Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

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Berlin, ***[Datum]***

Dear Pantelis,

FEE Cogito Series Paper – The Future of Corporate Reporting

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the above mentioned Cogito Series Paper (the 'paper').

With regard to the ideas raised by FEE the ASCG's IFRS Technical Committee had intensive discussions focusing on certain (but not all) aspects of the paper. Although we have taken note of all questions raised we are not in a position to answer the complete set of questions. Issues we did not deliberate mainly concern technological and policy-making aspects. Furthermore, for some aspects we did not reach a consensus within the IFRS Technical Committee. However, since we consider it useful for FEE to expand on contradictory views as well, we do not want to withhold these where deemed appropriate.

Whilst the majority of our IFRS Technical Committee generally supported FEE's suggestion to expand financial reporting into wider corporate reporting to address the wider needs for corporate information of a growing audience, this view is not shared by all in our German constituency. There are two main different opinions in this country, and the rift goes straight through all kinds of entities (big and medium-sized, listed and not listed etc.). Proponents of the basic idea of a wider corporate reporting claim to already prepare integrated reports and are therefore much closer to the views in the paper.

In contrast, opponents of this view argue that corporate reporting should refrain from venturing into grounds other than financial reporting and only include financial information. Other information demanded by various interested parties (e.g. NGOs) should rather be presented in specifically prepared reports. Those that hold this view argue strongly that these stakeholders have different demands, different timelines and reporting intervals, different assurance expectations etc.

that cannot be reconciled with those of financial reporting. Therefore, annual reports should exclude all information that are not mandated by law and that have nothing to do with financials.

Please find our detailed comments on the key recommendations in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Thomas Schmotz or me.

Yours sincerely,

Andreas Barckow
President

Appendix

Chapter 1: A growing audience for corporate reporting

Our view in general

To reach a broader audience for corporate reporting the reporting entities need to know that audience very well (e.g. who is interested in information, what kind of information are desired, etc.). In our view, the best way to generate such information involves communication between the entity and the (potential) audience. More precisely, the entities would initially have to figure out both, which stakeholders are 'relevant' and what information needs they have. The aim of gaining that information does encompass thorough consideration of the social, cultural, legal, and financial environment in which the entity operates. In the paper, this process is referred to as 'two-way communication', and we agree with it. Furthermore, we believe that this process needs to be performed on a regular or even continuous basis as we expect both, the relevant stakeholder groups and their information needs to be subject to constant change. Our reasoning for this assumption includes another aspect raised in paper, namely, that technology significantly drives and enables changes in the audience of corporate reporting. Technological progress in general enables a steady increase in the audience assessing any information as well as timely access and processing of that information.

The IFRS Technical Committee unanimously acknowledges that, from a purely technical perspective, there are no significant apparent impediments that would prevent entities from implementing and maintaining such processes. However, there is some doubt on whether such an approach can be appropriately applied in practice on cost-benefit grounds. Moreover, 'identifying the relevant stakeholders' assumes that the term 'stakeholder' is defined as well as commonly understood, which is put in doubt as well.

Answers to the questions raised at the end of chapter 1

Q1.1.	Which are the steps in the reporting process that assist in ensuring that the stakeholder's information needs are properly addressed?

Following the general view provided above, we would envisage the following steps:

1. Implement a continuous (or at least regular) process in which relevant stakeholders and their desired information are identified.
2. Define the information to be provided based on the stakeholders' information needs.
3. Derive information/data pertinent to the entity that form the basis for the information to be ultimately provided to the stakeholders.
4. Define reporting timelines.

5. Establish and implement procedures that start with the collection and processing of basic data and result in information provided to the stakeholders.

Q1.2.	Do you identify any impediments to reach to a broader audience for corporate reporting?

We do not see any technical impediments. Cost-benefit assessments could impact the steps mentioned before.

Q1.3.	When and how should stakeholders get involved in the reporting process?

Theoretically speaking, stakeholders should be involved in the reporting process on a regular basis as a minimum in order for an entity and its stakeholders to gain a mutual understanding of stakeholders' information needs.

Q1.4.	Do you agree that two-way communication between companies and their stakeholders is needed to focus reporting on stakeholder needs?

We agree.

Q1.5.	How could technology drive and enable changes in the audience of corporate reporting?

We did not deliberate this question.

Chapter 2: Content of corporate reporting: Financial reporting

Q2.1.	Do you agree that financial statements have lost, or are losing, some of its relevance?
Q2.2.	If so, which are the key issues resulting in the declining relevance of financial statements?

We observe and acknowledge that non-financial reporting has grown in importance. This development is driven by regulatory requirements as well as by an increasing interest of capital providers in non-financial information. An example of the first issue can be seen in the recent amendment to the EU Accounting Directive through which new requirements for certain companies to report on several non-financial matters came into force. Furthermore, and as examples for the latter, we are being told that analysts increasingly take non-financial information into account when assessing corporate values and that some banks have started cutting credit lines for companies that do not sufficiently report on non-financial matters.

Based on these observations, a majority of the members of our IFRS Technical Committee believes that even (potential) capital providers increasingly base their investment decisions on both, financial and non-financial information. This implies – as a matter of course – that the relative importance or relevance of financial information decreases in relation to corporate reporting as a whole, which is defined as comprising both, financial and non-financial information.

Other members of our IFRS Technical Committee doubt that non-financial information is considered to any material extent by users of corporate reporting, as is assumed in the FEE paper. They argue that, firstly, within the group of users of corporate reporting, capital providers will continue being the primary user and, secondly, this primary group of users will continue making their decisions based on financial information (only).

We unanimously believe that financial statements will definitely continue to be the primary source of information for capital providers. These stakeholders are usually interested in information about future cash flows, which, primarily, requires receiving financial information. In our opinion, non-financial reporting can only be decision-useful in combination with financial reporting. Therefore, we do not see a decline in absolute numbers as regards the relevance of financial statements, and we do not expect it to decline in future.

Another reason for many complaining about a perceived decline in the relevance of financial statements is commonly referred to as 'disclosure overload'. The growing number of disclosure requirements, which are not only set by the IASB but are, in addition, prescribed by law, or specified by regulators and enforcers, resulted in a check-list behaviour by preparers. This behaviour results in reporting all possibly relevant information irrespective of whether or not this information is material. This has led to financial statements including not only material information and, therefore, losing their relevance.

Q2.3. What are the key steps that should be taken by standard setters and policy makers to foster innovation and enable financial reporting to regain and enhance its relevance?

As mentioned before, entities have to consider a number of reporting requirements, some of which are not set by the IASB, but by third parties such as policy makers and regulators. To a certain extent, we observe that the latter groups are fighting to have certain information being included in the financial report. Although the IASB, through its Disclosure Initiative, has expressed its commitment to provide companies with more flexibility regarding their disclosures in order to enhance financial statements' decision usefulness, we see the risk of policy makers stepping in and taking up any leeway provided by the IASB, thus resulting in any flexibility being diminished.

We therefore conclude that in order to enable financial reporting to enhance its relevance, a permanent dialog between standard-setters and policy makers (as well as regulators, auditors, and enforcers) is key in defining, implementing and following joint actions that aim at enhancing financial statements' informative value to all stakeholders.

Q2.4.	How could technology assist in innovation for financial reporting?

We did not deliberate this question.

Chapter 2: Content of corporate reporting: Non-financial reporting

Q2.5.	Which are the key challenges in developing an international set of standards and/or guidance for NFI that can be applied across the board?

We have identified two main issues that, from our point of view, play a significant role for developing an international set of standards and/or guidance for non-financial reporting that can be applied across the board.

Firstly, we agree with FEE that there are many organisations all over the world addressing corporate reporting standards that involve non-financial reporting. In addition, we note that these organisations' frameworks for non-financial reporting do not seem to be sufficiently aligned. This has led to international diversity in both, standardisation and non-financial reporting. Even if some observe a certain degree of cooperation between these organisations, we fail to see that this degree of cooperation is sufficient to reduce the diversity mentioned above. Therefore, we strongly believe that the primary requirement for developing a mutually agreed-upon set of standards would be to have all key parties with a mandate for non-financial reporting working together, with the aim of closely aligning objectives, principles and concepts and acting accordingly.

Secondly, the desired level of standardisation needs to be agreed upon between those key parties (including standard setters) and policy makers involved. We agree with FEE that corporate reporting has to be aligned with the information needs of an entity's stakeholders. As neither the entities' stakeholders nor their information needs can be assumed being identical, it seems reasonable to conclude that entities should be given sufficient flexibility and leeway with regard to both, the structure of their non-financial reporting, and the information to be reported. On the other hand, comparability across different entities seems to pose a challenge if reporting was exclusively tailored to entity-specific stakeholders. Therefore, those developing standards need to strike an appropriate balance between retaining a stakeholder focus and comparability across entities. We take the view that standardisation of non-financial reporting should not go beyond general and principles-based requirements that address the structure of the medium of communication, even though we acknowledge that this comes at the cost of not achieving full comparability.

Q2.6.	Which organisation – if any – should take the lead in developing an internationally accepted principles-based framework for NFI?

As mentioned above (please see our answer on Q2.5.), we think that the level of cooperation between key parties (including standard setters) needs to be enhanced significantly in order to develop a single set of international, generally accepted non-financial reporting standards. That being said, we would not assign a leading role to any of the organisations involved with non-financial reporting at this stage as we believe that greater emphasis should be placed on better coordination of the initiatives that have already been established.

Q2.7.	What is the appropriate level of authority that those principles should have?
Q2.8.	What is the best approach to experimentation in the area of NFI? What challenges would constituents be expected to face?

We did not deliberate these questions.

Chapter 3: CORE & MORE – a new approach for corporate reporting

Q3.1.	Do you agree that the proposed CORE & MORE model could be a way forward for corporate reporting in the future? If not, why not?

The Core & More report took up a major portion of our discussions when addressing the paper. Although members of our IFRS Technical Committee expressed mixed views about what the model exactly meant and what its implications were, they reached a common understanding in that the Core & More model should aim at reaching a compromise between an “all-in-one-report” and a number of individual reports that are tailored to each stakeholder group. Based on this general understanding, the majority of the IFRS Technical Committee expressed its support for this idea.

A minority of our committee members did not support the concept of a Core & More model and casted doubts as to whether non-financial information would ever reach a degree of relevance for capital markets that would justify such information being addressed that prominently in corporate reporting. In contrast, and as they see it, corporate reporting would continue to be primarily focused on financials as, firstly, (potential) capital providers would continue to be the primary user of corporate information and, secondly, this group of users would continue to basing their decisions mainly on financial information.

Q3.2.	In which ways could the CORE & MORE help addressing the needs of a wider stakeholders' group?

As we fail to see what the term 'wider stakeholders' group' is intended to describe we do not feel in a position to appropriately answer this question.

Q3.3.	In which ways could the CORE & MORE help addressing the needs of a wider stakeholders' group?
Q3.4.	Do you have any thoughts on whether, when and how corporate reporting should be updated?
Q3.5.	How should policy makers and standard setters address the trade-off between standardisation versus innovation?
Q3.6.	What are the main challenges and the key benefits of a parallel experimentation in the area of corporate reporting?

We did not deliberate these questions in any detail.

However, we identified a further issue that all standard setters and policy makers should consider when developing principles for non-financial reporting. As FEE rightly points out in the paper, non-financial reporting is at an early stage compared to financial reporting. Therefore, most companies have a long history of shaping processes and related organisational matters with regard to the collection and processing of data relevant for financial reporting purposes, but they have only limited experience as regards non-financial reporting issues. When developing non-financial reporting standards both, standard setters and policy makers should take into account that companies need sufficient time to develop and implement such processes.

Chapter 4: CORE & MORE – a new approach for corporate reporting

Q4.1.	Which obstacles, if any, should policymakers remove to allow for innovation in corporate reporting?

The paper mentions a vicious circle on page 67. This circle is a good image for the main obstacle that would need to be removed. The primary condition for allowing innovation in corporate reporting is breaking this vicious circle. However, this will require one party to this circle taking the first step so that others can follow. As already said in our answer on Q2.3., the IASB's Disclosure Initiative already aims at providing companies with more flexibility regarding their disclosures in order to enhance the decision usefulness of financial statements. Since we consider the IASB's move to be 'the first step', we think other policy makers and further parties involved should – as a minimum – allow for that new flexibility to be maintained and should not set additional requirements aimed at filling the perceived gap.

Q4.2.	Do liability concerns, arising from non-compliance with reporting requirements, form a barrier to innovation?
Q4.3.	Is the current structure of dialogue between policy makers and corporate reporting constituents effective? If not, how should this be improved?
Q4.4.	What other mechanisms are needed to ensure requirements can adapt over time to achieve better coordination and consistency between different pieces of legislation?
Q4.5.	Do you have any examples of policies that enable innovation from your country? Should these examples be replicated at a European or an international level?
Q4.6.	Do you agree with the proposal for a group to assist in identifying the main challenges and the key benefits from new innovative proposals for the corporate reporting of the future?

We did not deliberate on these questions.