becomes important. Usually the company will try to massage analysts' expectations during the year towards a realistic outcome. This massaging takes place through analysts' meetings, examples of which can be seen in the BMW example – see Appendix 3.04.11 Examples of communications between BMW and investors.

A typical profits warning is like this:

> Banknote maker De La Rue sees shares tumble 13% after profit warning.
> 'This is Money' on 20 March 2018
> De La Rue, the maker of the new polymer £5 and £10 notes, issued a profit warning today and revealed the departure of its finance chief in an unscheduled announcement. The unexpected news sent shares in the company down more than 13 per cent or 82p lower to 520p.
> De La Rue said it was expecting its full-year results to be around the lower end of the current consensus range, but did not say why. Consensus estimates for operating profit currently sit in the range of 69m to £73m.

One has to read between the lines. The CFO was leaving. Perhaps there was something untoward? Perhaps not. Perhaps the company knew that they were unlikely to win the passport contract, but the suspicion will be there. And why warn that the profits estimates would be towards the bottom end of a range when that is quite normal - £69m instead of £73m is not really a significant amount.

Then in April, there was a second profits warning with the company downgrading its expected underlying operating profit for the year to about £60m - and this was after the decision on the passport contract went to a rival of De La Rue.

De La Rue's actual adjusted operating profits for the year (ending 31 March 2018), including the more troubled paper business but excluding a pension gain, were down 11 per cent from the previous year to £62.8m, despite a 7 per cent rise in group revenue to £493.9m[32]. However, the actual operating profit was £123m with the major adjustment being an exceptional gain on the measurement of the pension scheme – increasing operating profits from the adjusted figure of £62.8m (plus a small amortisation write-off on acquired intangible assets).

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[32] Hodgson, C., De La Rue shrugs off post-Brexit passport contract miss, *Financial Times*, 30 May 2018. Available at:
https://www.ft.com/content/29aff78c-634b-11e8-a39d-4df188287fff
See also https://www.delarue.com/investors/results-reports-and-presentations/latest-results
Accessed December 2019

Let's go back to the informational content of such communications between a company and the public. Examples of communications between BMW and investors are shown in Appendix 3.04.11 Examples of communications between BMW and investors. There are many interactions including a major set of presentations to analysts and professional investors.

New Governance code

This was released in 2018 and provides for greater shareholder power. It may be updated and slightly tightened or relaxed. Reporting on diversity, a stricter rule on independence, and a section on contribution to wider society feature among other issues[33].

> The UK Corporate Governance Code 2018[34] applies to accounting periods beginning on or after 1 January 2019. It places greater emphasis on relationships between companies, shareholders and stakeholders. It also promotes the importance of establishing a corporate culture that is aligned with the company purpose, business strategy, promotes integrity and values diversity.

This concentrates on including stakeholders and workers into the boardroom, the makeup, and diversity of the board room and a greater focus on remuneration of the directors - very much a Theresa May agenda but not so much a Boris Johnson agenda. See Appendix 3.04.12 Revised UK Corporate Governance Code 2018 FRC highlights.

We expect that this set of governance codes will be continuously evolved over time. The aftermath of the pandemic is such that it may be relaxed in the very short-term, though the number of financial failures will mean that it will be successively tightened over longer-term.

[33] FRC, The UK Corporate Governance Code, July 2018.
Available at:
https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF
Accessed August 2018.
[34] Ibid and
https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

Monitoring Group - global standard setter[35]

Lofty ideals: The Monitoring Group has been (2018) consulting on a major overhaul of the global audit standard setting process to enhance governance, accountability and oversight which could see a change to the role of the International Federation of Accountants (IFAC) and creation of a single audit and ethical standards setting body to replace the current split structure. Being cheeky, you might say 'good luck' and indeed that is what has happened.

The plans put forward by the Monitoring Group for a major overhaul of the global audit standard setting process[36], which include significant governance changes and the creation of a single audit and ethical standards setting body, have run into stiff opposition from key stakeholders. The consultation paper, aimed at strengthening the governance and oversight of the international audit-related standard-setting boards in the public interest, received 179 public comments. Due to the unexpectedly high range and volume of responses, the International Federation of Accountants (IFAC) commissioned law firm Gibson Dunn to conduct an independent, qualitative and quantitative analysis of the responses, which identified 'significant criticism' of the governance changes proposed. See the brief summary of the feedback from the last round[37].

Now with President Trump's rolling back regulations and Boris Johnson's Brexit, it is unlikely that there will be any convergence further. Though miracles may happen!

[35] OICSU-IOSCO, International Organization of Securities Commissions website.
https://www.iosco.org/about/?subSection=monitoring_group&subSection1=reforms-to-the-global-audit-standard-setting-process
Accessed November 2019

[36] BIS, Monitoring Group proposes reforms to global audit standard setting, *BIS Press Release*, 22 November 2017.
Available at:
https://www.bis.org/press/p171122.htm
Accessed January 2018
See also the summary of public comments.:
https://www.ifac.org/system/files/publications/files/A-Summary-of-Public-Comments-on-the-Monitoring-Group-Proposal-Gibson-Dunn.pdf

[37] Op. Cit. Monitoring Group publishes Summary of Feedback

Other recent issues

The arguments in favour of accountants including more non-financial information in their reports

Traditionally the objective of financial reporting is to present information about the *financial* position of a business (by means of a balance sheet) and its *financial* performance (in an income statement). Both statements present information about the elements involved (revenue, costs, assets and liabilities) in terms of money. The ultimate objective is to present a single figure that summarises the business's wealth (equity) and a single figure that summarises the business's performance (profit). This is a reasonable and worthy objective – it saves the account user a lot of trouble. This is particularly relevant for account users who have neither the technical knowledge nor the inclination to devote much time in analysing the accounts. It involves the accountant using his professional skill and judgement to inform the account user of the situation in a way that is best suited to his or her needs and understanding.

In order to reduce a mass of disparate information into a single figure, it is necessary that each separate item be expressed in the same denominator – money is the obvious choice. But it is abundantly clear that, for many items, money is a second-best choice. Consider the case where a company has spent a lot of money on an advertising campaign to promote its products. How should it convey information about this campaign to outsiders? A shareholder would clearly like to know what impact the campaign will have on future sales, as this will have an influence on the company's share price. One can think of, at least, three ways in which the campaign can be reported by the company:

1. The past cost of the campaign – this is the conventional accounting treatment;
2. The increase in future sales (and profits) that is expected to occur as a result of the campaign – based on the management's judgement;
3. Data about consumers' opinions about the company's product gathered both before and after the campaign – for example, the proportion of customers who have heard about the product and so on.

The items reported under points 1 and 2 are denominated in terms of money and can therefore form part of the calculation of the company's wealth and income. Since the monetary amounts reported under points 1 and 2 are likely to be very different, this raises the question as to whether the company should report two alternative figures for profit. However, there can be no doubt that all three points provide useful and relevant information concerning the company. Hence our conclusion is:

1. Accountants should continue to present financial statements (a balance sheet and an income statement) denominated in terms of money, and
2. These statements should be supplemented by additional information (denominated in both monetary and non-monetary terms) that is useful and relevant for an understanding of the business's position and performance.

Increasing divergence between book and market values (the intangibles problem)

There is an increasing divergence between book and market values and partially attribute that to information that is outside of the financial report. Some of this gap is attributed to non financial information within the report itself. However, as there is no clarity as to what external information is a driver of value, there may be considerable differences between industry sectors. Deloittes'[38] and others rightly say there is also a lot of noise which may result in the information being visible only to those with the tools and skills to cut through the fog. Sometimes that information is available to a privileged few as shown by the numerous presentations to analysts/media.

Now the stock market value of a firm and its actual performance bears little resemblance to any valuation formula that we have traditionally been taught such as multiples of profits or the net present value of a dividend stream. Market values are just sky-high. Companies which make a loss can still be valued in billions. Snap Inc (the chat app Snapchat) has a market capitalisation of around $25 billion, down from $30 billion on its initial day of trading in March 2017. Yet during the full year 2017, Snap Inc reported a net loss of $3.4 billion up from $0.5 billion the previous year. And its net free cash outflow was close to $1 billion (negative cash flow). But daily active users increased by 18% year-over-years to 187 million. Investors obviously equate that figure to represent future revenue streams through advertising. We will go into this further in Chapter 9 with some solutions. See also Appendix 3.04.13 (A note on intangibles). .

Big data

As discussed more fully in Chapter 7, another big driver could be Big Data which includes social media and the chat apps. These can influence the purchase decision. TripAdvisor has become mandatory whether you believe the reviews or not. Interviewees report that they have seen how they can strike fear into the heart of a small hotel owner, who will often bend over backwards to avoid a negative report. Conversely, the sheer volume is important and has lead Edgar House in Chester to be voted the most romantic hotel in the world. (TripAdvisor 2017 survey) with 589 reviews for a seven bedroom boutique hotel[39]!.

Forward-looking statements

The increasing focus on non-financial information and the growing requirement to provide forward-looking information including essentially a numerical forecast of the business and additional 'what if' questions answered. This is an area that we believe will be expanded. The Brydon Review's resilience concept will be further discussed later in Chapter 9.

Of course forward-looking statements can be

1) Based just on financial statements with or without numerical values
2) Using non-financial information and metrics such as volumes, with or without numerical values

38 'Thinking Allowed - The future of corporate reporting', July 2016, Deloitte.

39 Riches, C., This hotel has beaten rivals in Paris, Venice and Barcelona to be crowned the most romantic in Europe, Daily Mirror, 30 Jan 2017.
Available at:
http://www.mirror.co.uk/news/uk-news/hotel-beaten-rivals-paris-venice-9723222
Acessed December 2019.

3) Providing a view of the competitive environment and competitive information and the impact on the company in question.

Items 2) and 3) could include units, pricing, segmentation, market share and market penetrations and this can be provided with multiple scenarios, with sensitivity analyses and stress tests.

As we noted before there is growing interest in including forward-looking information and indicators. A recent survey by KPMG, the Survey of Business Reporting, reported that 25% of the companies included (270 companies across 16 countries) provide short-term forecasts in their annual reports[40].

This suggests as a way of improving the value relevance of the annual report and adds to the debate on the purpose of the annual report and whether its role is primarily confirmatory or predictive. We think it will move towards being more predictive.

The Brydon review breaks the future down into three reports[41]:

> The future can be broken down into different time periods about which the directors should be able to make statements with varying degrees of confidence: the short term (up to two years), the medium term (from the end of the short term to five years) and the long term (beyond five years), an indeterminate period. It would better inform users of financial statements if these three time periods were brought together in a coherent view of the future, linked firmly to the directors' Risk Report.

Each of these time periods has its own test and definition including survival, and different scenarios and possible longer term threats. And of course stress testing. The auditors would need to report to the FRC/ARGA if there is any weakness or anxiety about the resilience in all three time periods.

[40] KPMG, Room for improvement. The KPMG Survey of Business Reporting, second edition, 28 April 2016. Available at:
https://home.kpmg.com/xx/en/home/insights/2016/04/kpmg-survey-business-reporting-second-edition.html
Accessed December 2019.

[41] Brydon, D., Assess, assure and inform. Improving audit quality and effectiveness. Report of the independent review into the quality and effectiveness of audit, December 2019. Pages 80-82.
Available at
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf
Accessed December 2019.

Periodic and continuous data and reporting

There is a universal movement to issue statements that will either be almost continuous in real-time, as well as periodic reports akin to the Annual Report though heavily expanded and may be split up into various reports with an overview. No one seems to be in favour of the quarterly report, though any message signalling changes to profit forecasts are valuable to shareholders, analysts and those people dealing or advising on share purchases.

Real time reporting

Gilly Lord and James Chambers both from PwC argued for real-time reporting and make their case:

> The historical viewpoint will be supplemented by real-time and forward-looking information, giving investors and other stakeholders a viewpoint not only on how value has been created, but how it will be created in the future. Performance will be measured in terms of traditional financial capital, but will also be demonstrated by new measures like social, intellectual, human and relationship capital.
> Reporting will happen when investors need it, which, in a digital and immediate world, will mean all-year-round and round-the-clock, not just through quarterly or annual releases. Relevance will be essential: information will be provided not just for the sake of it, but to aid investors and to inform their understanding. The new model will cut the clutter and report what and when it really matters.
>
> To meet the need for real-time assurance, advanced technology will play an important role. Auditors will use sophisticated data analytics to analyse and assess huge data sets in seconds. Split second investment decisions will take account of assurance status, but there will also be huge benefits for management by enabling them to identify and tackle problems much earlier. However, while technology will be essential, it will remain a tool of the dedicated, high-quality audit professional, applying their values and professional scepticism in the delivery of a world-class audit.
> Source: Taken from PwC "Audit of the Future".

It is fair to say that in our numerous interviews others did not share their enthusiasm for real-time reporting, other issues were of higher priority.

Integrated Reporting

Integrated reporting was a good start to expanding the scope of reporting. However, whilst still keeping to some of its original ideals, we argue that it seems to have not fully succeeded in its current form. One author believes that this movement has failed. This book adds to integrated reporting with a thoroughly practical form of financial reporting - hybrid accounting - which should enable accounting and financial reporting to meet the challenge of the future. It relies heavily on new technology and being clear and concise.

Standardisation vs. company's profit measures/definitions

The International Accounting Standards Board (IASB) has proposed new financial reporting standards[42] to combat the WeWork issue raised in Chapter 1, This should make company performance comparisons more straightforward for investors. Those profit figures have so many assumptions that in our opinion they are useless as a predictor of futures performance. The potential investors agreed leading to the withdrawal of its IPO – though Softbank did step in. The IPO valuation was initially $47 billion (August 2019) and plunged to below $5 billion by November 2019. It this sort of manipulation of made-up figures which has led the IASB to attempt to stand arise.

Under their proposals operating profit, one of the most widely used measures to assess a company's financial health, would be more strictly defined. Currently, companies report and measure operating profit in a variety of different ways. There is no internationally agreed definition of how this metric should be reported[43]. Neither in the UK. The FT reported:

> The IASB wants to introduce in financial statements two other new measures of earnings — operating profit, and income and expenses from integral associates and joint ventures — along with profit before financing and income tax.
> Under IASB's proposed reporting standards, companies will also be required to provide clearer explanations about how some key management-defined performance measures are constructed and why these metrics are important[44].

We found and the IASB confirmed this that Investors and other stakeholders found that profit figures were often confused and had various definitions making comparisons difficult. They also expressed concerns about the quality of disclosures of adjusted profit, adjusted operating profit and adjusted EBITDA (earnings before interest, tax, depreciation and amortisation).

This process of definitions and standardisation will, we think, continue over time in the interests of clarity and making comparisons. It also would provide an absolute yardstick. No one believed the WeWork profit measures as they seemed totally strange to investor (we found). It lead to a feeling of unreality.

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[42] Flood, C., Accounting standards body calls for changes to corporate reporting, *Financial Times*, 17 December 2019.
Available at:
https://www.ft.com/content/6d972fa4-b2c5-4283-b546-abf90b67fcc4
Accessed January 2020.
[43] At least nine different definitions of operating profits were identified in a sample of 100 companies analysed by the IASB. The differences can make meaningful comparisons between groups problematic for investors and analysts.
[44] Ibid.

Other overall methods of communication

These include press releases about new products or ventures, personnel changes, results, profit warnings and other information which has to be disseminated to the market generally. To ensure that the distribution of news/information is undertaken fairly, listed companies have to use a service like the RNS (Regulatory Information Service). This is defined as a primary information provider; or an incoming information society service, established in an EEA state other than the UK, that disseminates regulated information in accordance with the minimum standards.

Of course the closeness between analysts and the management of a company can give rise to delicate circumstances in respect of privileged or market sensitive information. Professional investors, analysts and hedge fund managers (including those want to short) seem to prefer talking to management rather than listen to or read or rely on just presentations or press releases.

However, the entire processing of reporting we define as including statements and messages to the analysts, the institutional shareholders, hedge funds, other professional shareholders, potential shareholders and the wider public, of which we would say the most important are probably in order of importance (according to our evidence)

a) Profit warnings, or forecasts or any signalling or profits
b) Statements of takeovers or defence of a hostile takeovers, mergers
c) Personal meetings
d) Financial press and specialist pages of usual press and media
e) Analysts presentation
f) Statements of takeovers or defence of a hostile takeovers, mergers
g) Annual report and press releases and statements before and after
h) Quarterly reports
i) The Annual General meeting, press releases and statements before and after

Convergence with the EU and US

Convergence with the EU

The whole question of convergence with the EU is discussed in Appendix 3.04.14. The Boris Johnson government wants to diverge from alignment with Europe. We are not sure how much or which industries and there will always be a degree of fuzziness over definitions – and, of course, Northern Ireland will be aligned – that is probably good for businesses moving to Norther Ireland. That said 45% of all our exports were to the EU. So anyone exporting goods to the EU most make their products align with European regulations. Also if you want to attract EU investors or be quoted on an EU stock market, then you will have to align with the European updated IFRS and any other required by the EU.

So for some companies non-alignment with the EU will make no difference. For others there will be divergence of standards and the obvious one to go with is the US or whatever the UK government decides.

Apart from fisheries, the bigger argument between the UK and the EU is over financial market access in the continuing trade talks. The UK will lose its passport to EU markets and will have to qualify for "equivalence" to retain access. Though even for the financial markets such irksome regulations as comprised ion MFID II and Solvency II could be watered down tin some form of approximate 'equivalence'. For the UK a sticking point is that under 'equivalence' the EU can eject foreign banks with only 30 days' notice, as it did with Switzerland in 2019 year over a Swiss-EU trade dispute.

Convergence with the US and Global Reporting.

The wider convergence of regulations is discussed in Appendix 3.04.14 Convergence and Global Reporting. Any trade deal, which we believe will happen, with the US may require closer alignment of goods being exported to the US and even all products sold in the UK (to allow for US imports to be sold in the UK). However any initiative for global convergence seems a long way off.

The drive towards greater regulation

Reporting has evolved and responded to each crisis and financial scandal over time but such scandals and reporting and audit failures continue to occur. The recent pandemic will add to woes faced by reporting. Commercial life will and behaviour will change forever. Home working will become more of the norm for office workers. Online retailing will continue to accelerate among a whole plethora of other evolving changes. When commerce changes we can expect changes to reporting. However there are some things which never change. Conventional accounts do not tell the whole story of Big Tech companies' growth. But thy are still produced. So, we believe, that the first steps can be discerned and undertaken relatively quickly.

There is and has been an inexorable drive towards greater regulation. This has been the trend in the UK, Europe and the US, with the exception of the Trump administration, ever since joint stock companies were invented with their terrifying results on these who invested when things went wrong. Not all the increased regulations have been welcomed. For example, take the secret reserves of banks, one person commented:

> I wonder whether the 1948 Companies Act was correct in permitting undisclosed reserves for banks and insurers and thereby providing an exemption from the true and fair view obligation. I am not convinced that users of accounts understand today how impairments in bank loan books are audited and the inherent limitations on that process. Nor is the difference understood between provisioning for financial reporting and that for regulatory reporting for capital adequacy purposes.

However, every time there is a failure or issue, the solution always seems to be regulation. And that may be fair enough. If the system was working, we might expect one or two outliers but in general. But not as many as are currently revealed. The effect of the GFC post 2007-09 is still ongoing. Cases, settlements and fines have not been fully completed. The total of fines and settlements will probably close at something nearing $200 billion or more in the US and Europe. That is a fraction of the total estimated cost of more than $22 trillion in the US alone.[45] This may fall into insignificance compared to the pandemic, nevertheless it was large in those pre-pandemic times.

However, there are economic consequences of business failures. But there are others. In the US sharp practices continue, for example, Wells Fargo Bank's settlement against a class-action agreed $480m for sham accounts and other practices. We think that mistakes such as Connaught and others have largely gone unnoticed (not everyone agrees). But Tesco, HBOS (from the GFC period) and currently Carillon, Steinhoff, Wirecard and others almost certainly mean that there will be more rather than fewer regulations. We know that transparency is becoming more important and privacy less so. There is a premium for openness and the next generation cohorts want more rather than less information.

To be updated in November 2020 post US election.

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[45] Melendez, E., D., Financial Crisis Cost Tops $22 Trillion, GAO Says (US), *Huffington Post*, 2 February 2013. Available at:
https://www.huffingtonpost.co.uk/entry/financial-crisis-cost-gao_n_2687553?guccounter=1
Accessed July 2017

What about the Trump roll-back of regulations? Firstly, sooner or later climate change regulation will be forced upon the US by worsening climate phenomena. Secondly, it will probably take one or two major failures or frauds to have those financial regulations rolled back – even if the Trump administration lives on for a decade or so. Democrat policies may re-impose those regulations. Either way the US is likely to re-join the tougher regulatory climate at least by 2030 or so in our view.