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‘The financial reporting system’ – a practitioner view

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What Power (2021) says about the financial reporting ecosystem and systems thinking strikes a chord with much of our own thinking.

Obviously, the work that we do looking at things like governance, looking at corporate reporting, financial reporting, looking at audit, is all interconnected. Each influences another; changes that you make in one part of that infrastructure will affect the quality of reporting, the quality of governance, and indeed the quality of audit.

What do we want this system to do? Well, what we want it to do is to work better in the interests of users, and there is the first challenge. There are trade-offs between its usability and its effectiveness, and its complexity, and that is something that has to be overcome, because what we are dealing with is a highly complex landscape which reflects different sources of information, different maturity of information – so, for instance, that that supports financial versus non-financial reporting – and also reflects different accountability and different levels of regulatory scrutiny.

The challenge is of course that you cannot say that we have something that is ‘absolute’. What we have is something that is a highly judgemental information landscape which, taken together, goes to form this system, this process of financial reporting.

Recently we issued a major discussion paper, *The Future of Corporate Reporting* (FRC 2020), and that reflects some of the challenges that Power (2021) illustrates. We note in that discussion paper that financial reporting provides particular challenges. It is dynamic, so it continues to iterate and develop. It is interconnected, and therefore it will have to be flexible in the way that reporting is taken forward to better meet users’ needs. Of course, it is absolutely vital that the information that it generates can be properly assured and properly audited, and I see that spreading more widely.

When I refer to different levels of accountability and regulatory scrutiny, I mean that it has to meet the needs of different user groups, and it reflects in our system our ability to use different

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mechanisms, like the setting of standards, which form a harder framework, and influencing behaviour to change markets, which is of course a much softer one. If you look, for instance, at the debate at the moment around the treatment of goodwill, we see lots of overlapping pieces of the architecture: sources of information, financial reporting requirements, key judgments that have to be made by directors, and indeed by those who assure the information and those who provide it. We see a series of almost societal expectations and norms, and those continue to develop, and it also links into auditability.

We are not able to rely on things iterating and developing alone if we want to raise standards, and I think this is one of the challenges in looking at the oversight of this financial reporting framework. Different elements of it will continue to develop and change at different paces, and therefore what we do not have is a series of hard levers to drive change, but actually a slightly softer mix.

I think what Power (2021) says about information ecology is very interesting. Naturally, we have information which sits in a landscape of judgments and, because of that, we always have an assessment about whether something is materially right and not absolutely right, and of course, with the recognition that there is a broader stakeholder base, and it is not just, for instance, driven by the needs of investors. There are wider groups of stakeholders who have an interest here – information will be interpreted in different ways by different groups, so it is very difficult to envisage a system that provides one convenient or one consistent outcome for everyone.

In the context of the FRC itself, our infrastructure – our system – works by looping between different components. We are able to work in a directive way through the setting of our standards, of putting out clear requirements. Of course, we monitor audit work and we monitor corporate reporting to allow us to detect where things are done well and where things are done badly so that they can be addressed, and we try to deter through our enforcement work.

What Power (2021) says about systems boundaries is really interesting because the boundary continues to expand and take in more things. We have seen a major shift towards much wider non-financial reporting about climate-related matters, and again, that puts different stresses and different demands on that system to be able to properly meet the needs of users.

I suppose as long as the outcome that is being delivered is a positive one, and as long as it is driving standards up, does the system boundary and the system that supports it need to be too specifically developed? Possibly not.

I agree with Power's (2021) observations on granularity being important, but in the end, of course, it is all players, be they professionals who are producing information or professionals who are assuring that information, or those who are overseeing the running of the entities that either generate it or rely on it to drive their business that are all going to require different things.

I suppose it is right to end on the final point about regulators in the system. Are we in the centre? Well, I agree to many stakeholders it may look like that but, actually, I think that position is more akin to one conducting an orchestra than it is driving all parts of the system in a consistent way. Although regulation is there to drive positive outcomes, it cannot regulate and it cannot work for every different situation. We have something that is principles-based, something that is drawn on information, and something that needs to continue to iterate and develop, and I think we have to accept that there are certain things that regulatory authorities can control and oversee but, in a highly complex and highly decentralised framework, there are always going to be challenges of just what can be controlled by whom at any one point.

I think that Power (2021) provides a really fascinating discussion and something that is a really important intervention at the current time. Considering how the public interest fitted in here, the public interest continues to iterate and develop, and that is why we cannot really provide an absolute definition for what the public interest is. The public interest continues to

iterate and develop and change to meet a user group that itself continues to iterate and develop and change, and user needs that continue also to iterate, develop and change.

Disclosure statement

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