

BIS | Department for Business
Innovation & Skills

**THE FUTURE OF NARRATIVE
REPORTING**

The Government Response

MARCH 2012

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Introduction

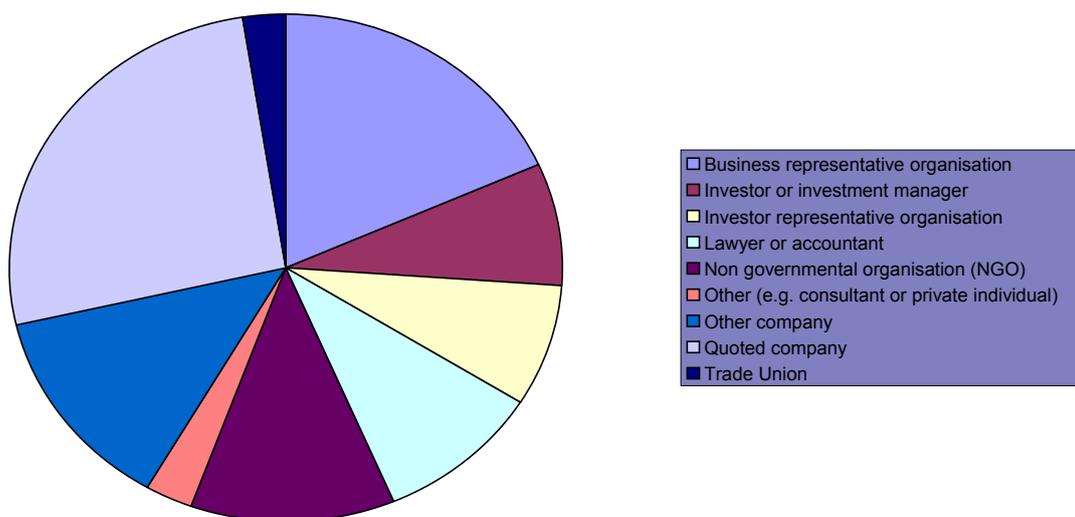
Annual reports are designed to provide the information shareholders need to understand how the companies they invest in are being run. They are a vital tool to facilitate the stewardship of our companies and to encourage engagement with those running them. Over the past few years annual reports have got longer and longer and it is increasingly difficult for shareholders to distil the pertinent information they need from the information provided.

Responses to previous BIS consultations “The Future of Narrative Reporting”¹ and “A Long-term Focus for Corporate Britain”² provided evidence, and a consensus view, that changes to the narrative reporting framework were needed. Preparers and users want it to be easier to draw out strategic company information from the increasing volume of published company data.

In September 2011 the Government published a further consultation on narrative reporting³ which proposed to allow companies to separate out the strategic, headline information that all shareholders are likely to want to see into a concise Strategic Report. The remaining information would make up the Annual Director’s Statement which by default would be made available on company websites.

Consultation responses

The Government received 116 responses from a wide range of stakeholder groups, broken down by type below. A summary of these responses is set out at Annex A and a full list of those who responded is at Annex B. There was a great deal of support for most of the proposals, and also for our commitment to work with stakeholders over the coming months to further develop the proposals. We intend to publish draft regulations and a full impact assessment later in the year.



¹ <http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation>

² <http://www.bis.gov.uk/Consultations/a-long-term-focus-for-corporate-britain>

³ <http://www.bis.gov.uk/Consultations/future-of-narrative-reporting-further-consultation>

Next steps

The format of Narrative Reports (questions 1-8)

Given the large degree of support from consultation responses we are minded to develop proposals to change the structure of narrative reporting to allow companies to produce a high level Strategic Report that is backed-up with an Annual Director's Statement.

Over the next few months we will work with the FRC and representatives from the sectors that have responded to the consultation to clarify the detail of the Strategic Report and work to establish the full breadth of information that should go into the Annual Director's Statement whilst ensuring that we do not create duplication. We want to develop a format that is flexible enough to allow companies to tell an integrated story in their own words, starting with their business model and strategy, covering their performance and looking towards their future.

Simplifying disclosure requirements (questions 9-14)

One of the key drivers for looking at the format of narrative reporting was the need to simplify reports for the benefit both of those who write them and those who want to read them. We want the reports to be more user-friendly, providing more helpful information concisely. There was a lot of support to remove the Companies Act disclosure requirements listed in the table on page 23 of the consultation paper and to address the areas of overlap highlighted in the consultation. The Government will develop proposals to do this as part of the Red Tape Challenge. Those responding to the consultation also suggested other possible simplifications or areas of overlap. We will also consider these as part of the Red Tape Challenge.

We note the increasing interest from investors, consumers and wider society in the environmental and social impacts of business, and believe this should encourage businesses to include these impacts in core business planning.

There was a great deal of support for the proposal to include information about the proportion of women on boards and in companies as a whole, in line with Lord Davies's recommendations and with increasing transparency on gender equality in workforce information.

Reporting of remuneration (question 15-28)

Following the BIS Discussion Paper on Executive Remuneration⁴ that was published last year, on 23 January 2012, the Secretary of State for Business announced to Parliament a package of measures to reform the governance of executive pay to make it more transparent, give shareholders more power and reform remuneration committees.

The area of executive pay is coming under an ever increasing level of scrutiny, not just from shareholders but also from the media and the public. The increasing importance of remuneration reports makes it unwise to separate out the information across different

⁴ <http://www.bis.gov.uk/Consultations/executive-remuneration-discussion-paper>

aspects of reporting. Further, the introduction of a binding vote means that shareholders need a stand alone document on which to vote, without impacting on other areas of reporting. Given that companies will still want to cross-refer we expect there to be key information about pay in the strategic reports and that companies will want to draw on their analysis of strategy, risk and performance in their remuneration reports.

As the Secretary of State announced in January, remuneration reports will be split into two sections, one detailing the proposed future policy for executive pay, the other setting out how pay policy has been implemented in the preceding year. The detail of what will be included in these two sections of the reports can be found on Hansard and are included at annex C.

On 14 March the Government published a consultation seeking views on proposals to enhance shareholder voting rights. This includes reform of the current voting arrangements to give shareholders a binding vote, enabling them to exert more pressure on boards.

Audit, Assurance and Audit Committee Reports (questions 29 - 32)

There was little appetite for a change to the level of audit or assurance that should be applied, and little consensus amongst those who did want to see a greater level of assurance about what it should cover.

In addition to the questions in last year's consultation paper, the FRC's reports on Effective Company Stewardship also considered:

- the remit of audit committees, how they report and how to improve discussions between investors and audit committees about appointing auditors
- proposed additions to auditing standards, in particular relating to communications with audit committees and further disclosures that companies might make about their choice of auditor.

Amendments to the FRC's Corporate Governance Code and Audit Committee Guidance will be made this year in the light of these consultation exercises, and the FRC will consult on the detail of these amendments.

Guidance and the role of the FRRP (questions 33-35)

One of the crucial elements that has to be in place for the new structure of reporting to work is the right kind of guidance. Guidance that helps organisations to write reports, rather than merely creating more material they need to wade through and comply with.

There was a lot of support for the existing ASB guidance, but of course this will need to be revised to be relevant for a new Strategic Report. We would like to work with stakeholders, the ASB and the Financial Reporting Lab to look at what guidance would be most helpful for companies writing a Strategic Report.

Responses did not support reforming the remit of the FRRP but agreed that there might be a need to publicise the role of the FRRP more widely. We intend to discuss how its work and role can be better publicised with the Panel and to await the reform of the FRC later this year.

Annex A: Summary of responses

Question 1

Do you agree in principle with restructuring the current reporting framework into a Strategic Report and an Annual Directors' Statement?

Of the three quarters of organisations that expressed a clear view, around four fifths supported the proposed new structure. Many felt that the proposal was a good way of simplifying the information that investors get and ensuring that the strategic view can be given, without losing the information that a more specialist audience wants. Some supported the proposed changes but put forward reservations, such as making sure having two reports did not create a more complicated system for shareholders, and that we didn't lose sight of the international obligations that some companies need to meet.

Both organisations that supported and opposed the new structure said it was important to ensure that the Strategic Report can stay strategic, and that it is not diluted by extra requirements.

Less than a fifth of responses showed outright opposition. Many of these organisations were concerned that the separation might create duplication, which would increase the amount of material that was produced. One or two said that the current framework was adequate, and the changes to reduce clutter could be made through improving the guidance rather than the format.

Several responses pointed out that it was important that the boundary between the two reports should be flexible and many said that overall what should be achieved through these changes was to make it easier for companies to "tell their own story" (IoD). Others pointed out that it was important that there was a clear understanding not just about what must be written, but what the purpose was: the objective of narrative reporting.

Question 2

This suggested what would be covered in the Strategic Report.

Over two thirds of responses covered and this question and almost four fifths of them were supportive of this suggested format of the Strategic Report.

Many of the supportive respondents thought that the business model was the key piece of information for the report and that this combined with information about strategy and risks would give shareholders a clear picture of the challenges faced by the company. Some thought that a few scenarios should be included with an explanation of how the business model would perform. There was some discussion on the use of Key Performance Indicators and what would be the best way of integrating them into the reporting framework.

There were differing views on the inclusion of social and environmental information. Some respondents felt that these were helpful indicators to shareholders while others argued that they should only be included to the extent necessary for an understanding of the business, and to be driven by shareholder demand.

Some of the organisations who did not support the proposed structure of the Strategic Report felt that it would be too long as companies try to disclose information in too much detail.

Most felt that only material information should be included in the Strategic Report.

Question 3

Do you agree that the proposed Strategic Report should replace the Summary Financial Statements?

The majority of the responses, four fifths, supported the proposal that the Strategic Report should replace Summary Financial Statements. Some responses pointed out that it was important that the Strategic Report was able to fulfil the needs of those shareholders who have elected to receive Summary Financial Statements.

Some of those who were not supportive of the proposal felt that the Summary Financial Statements was fulfilling an entirely different role to the Strategic Report and should be retained. They were concerned that this financial information might dominate the Strategic Report, taking the focus away from the strategic elements of the report.

Question 4

Do you agree that the Strategic Report should be signed off by each director individually?

Of the two thirds of organisations who gave a view, around three quarters opposed this proposal. Only one quoted company supported it, and only two investor organisations. The main argument against the proposal was that it is unnecessary since the board is already collectively responsible for the content of the report, and indeed requiring individual directors to sign the report might undermine the collective responsibility of the board. Some also said that it might result in more boilerplate text and caveats about the content of the report. Many companies, particularly international ones, were concerned about the costs and logistics of getting multiple signatures.

Those who supported it agreed that it would encourage directors to take more responsibility for, or interest in, the content of the report. There was little support for the suggestion that the company secretary should sign the report, with respondents pointing out that they were not board members.

Question 5

This suggested what would be covered in the Annual Directors' Statement for quoted companies.

Nearly two thirds of those who responded to this question supported the proposal but there was much debate on the format and content of the Statement, with many people feeling that the purpose of the Statement was not clear and that the focus must always be on shareholders and investors. Some were worried that there was a risk of duplication between the Strategic Report and the Annual Directors' Statement.

Some of those who did not support this proposal were concerned that the Annual Directors' Statement will become the repository for left-over, compliance based information and will have little focus. One response described it "a dumping ground for other stuff". There was little support from these against the proposal to the Statement having a prescribed structure as this would remove the flexibility of companies to tailor the document to specific audiences.

Question 6

Do you agree that companies should be able to include material in the Annual Directors' Report (for example information on policies and procedures) by cross reference to information published elsewhere (for example on the company's website)?

Of those who responded, over three quarters were in favour of information being included by reference in the Annual Directors Statement.

The majority of the organisations who agreed with this proposal felt that it would keep the costs of preparation of annual reports down and reduce the overall length. However there were concerns on ensuring that this information was correctly "time-stamped" and what information would be included in hard copies of the report.

Those who did not support the proposal were concerned about auditing linked, dynamic information and that the multiple locations of disclosures would obfuscate information and cause confusion for shareholders. A dual reporting structure would pose challenges for those companies who are listed on more than one market.

Question 7

If companies are able to include material in the Annual Directors' Statement by cross reference (question 6), do you agree that they should make an annual statement confirming it has reviewed that information and noting any significant changes?

About two thirds of responses covered this and around three quarters of them supported the proposal. Those who were opposed were concerned that this might require the auditing of the information that is cross-referenced to. They felt that it was important that the boundaries of what this statement would apply to should be clarified. Others pointed out that under directors' duties, any information on a company's website should be. Those who supported it felt that this would be a useful step to ensure that cross-referenced information was reliable. Some said that it would be important to clarify what might constitute a 'significant' change.

Question 8

Do you agree that the Annual Directors' Statement should be presented online with a hard copy available to shareholders only on request?

Over two thirds of organisations responded to this question, with nearly four fifths supportive. Of those who did not support the proposal the key issue was that the current

elections to receive hard copies of reports might be lost. Several others said that the new format, with two separate components might make downloading or printing the document more difficult.

Respondents said it was important that online versions were searchable and that there was flexibility about how information could be presented (as a stand alone PDF document or as an HTML webpage). Some companies with dual listing said that making the Annual Directors' Statement entirely on-line would present challenges for their business.

Many supporters of this proposal wanted the same to apply to the Strategic Report so that shareholders should get an electronic version, unless they elect not to.

Question 9

Do you support removal of the disclosure requirements arising from company law identified? If not, please provide evidence of their relevance to users, including why disclosure in the Annual Directors' Statement is necessary for meeting their needs.

Are there any other disclosure requirements arising from company law that in your view could be simplified or removed?

Around two thirds of responses covered this question. Of those, around a tenth did not support removing any of the disclosures in the table on page 23 of the consultation paper. Around a quarter supported the removal of some of the requirements, and almost two-thirds supported the removal of all of them. Many people put forward other disclosure requirements as possible candidates for simplification, and we will look at these as part of the Red Tape Challenge.

Question 10

Are there areas where the Listing Rules, IFRS, company law and the Corporate Governance Code are inconsistent or require similar disclosures? If so, how could these best be resolved?

There was general agreement that areas of overlap should be addressed. As well as the areas outlined in the annex to the consultation paper, people suggested other areas that we should examine for overlap. We will also look at these as part of the Red Tape Challenge.

Question 11

Should quoted companies be explicitly required to include information about human rights (to the extent necessary for an understanding of the development, performance or position of the company's business) in the Strategic Report?

Just over half of respondents expressed views on this question. A substantial majority agreed that there should be an explicit requirement for quoted companies (and some suggested it should also apply to larger private companies). Most qualified this by noting that only reporting should only apply where human rights issues were of strategic importance and/or material to understanding, however (and those who disagreed with an explicit requirement made similar statements). There was broad agreement that companies whose sectors or countries of operation gave rise to strategic human rights

risks should report them, but that a general requirement on all companies would encourage boilerplate or irrelevant statements. Some also noted that if reporting were required, clarification would be needed on what was included within the definition of human rights.

Some who disagreed with the inclusion of human rights information said that this was not of interest to investors as the primary audience for reports. But most organisations representing investors, along with those representing workforce and wider community interests, agreed that human rights reporting should be reported if material, and noted increasing interest from investors and consumers in companies' social and environmental impacts.

Respondents generally expressed support for the Ruggie principles on human rights, and for companies engaging with and providing information on these issues outside the Strategic Report - for example through inclusion in the Directors' Statement, as part of separate sustainability reporting or on websites.

Question 12

Do you support the Government's proposals for company disclosure of the proportion of women on boards and in companies as a whole?

Just over half of the responses covered this issue and around three quarters of them supported the proposal. Those who were not in favour felt that there was no need to add this requirement to narrative reports since details about directors were already included in existing disclosures and additional disclosure on the number of female employees in the organisation as a whole would not provide meaningful information to stakeholders. Some also said that the issue was being adequately addressed by the FRC through the Corporate Governance Code.

There were different views as to where the information should be recorded as some respondents did not agree that it should be included in the Strategic Report.

Question 13

Do you agree that the current UK liability regime does not discourage companies from making meaningful forward looking statements? If you believe that there are issues with the current regime, do these relate to:

- companies listing in the US as well as in the UK,
- companies contemplating a prospectus,
- common misunderstandings about the UK liability regimes
- other concerns?

Responses to this question were evenly divided as to whether the UK liability regime discouraged meaningful forward looking statements. Those who did think that this was a problem were concerned that statements are perceived as commitments and that directors may be wary of exposure if presenting facts that have a reputational risk or contain elements of commercial confidentiality. Some dual listed companies pointed out that, as

they only published one report compliant with all regulatory requirements, greater care was needed when making these statements.

Question 14

Would improved understanding and awareness of the UK liability regime help encourage more meaningful, forward looking statements? Are there other activities or changes that the UK Government could make that you believe may be necessary?

About half the responses covered this question with about half of them supporting the suggestion that improved understanding would encourage more meaningful forward looking statements. Some felt that if due diligence could be demonstrated when the statement was made, then directors should not be held liable.

Some respondents remarked that rather than a lack of understanding, it was outside factors, such as the current turbulent economic climate, that inhibited this type of disclosure.

Question 15

Do you agree that the key information on remuneration should be included in the new Strategic Report? If so, would a standard format for this information be helpful?

Most respondents agreed that key information on remuneration should be included in the Strategic Report. Those that disagreed tended to argue that remuneration details do not constitute key strategic information. There was more hesitation regarding the adoption of a standard format for such information, with respondents more or less split on this issue. A few respondents stated that there was no need for a restructuring of company reporting.

Many respondents felt that a standard format would not be appropriate for the Strategic Review as sufficient flexibility to provide the relevant context for disclosures is called for. Although background information is proposed to be provided in a separate Annual Directors' Statement, doubts were expressed about the extent to which readers would actually cross refer between documents. Hence the need for adequate descriptive flexibility in the Strategic Report.

That said, concerns about excessive duplication of information between the Strategic Report and Annual Directors' Statement were also raised. Apart from imposing additional information processing costs, another disadvantage raised was uncertainty over which report would be subject to a shareholder vote. A common point among those that supported a standardised format was that it would facilitate comparisons across companies by making disclosures consistent.

Question 16

Which elements of the current disclosure requirements could be moved to the Annual Director's Statement, or removed entirely?

Most respondents were in favour of moving the bulk of currently required detailed disclosures to the Annual Directors' Statement in order to avoid cluttering the Strategic Report with unnecessary detail. Many respondents were also in favour of removing

disclosures which they felt served no useful purpose, such as information which does not vary on a yearly basis or the current requirements to disclose a Total Shareholder Return graph. On the other hand, common examples given of items that could be included in the Directors' Statement included policies regarding external directorships, service contract details, share plans, pension schemes and incentive schemes.

In contrast, there was also a notable minority of respondents that expressed reluctance over removing any existing disclosures, either stating that the entire Directors' Remuneration Report as it currently stands should remain in the proposed Annual Directors' Statement, or that due consideration be given to shareholder requirements prior to the deletion of disclosures.

Question 17

Do you agree that quoted companies should be required to disclose the total remuneration of each director in a single cumulative figure? If so, how should it be calculated so that it accounts appropriately for the various elements of remuneration packages, including share options, LTIPs and pensions?

The majority of those that expressed a clear view were in favour of requiring quoted companies to disclose total remuneration of each director in a single cumulative figure. A number of respondents supported the idea in principle, provided the methodology for working it out was meaningful and comparable.

Of those that did not agree, in the majority of cases this was because they felt that it would be too complicated to develop a single figure that enabled insightful comparison between companies. Some felt that so much explanation would be required that the objective of simplification would not be achieved.

A number of respondents commented that more work would need to be done in order to work out the best way to calculate the single figure. Some highlighted the US model as a good place to start. Of those that did comment, most were in favour of including the range of benefits received by directors including, for example, share awards and pension contributions. Most respondents who did comment highlighted the need to draw a distinction between amounts received and amounts awarded and a couple of respondents argued that reports should be split into actual pay and the future potential. Some respondents also wanted to see the change in pay over time. The majority said that the main area of challenge was in relation to calculating the value of share awards and defined benefit pension schemes.

Question 18

Would there be benefits in introducing a requirement to disclose the pay of the highest earning executive officers below board level and, if so, to which companies and individuals should such an obligation be extended? Are there alternative ways of improving shareholder oversight of the performance and pay of influential non-board executive officers?

There was a great range of responses to this question and the balance of responses was fairly evenly mixed. Of those that were not in favour of disclosing the pay of the highest earning executive officers below board level, the most common reasons given were that it was not clear what benefit this would bring, the fact that it would make reporting more

burdensome and complex and the risk that this would lead to a ratcheting up of pay in the same way as has been seen for chief executives.

Many respondents made reference to the fact that companies are already required to disclose aggregate remuneration for key management personnel under IAS 24, suggesting that an additional disclosure requirement is therefore not necessary. A number also flagged that in many cases Remuneration Committees already consider remuneration for senior executives. Some respondents felt that this was the most appropriate forum for assessing pay of other senior employees as well as the ratio to average earnings and that these discussions did not need to be made public.

The main reason given by those in favour of disclosing the pay of the highest earning executive officers below board level was that this would increase the level of transparency. The majority of these respondents suggested that this should apply to those individuals who are paid more than the lowest paid director. Some felt that companies ought to have discretion about who should be subject to such a disclosure. Of those respondents in favour, not all felt that the disclosure should be broken down by individual. Alternative suggestions included disclosing the information in bands, including the number of individuals in each bands, or on an aggregate basis.

Question 19

Do you agree that quoted companies should be required to disclose how remuneration awarded relates to performance in the relevant financial year and to the companies strategic objectives?

The vast majority of those that responded to this question were in favour of companies being required to disclose how remuneration related to performance in the relevant financial year as well as the companies strategic objectives. Many of those that set out their reasoning suggested that this information was essential to shareholders in being able to hold the company to account. A number of respondents highlighted that this was already good practice and that more companies are adopting such an approach. This led some to conclude that this recommendation should be taken forward by best practice rather than legislation.

There was some discussion amongst the responses received about the type of performance measure, noting that the figures should be appropriate and useful. There was some concern expressed amongst respondents that care would need to be taken so that companies are not required to put commercially sensitive information into the public domain. A number concluded as a result of this that disclosure requirements should pertain only to high level information.

Some respondents also commented on the presentation of this information, arguing that any tabular or graphical presentation would need to be accompanied by an explanation of some sort. It was also argued that there was a need to be careful to avoid companies 'boilerplating' reports and that there is a case for allowing companies to decide how to present the information so that it was meaningful.

Question 20

Should quoted companies be required to illustrate performance and the total remuneration of the CEO for the last five financial years, to enable shareholders to assess the relationship between total pay and performance over time? If so, which performance measure would be the most appropriate?

Respondents were fairly evenly split between those who thought that this is a good idea and those who did not. Of those in favour, the main reason given was that this would provide shareholders with the information necessary to make their own judgements about the link between performance and pay. Not all respondents in favour were supportive of a graphical illustration, feeling that an explanation would also be necessary.

Of those against, many argued that such a requirement would be of limited benefit to shareholders and subject to a number of practical difficulties including the short tenure of many CEOs, the fact that there is no single measure of performance that will be relevant for all companies and the potential distortionary impact of a change in company strategy. Some also highlighted the challenges with calculating the total CEO remuneration package for each year.

There were also a range of opinions about the most appropriate performance measure that would enable a meaningful comparison, including about the value of TSR as a metric of performance. Some respondents argued that TSR alone is not enough and that there should be a range of measures that are not limited to share price metrics. Alternatives suggested included financial and non-financial factors directly within the individual's control such as profitability before tax and performance against KPIs used to assess the success of the business model. Some respondents suggested that there was not one single measure that would be consistently relevant to all companies over time.

Question 21

Should quoted companies be required to explain how the performance criteria for remuneration policy for the year ahead relates to the company's strategic objectives, as set out in the new Strategic Report?

The majority of respondents were in favour of requiring companies to explain how the performance criterion for remuneration policy for the year ahead relates to the company's strategic objectives. It was felt that this additional requirement would aid transparency, give shareholders confidence that directors were being incentivised properly and give them a more effective opportunity to influence. Some respondents wanted a particular focus within the report on how performance targets under particular remuneration plans (both long term and annual) incentivise performance whilst others felt that companies should disclose their policy for how they would assess the performance criteria. A number of respondents also expressed the view that the timeframe should be longer than a year and should take account of multi-year performance periods.

Those that were not in favour raised concerns around the need to respect commercial sensitivities. Some felt that this meant that the disclosures would be so high level as not to be beneficial.

Question 22

Should quoted companies be required to provide estimates of the total future remuneration of executive directors if they exceed, meet or do not meet their performance criteria?

While several respondents agreed in principle, a number of responses expressed concern over the practical difficulties involved in making such a disclosure feasible and meaningful, particularly with respect to calculating remuneration which is sensitive to share price movements. A number of respondents suggested that a standard methodology should be established in order to make comparisons across companies feasible. Some raised concerns that this would be difficult to achieve given the different circumstances of individual companies.

Obstacles mentioned included the complexity of performance criteria (especially those which are benchmarked) which makes forecasting difficult, the subjectivity that remuneration committees may exercise in making judgements regarding satisfactory performance, that sufficient information is already provided in this regard and the risk that such a disclosure would be interpreted as a forecast of company performance.

Among the respondents that agreed, it was noted that such a disclosure would enable them to better hold management to account and establish a clearer pay-performance link. It was stated that if such a proposal were to take effect, it would be helpful to provide a range of results under different scenarios whilst avoiding excessive detail and providing information on what would happen when targets are narrowly missed.

Question 23

Should quoted companies be required to disclose the performance criteria for annual bonuses? If so, should companies be permitted to delay the publication of commercially sensitive performance criteria for up to two years?

A majority of the respondents that explicitly answered the question agreed that companies should be required to disclose the performance criteria for annual bonuses, as this information is of interest to shareholders. Those that did agree with the disclosure requirement also tended to acknowledge that where information is commercially sensitive, it should not be published. This is in contrast to the primary argument of those that disagreed with the disclosure of bonus criteria who argued that such information is commercially sensitive by its very nature and should not therefore be put into the public domain. These respondents also suggested that the inclusion of such criteria for every board member could lengthen reports substantially.

Opinion diverged on whether companies should be permitted to delay the publication of commercially sensitive information. The respondents who were most in favour of the disclosure requirement stated that such a delay would render it less relevant. Respondents at the other end of the spectrum argued that commercially sensitive information does not cease to be sensitive even after the passage of two years.

Some respondents suggested that engagement with shareholders could help where there are concerns about commercial sensitivity.

Question 24

Would disclosure by quoted companies of the ratio between the pay of the company's Chief Executive and the median earnings of the organisation's workforce provide useful information to shareholders? If so, how should the ratio be calculated?

Overall, there was broad disagreement that requiring quoted companies to disclose the ratio of CEO pay to median employee earnings would be meaningful. Some respondents felt that shareholders already had access to information of this sort, for example under existing Companies Act requirements to describe how broader pay conditions throughout the firm are accounted for in determining director pay whilst others noted that it is already possible to calculate the ratio of CEO pay to that of the average worker using data that is currently subject to required disclosure. It was also noted that firm-specific factors, including workforce composition and main country of operation, could obscure meaningful comparison among companies.

Those respondents that were more supportive of the measure suggested that this disclosure would be useful, provided sufficient clarity on the constituent parts of CEO pay and the composition of the workforce. It was suggested that even though the use of such a ratio as a comparator across companies might be questionable, it may be a useful indicator of within-company trends over time, and it would help to focus attention on pay gaps. It was also remarked that shareholders already have the right to request the disclosure of this information. Some respondents noted that one possibility would be to list the number of workers in different pay bands.

Question 25

Do you agree that quoted companies should be required to disclose the total spend on directors' remuneration as a proportion of profit for the relevant financial year?

Most respondents suggested that there would be no value in mandating explicit disclosure of this ratio, since it can already be computed with available information, especially if the proposal to require disclosure of the total remuneration of each director in a single cumulative figure is taken forward. In particular, it was noted that IFRS provisions already require the disclosure of remuneration of key management personnel, which interested users can compare with profits or other information.

Some respondents commented that this information would not be that meaningful given that spend on directors' remuneration is contingent on the number of directors, which varies over time within firms as well as between companies. It was also noted that although the quantum of director remuneration is likely to be higher at large companies, it is unlikely to be a significant figure in relation to profit.

It was therefore suggested that shareholders may have an interest in the proportion of spend on remuneration compared to profits reinvested, distributed as dividends or compared to other key expenditure.

Question 26

Should the amount of fees paid by companies to remuneration consultants be disclosed, and is there any further information which should be disclosed by companies in relation to the procedure for setting directors' remuneration?

Overall there was widespread agreement that fees paid to remuneration consultants should be disclosed. In addition, many respondents suggested that details of the services provided by remuneration consultants, as well as their affiliate companies, any conflicts of interest and the manner in which they were resolved should also be disclosed. Under the UK Corporate Governance Code, companies are already required to disclose existing connections that consultants may have with the company in question.

Those that disagreed with the measure tended to emphasise that companies employ the services of remuneration consultants in different ways depending on the individual needs of the company, making it difficult to compare across companies. Furthermore, even for a given company, remuneration consultancy fees are subject to variability from year to year depending on the scale of changes that are made to remuneration policies. It was noted that yearly variability in this regard is likely to be more of an issue than is the case for audit fees, which tend to be relatively standard across companies.

Some respondents raised concerns that this could result in the release of sensitive information which could in turn potentially discourage the use of independent advisors. It was also suggested that increased transparency in this regard could escalate the amount companies spend on consultants, since there would be a concern that an individual company may be under-spending on independent advice.

Question 27

Do you agree that company law and the Listing Rule disclosure requirements on remuneration should be made fully consistent?

There was strong agreement with the general notion that company law and the Listing Rule disclosure requirements should be made consistent. Many respondents welcomed measures to improve consistency, especially in recognition of the need for companies to adhere to best practice guidelines issued by bodies including the ABI, NAPF and the FRC. Respondents also commented that undue burden should not be placed on unquoted companies which are not subject to Listing Rules and that it would be important to maintain flexibility of the Listing Rules and the 'comply or explain' regime rather than prescribing additional disclosure.

On the other side of the argument, the point was made that compliance with both company law and Listing Rules does not present material reporting costs and therefore this area should not be prioritised for change. It was felt that certain provisions which are specific in nature should not be removed solely on the grounds of consistency without due consideration.

Question 28

Would reporting under International Financial Reporting Standards provide an appropriate basis for disclosure of remuneration in the preceding financial year if this were required on both an aggregate and individual basis?

Only around two-fifths of those who gave a view supported this proposal. Those unresponsive were concerned that using IFRS, the number produced would not be useful to shareholders in understanding executive pay. Others felt that the procedural elements of using IFRS were too complex and would add to the reporting burden for companies as

IFRS did not specifically address remuneration reporting. Some suggested that IAS 24 would be a more suitable metric to use.

Of those that were supportive the key view expressed was the need for transparency in remuneration disclosure.

Question 29

Do you agree that the current legislative regime for audit and assurance for narrative reporting is adequate for your needs?

If you support assurance beyond the consistency of the Strategic Report and the Annual Directors' Statement with the accounts, then please explain what you believe assurance should be provided on and the benefits that you believe will ensue.

About half the responses covered this question, with just over three quarters not wanting to see additional assurance and audit, while just under a quarter felt that there was a role for more.

Those who supported greater audit or assurance suggested several different areas for additional audit, with no real consensus and only a handful felt that this should apply to the whole of narrative reporting in the way that it does for financial reporting. Some thought that any narrative on strategy and business model should be subject to audit, given their importance to investors. Some suggested that the audit committee should ensure that the report was accurate.

Those who opposed additional audit felt it would drive down reporting standards, and might encourage companies to resort to boilerplate reporting. Some were concerned that the new framework would scatter information and this would detract from the core work of the auditor.

Question 30

Are there any actions that the Government could take to make the process of obtaining additional assurance on specific information in company narrative reports easier or less costly?

Many of the organisations who responded acknowledged that this was an issue between the company and its shareholders.

Of those who thought that the Government could do more to increase audit and assurance levels without increasing costs, a major theme was clarity. They thought once the role of the Strategic Report and the Annual Directors Statement, including disclosure requirements, was clear then the levels of assurance would follow on from this.

Of those who did not think that the Government could do more, the main theme was the cost of audit and assurance. Some suggested that as reporting becomes more integrated, costs would reduce.

Question 31

Do you agree that the Audit Committee Report should contain, in addition to existing requirements:

- **How long the current auditor has been in post; and when a tender was last conducted.**
- **The length of time since the directors, including members of the audit committee, have held discussions with principal shareholders about the company's relationship with its auditors, including the quality of service provided?**

On this question there appeared to be general support for disclosing the length of tenure and when a tender was last held, and general opposition to disclosing the length of time since directors and/or the audit committee held discussions with shareholders about the external auditor.

On length of tenure, of those that commented there were only three or four opponents, including two companies, while a handful said that any decisions should be deferred until publication of the European Commission's proposals on audit and the findings of the Competition Commission's investigation into the market for the audits of large companies in the UK.

A handful of responses supported more disclosure on discussions with shareholders but there was substantially more opposition, including from all of the companies that responded and some major investors. Various reasons were given, the main ones being shareholders' general disinterest in discussing audit issues and because they have to approve the auditor every year so they already have the ability to influence decisions on the choice of auditor. Some also felt that disclosure of this nature might result in boilerplate reporting that provides little insight for shareholders. Some also said that the existing requirements on companies and investors in the Corporate Governance and Stewardship Codes were sufficient to ensure further information was not needed. A number of respondents commented that if extra disclosure requirements were introduced, it should be done through the Codes rather than regulation.

Question 32

What would the impact be of the proposals covered in question 31 on the cost of preparation of the Audit Committee Report and in terms of the benefits to investors of having access to this information?

The responses to this question tended to echo the responses to question 31 in that the first element was supported and the second was not. Respondees thought that including information in the audit committee report about how long the current auditor had been in post and when a tender was last conducted would not increase costs, since the information was already available, and would be of benefit to investors. Going further, to cover details of discussions about auditors would be of less interest to shareholders, and it would be more costly to provide it. Others thought that costs were irrelevant here since the disclosure would be invaluable in painting a better picture for shareholders.

Question 33

What guidance should be provided for preparers of the Strategic Report and the Annual Directors Statement?

About two thirds of responses commented on guidance. The majority wanted high-level principles-based guidance. There was also a lot of support for using best practice and case studies. Most people felt strongly that detailed guidance reduces flexibility, encourages boilerplate reporting and adds to clutter, although some organisations refuted this.

Some organisations suggested models or mechanisms for guidance, with many suggesting that the Accounting Standards Board's RS1 guidance should be revised, and others suggesting that the Financial Reporting Council's Financial Reporting Lab should be involved.

Although there was not much support for detailed guidance generally, many recognised that there was a place for it in certain areas, possibly to cover some of the newer requirements or areas, like reporting on environmental, employee or CSR matters, or for developing strategic frameworks, business models or identifying key risks. Given the flexibility of the envisaged framework, some suggested that guidance on assessing materiality would be helpful and one organisation said that companies needed support to encourage critical thinking.

Some organisations supported the creation of a skeleton or minimum requirement or compliance framework, to make reports more comparable, but very few called for prescriptive guidance. A handful suggested that there is no such thing as too much guidance.

Several organisations pointed out that the different nature of the Strategic Report and the Annual Director's Statement meant that the guidance for them should be different in nature.

A substantial minority (about a sixth of those who expressed a view on guidance) said that there was no need for guidance as such. Some said that we should allow best-practice to develop over time instead. Some said that there is no need for guidance if the law is clear, and that it might be counter-productive to produce guidance for the Strategic Report as it will reduce flexibility and tie companies down.

A handful of organisations said that it was important that the guidance covers not just what should be in reports, but how reports should be written, and even why. This would be particularly relevant for the strategic element of the report.

Question 34

Should the reporting statement and supporting guidance remain voluntary?

Of those who expressed a clear view, a large majority felt it would be unhelpful to make the guidance mandatory and that the current voluntary framework operates successfully. Responses said that mandatory guidance would add clutter to the reporting framework, would encourage a tick-box approach, reducing flexibility and making companies more cautious in what they say. Some said it would make preparing reports more time consuming and expensive, as it would create additional material people had to refer to and comply with.

Those who supported mandatory guidance felt it would increase the comparability of reports and push up the level of compliance with statute. A handful who supported mandatory guidance suggested that it could be on a “comply or explain” basis.

Question 35

Do you agree that understanding of the profile and working practices of the FRRP should be enhanced, but that the remit of the FRRP should remain unchanged?

Of those who gave a clear view, the vast majority agreed with the proposal that there was no need to change the remit of the FRRP and that it would be helpful to enhance the profile and working practices of the FRRP.

Those who agreed with the proposal that the remit was already the right one felt it was important that the role of the FRRP did not change in a way that put the FRRP between shareholders and companies. One quoted company said this would discourage voluntary disclosure. Many organisations did agree that there was a need to reenergize and publicise the role of the FRRP. Some said that the FRRP should work more proactively both in monitoring and in taking action and carry out more enforcement. Some were concerned that the Panel didn't have the resources or capacity to achieve this, and for instance, would benefit from having permanent staff. One consultant said that the panel needed greater expertise on the more abstract elements of reporting, such as CSR reporting. Some felt that the Panel should be entirely independent.

A handful of organisations suggested that it would make more sense wait until after the reform of the FRC this year before looking at whether changes to the FRRP were needed.

Annex B: List of Respondents

1. 100 Group of Finance Directors
2. 30% Club
3. ACCA
4. Addison Corporate Marketing
5. Alithos Limited
6. Association of British Insurers
7. Aviva
8. Barclays PLC
9. BDO
10. BlackRock
11. Black Sun
12. BP
13. British American Tobacco plc
14. British Bankers' Association (BBA)
15. BT Group plc
16. Capita Company Secretarial Services
17. Capital & Counties Properties PLC (CAPCO)
18. Carbon Disclosure Project
19. Carbon Tracker
20. Carillion PLC
21. CentreForum
22. Centrica plc
23. CFA Society of the UK (CFA Institute)
24. Charity Commission
25. Chartered Institute of Building
26. Chartered Institute of Internal Auditors
27. Chartered Institute of Personnel and Development (CIPD)
28. Church of England (Ethical Investment Advisory Group)
29. Chartered Institute of Management Accountants (CIMA)
30. Client Earth
31. Clifford Chance LLP
32. Climate Disclosure Standards Board
33. Confederation of British Industry
34. Corporate Responsibility Coalition (CORE)
35. Deloitte LLP
36. Diageo plc
37. eFactory Limited
38. EIRIS
39. Ernst and Young LLP
40. F&C Investments
41. FairPensions
42. Financial Reporting Council
43. Freshfields Bruckhaus Deringer LLP
44. Future Value
45. GC100
46. GKN plc
47. GlaxoSmithKline plc
48. Grant Thornton UK LLP

49. Hargreaves Lansdown plc
50. Hay Group
51. Hermes Equity Ownership Services Ltd
52. HSBC
53. ICC UK
54. Institute of Chartered Secretaries and Administrators (ICSA)
55. ICSA Registrars Group
56. Institute of Directors
57. Institutional Investors Group on Climate Change
58. Investment Management Association
59. Investor Relations Society
60. Ekkleisa, LVSC, One Society & Church Action on Poverty (joint response)
61. Jupiter Asset Management Ltd
62. Kepler Associates
63. Legal & General Group Plc
64. Legal & General Investment Management
65. Lloyds Banking Group plc
66. Local Authority Pension Fund Forum
67. London Stock Exchange Group
68. Marks and Spencer Group plc
69. Mazars LLP
70. Mercer UK
71. MM & K Limited
72. Monash Centre for Regulatory Studies
73. MVC Associates International
74. National Grid plc
75. Nationwide Building Society
76. One Society
77. Patterson Associates LLP
78. Premier Farnell plc
79. Prism Cosec
80. PricewaterhouseCoopers PwC
81. Quoted Companies Alliance (QCA)
82. Radley Yeldar Ltd
83. Rio Tinto plc
84. Roger Morton
85. RPMI RailPen
86. Rupert Robson
87. SABMiller
88. SharePlan Lawyers Group
89. Shire PLC
90. Smith & Nephew plc
91. Standard Chartered PLC
92. Strategic Planning Society
93. Tesco PLC
94. The Association of Corporate Treasurers
95. The Association of Investment Companies
96. The Co-operative Asset Management
97. The Institute of Chartered Accountants in England and Wales (ICAEW)
98. The Institute of Chartered Accountants of Scotland
99. The Law Society

100. The Royal Bank of Scotland Group plc
101. The South Yorkshire Pensions Authority
102. The SROI Network
103. Total Eco Management Chartered Consultancy
104. Towers Watson
105. Trades Union Congress
106. UK Individual Shareholders Society (ShareSoc)
107. UK Shareholders Association
108. UK Sustainable Investment and Finance Association
109. UNILEVER PLC
110. Unite
111. Universities Superannuation Scheme Ltd
112. University of Edinburgh Business School
113. Vodafone Group Plc
114. Waller & Associates
115. WWF-UK
116. Xstrata plc

Annex C: Executive Pay

On 23 January 2012 the Secretary of State for Business announced to Parliament a package of measures to reform the governance of executive pay. He announced that Remuneration Reports will be split into two sections, one detailing the proposed future policy for executive pay, the other setting out how pay policy has been implemented in the preceding year.

The proposed content of the future policy section of the report includes:

- The composition and potential level of pay for each individual director
- How proposed pay structures reflect and support company strategy and KPIs⁵
- What the performance criteria are, how performance will be assessed and how this will translate into total level of reward for each individual under different scenarios (e.g. on target and stretch performance)
- How and why the company has used benchmarks and other comparison data to inform pay levels and structures
- How employee pay and views have been taken into account
- How shareholder's views have been sought and taken into account, including the results of the previous year's votes on remuneration.
-

The proposed content of the section of the report outlining how pay policy has been implemented includes:

- A single figure for the total pay of each individual director
- How pay awards relate to company performance and the policy agreed by shareholders at the start of the year
- How spend on executive pay relates to other dispersals, such as dividends, tax, business re-investment and general staffing costs

⁵ The Government is conscious that the publication of certain performance targets could compromise commercial interests and will work with companies and shareholders to balance this against the need for greater transparency

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