BIS | Department for Business Innovation & Skills

Consultation response form: The Future of Narrative Reporting

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation by be received by 19 October 2010

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Please tick the box from the following list of options that best describes you:

	Quoted company
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
	Non governmental organisation (NGO)
	Trade Union
	Lawyer or accountant
X	**Other (e.g. consultant or private individual)**

Value of narrative reporting

<u>Question 1</u>: Are company directors providing useful and relevant information on the company's:

i) forward-looking strategy and
ii) principal risks and opportunities?

Comments
Yes, but current provision is incomplete for a variety of reasons (see response to Qu2 below).

<u>Question 2:</u> What are the constraints on companies providing information on these issues?

Comments
Each company faces both incentives and disincentives to disclose information. While these influences are mostly generic, the magnitude of the influence varies from company to company and over time. A recent survey of UK listed company Finance Directors investigated these influences in relation to intellectual capital disclosure. This report, published by the Institute of Chartered Accountants of Scotland, was undertaken by myself and Sarah Thomson of Stirling University.* The major constraints are (p. 59): 1. Proprietary costs, i.e. fear of giving away company secrets (proprietary information) that could help competitors; 2. Potential litigation costs, i.e. fear of providing misleading information (an example here is forward-looking information); 3. Preventing the creation of unrealistic expectations; 4. Avoiding setting a disclosure precedent; 5. Information about specific products and services provided that customers are unwilling to allow to be disclosed (p.124) *** Hard copy sent to Jane Leavens** *[Full reference: Beattie, V. and Thomson, S.J. (2010), Intellectual Capital Reporting: Academic Utopia or Corporate Reality in a Brave New World?, Edinburgh: Institute of Chartered Accountants of Scotland.]*

<u>Question 3:</u> Does the information provided reflect the issues discussed by the directors in board meetings?

Comments

N/A

<u>Question 4</u>: Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?

Comments
N/A

<u>Question 5</u>: If a company does not provide sufficient or material information to you, do you challenge it? Is there anything which could help you to do so?

Comments
N/A

<u>Question 6:</u> What other sources of company information do you use and how valuable are they (e.g. information provided on the website, analysts' briefings, dialogue with the company, corporate social responsibility report)?

Comments
The issue was investigated in the study referred to in the response to Qu2 above. See Table 4.7 (pp.66-68). One-to-one meetings with investors and analysts and presentations to these groups generally rate higher than the corporate annual report. Webpages, press releases and conference calls generally rate even lower.

<u>Question 7:</u> Is there scope to reduce or simplify the requirements on which companies report?

Comments
Narrative reporting should provide a (non-fictional!) story about the business. The core of this story should be an outline of the business model (which includes strategy, risks and opportunities).

<u>Question 8:</u> Is there scope to arrange the information in a more useful way?

Comments
Different users wish different levels of detail. Modern technology makes it increasingly possible for users to be able to drill down to the required level of detail from the core story. A tension in narrative reporting is whether to interweave the various strands of the story or arrange the information by topic (e.g. strategy, risk, intellectual capital, social and environmental, etc). The former approach eliminates duplication but makes it difficult for the user to locate information about a particular issue. The latter approach results in duplication but makes it easier for the user to find information. XBRL developments are important in this respect. This technology will mean that narrative reporting (as well as the financial statements) are tagged. This will allow information about specific topics to be readily located by users. In part, this has the potential to overcome concerns about information overload and excessive complexity.

Business Review

<u>Question 9</u>: Looking at an Operating & Financial Review and the existing business review (see Annex D), do you see value in reinstating elements of an OFR and if so what would they be? In particular, would a statutory reporting standard help to improve the quality of reporting?

Comments
The effect of different regulatory regimes on the quality of narrative reporting is something that I ha outcomes from the US (mandatory, rules-based narrative reporting) with the UK (best practice guid matched on size and industry sector. We conclude that, contrary to the findings in relation to finan based system produces higher quality outcomes in relation to narrative disclosures *** Hard copy sent to Jane Leavens.** [Full reference: Beattie, V., McInnes, B. and Pierpoint J. (20 <u>Narrative Outcomes from Alternative Regulatory Regimes</u>, Research Report, Institute of Charter http://www.icaew.com/index.cfm/route/159806/icaew_ga/en/Technical_amp_Business_Topics/Tho]

<u>Question 10</u>: The business review provisions require quoted companies to report, to the extent necessary, on:

- **main trends and factors likely to affect the future development, performance and position of the company's business**

- **information on environmental matters**
- **information on employees**
- **information on social and community matters**
- **persons with whom the company has essential contractual and other relationships**
  - **i) is this information useful to you? How do you use it?**
  - **ii) Could disclosure be improved? If so, how?**
  - **iii) Are there key issues which are missing? If so, please explain?**

Comments
The information topics and specific information items that expert users and private shareholders find useful is something that I have researched with a colleague* By means of a large-scale questionnaire, we ask about the usefulness of eleven topics (inc. the financial topic) and 130 individual information items (some of these are the financial information items found in the financial statements). Results can be found in Table 3.1, pp.20-24 (expert users; 159 respondents) and 3.2 pp.26-30 (private shareholders; 235 respondents). While financial items top the rankings, many narrative information items follow closely, especially items that describe the business. Many significant differences exist between the views of users and preparers (finance directors and auditors). *** Hard copy sent to Jane Leavens.** [Full reference: Beattie, V. and Pratt, K. (2002), Voluntary Annual Report Disclosures: What Users Want, Research Report, Institute on Chartered Accountants of Scotland, Edinburgh]

Question 11: Would more guidance be helpful? If so, what form should this take? For example, best practice example, sample Key Performance Indicators, etc?

Comments
As explained in response to Qu9, research evidence indicates, perhaps surprisingly, that additional detailed guidance does elicit more information. However, the information that is relevant to each company varies; therefore detailed guidance can only ever address generic elements (possibly at the industry level).

Question 12: Should there be a shareholder's advisory vote on the Business Review?

Comments

N/A

<u>Question 13</u>: Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?

Comments
In my view, based on the research cited previously, non-mandatory solution will not have a significant impact because it will not change the cost-benefit trade-off (i.e. disincentive-incentive trade-off) faced by companies).

Directors' Remuneration Report

<u>Question 14:</u> Do the current disclosure requirements provide clear and usable information about:

- **the total remuneration paid to directors, and how this is made up;**
- **the performance criteria for payments to directors, and how these relate to the company's strategic objectives;**
- **company performance against these criteria, so that there is a demonstrable link between pay and performance.;**
- **the process by which directors' remuneration is decided?**

Comments
N/A

Costs

<u>Question 15:</u>
If you can provide any information on costs associated either with the existing narrative reporting requirements eg preparing your business review or your views on potential costs and benefits in relation to any of the ideas in this consultation, please give details

Comments

N/A

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