London School of Business & Finance

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Jane Leavens
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Department for Business, Innovation & Skills
1 Victoria Street
London SW1H 0ET
By e-mail to Narrativereporting@bis.gsi.gov.uk 14 October 2010

Dear Ms Leavens

The future of narrative reporting

Thank you for the opportunity to provide comments on the above consultation paper.

Responses to the consultation questions on which we are able to comment are set out below. By way of background, it is London School of Business and Finance's mission to become the first choice for business education in Europe. Through educating the world's most creative, talented and ambitious students, London School of Business and Finance aims to bridge international boundaries and provide individuals around the globe with an opportunity to achieve academic, personal and professional success. LSBF attract over 15 000 quality candidates from over 140 countries worldwide, and continues to experience exponential growth, both on-campus and online, all around the world, while continuing to develop corporate training, partnerships and associations with best-practice organisations globally.

In partnership with established and globally renowned academic partners, LSBF deliver two accredited MBA programmes and a suite of postgraduate and undergraduate business degrees (in partnership with University of Wales and Grenoble Graduate School of Business, triple accredited by AMBA, EQUIS and AACSB). LSBF is also a well established provider of professional programmes such as the ACCA, CIMA, CFA® and CIM, and operate best practices school-wide.

The school continues to expand rapidly in response to demand from UK domestic and international students for globally accredited business qualifications and currently operates four campuses across the UK; London (Holborn and Marble Arch), Birmingham and Manchester as well as international offices in Prague (Czech Republic), Toronto (Canada), Moscow (Russia), Hong Kong (China), Johannesburg (South Africa), Port Luis (Mauritius), Bogota (Colombia) and Almaty (Kazakhstan).

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1. **Are company directors providing useful and relevant information on the company's: forward-looking strategy, and principal risks and uncertainties?**

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The evidence to date is mixed. For example, the Accounting Standards Board surveyed a sample of FTSE 350 and FTSE Small Cap Index corporate reports in 2008/09 and, among other things, examined the way the sample described their business model. They then scored disclosure according to simple criteria out of 5. 52% of the sample scored only 2 out of 5, with 32% scoring 3 out of 5. Of the 32% they noted:

> We understood what they sell, where they sell it and who they sell it to but this generally fell short of describing the business model – that is a comprehensive explanation of how all of the different components of the business work together to generate cash

Given that these companies should represent the cutting edge of the reporting community this result is both disappointing and disconcerting for current and future investors.

In terms of risks and uncertainties, too often corporate reporting confines itself to a long list of risks with little evidence of the steps in place to mitigate those risks. This point is also made by the Chartered Institute of Management Accountants (CIMA) – "Review puts narrative reporting under the microscope" November 2009, Insight e-magazine. Of particular interest to investors is that class of risk which is considered to be highly unlikely to occur, but if it were to occur would be catastrophic for the corporation, and for which no form of insurance or offset is available. This is the risk category which should keep board members awake at night and should be openly and frankly communicated in the narrative report.

Generally there is only scant evidence in corporate reporting of the stress placed on the business model in the context of a carbon constrained future.

2. What are the constraints on companies providing information on these issues?

Commercial confidentiality is undoubtedly one of the key constraints on companies providing such information. However there is evidence of a lack of "pull" from the investor community to want such information. For example, research commissioned by the Association of Chartered Certified Accountants (ACCA) – "Narrative Reporting: Analysts' Perception of its Value and Relevance" by Campbell and Slack, 2008 – found an almost perverse tendency among sell-side analysts to positively ignore narrative reporting in favour of a total reliance on the accounting numbers.

It should also be noted that financial reporting, popularly misconceived as a report of historic results (in fact, financial statements are saturated with assumptions about the future) does not have a robust language for dealing with uncertainty in disclosures. And in terms of a carbon constrained future, uncertainty in reporting is the only certainty. Uncertainty does not fit well, either, with the spirit of the Companies Act 2006 which specifically requires directors to "promote the success of their company". There is clearly a need for training and guidance in how

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to report uncertainty in business. The ISO guidance on the expression of uncertainty in measurement may be helpful in this context.

3. **Does the information provided reflect the issues discussed by the directors in board meetings?**

The privacy of the board meeting obviously makes it difficult to respond to this very pertinent question. This is self evidently an area where applied research among corporations bold enough to open their doors would provide leadership and evidence of good practice. The emerging practice and disclosure of the work of the quoted company's Audit Committee is an important source of evidence that would also help to answer this question.

4. **Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?**

Anecdotal evidence from the financial press suggests an over emphasis on board performance and remuneration to the detriment of critical engagement with the company's business model and its potential to inflict social harm (e.g. arms, alcohol, tobacco) or reliance on key human resources. It also seems to indicate that the right information is not available for shareholders to detect perverse trends, for example, the explosive growth of highly profitable, highly risky and highly complex financial instruments in the five years leading up to the recent banking crisis

5. **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?**

No comment

6. **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 reports?)**

Most, if not all of the FTSE 350 companies will provide an investors' pack which is widely relied on in preference to the financial statements. Royal Dutch Shell is exemplary in its regular use of scenario modelling, of publishing the results and of being open and honest about the challenges to its business model as a result. It would be good to see such practice across other industrial sectors.

Corporate Social Responsibility reporting remains uneven and fragmented, with a constant tendency towards "green wash" remaining evident. This is not helpful for current and future investors, particularly those seeking to establish the risks inherent in a "carbon-heavy" portfolio.

7. **Is there scope to reduce or simplify the requirements on which companies report?**

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Yes, and the "Louder than Words" project, commissioned by the UK Financial Reporting Council is to be welcomed. But part of the blame for the increasing complexity and length of financial statements must rest with the accounting standard setters themselves. FRS17 and IAS19, for example, have unleashed pages of additional disclosure whose main result seems to have been the decimation of occupational pension scheme provision in the UK. Recently the CFO of Oxfam, echoing calls from Tesco, seems to indicate another forthcoming wave of overly complex disclosure around leasing. It would be helpful if accounting standard setters paid more attention to a) matters of greatest importance, e.g. accounting for greenhouse gas emissions, and b) to the law of unintended consequences arising as a result of the implementation of their standards.

8. Is there scope to arrange the information in a more useful way?

One of the most fundamental pieces of information for current and potential investors is the status of the company as a going concern. It would be very helpful to clarify in the first instance the definition of "foreseeable future" in this context. Under IFRS accounting standards, foreseeable future refers to a date at least 12 months from the last balance sheet date. Under UK GAAP foreseeable future is defined as at least 12 months from the date of the directors' signing of the financial statements – which may be up to 9 months after the last balance sheet date.
But the directors' assessment of whether their organisation is a going concern is such a fundamental issue that serious consideration should be given as to one prominent, common place in the financial statements where this assessment resides. Anecdotal evidence from review of statements over the last two years shows both unevenness in reporting of the assessment, as well as evidence being located in two or three or more, inconsistent locations.

9. Looking at an Operating & Financial Review and the existing business review 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?

We consider there would be value in the following elements being either reinstated or included:-

- An explicit addressing of adaptation to and mitigation of the effects of climate change and its impact on the organisation's business model over the longer term
- Specifically addressing the going concern status of the organisation
- Specifically addressing potential catastrophic risk where no insurance or offset is readily available
- Addressing potential societal harm arising as a result of the organisation's value proposition

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- Specifically addressing areas of weakness or uncertainty on the organisation's balance sheet, e.g. a long term build up of Goodwill or other intangible assets with no evidence of impairment

We are not persuaded that a statutory reporting standard would help to improve the quality of reporting. Indeed statutory intervention will always increase the likelihood of "boilerplating" of disclosures.

10. Are there key issues which are missing from the business review provisions?

One of the key omissions in our opinion is how the organisation intends to manage future likely regulation. For example, we would draw your attention to the Climate Disclosure Standards Board's (CDSB) "Climate Change Reporting Framework". This draws on a number of relevant sources including "recognised GHG emission reporting schemes", developments in international environmental, securities and business regulation on climate change disclosure and International Financial Reporting Standards. This has consciously been developed to include all known voluntary and mandatory GHG schemes around the world while seeking not to duplicate or overlap with them.

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

Such guidance would be helpful, but only to the extent that it is indicative. For example, there is a well known tendency for some organisations to develop a plethora of KPI's which rather than enhance performance simply lead to information overload and to measuring the wrong things. It would be helpful if such guidance were clearly maintained in one place. Currently guidance may come from the Financial Reporting Council and/or the Accounting Standards Board as well as the International Accounting Standards Board and the professional accounting bodies.

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

Yes. This would be constructive.

13. Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?

The most obvious non regulatory driver is peer review pressure provided by an organisation's direct competitors, and this should be encouraged. Encouragement may come from analysts explicitly comparing and contrasting pairs of direct competitors' financial statements. Awards ceremonies may be another useful source although judging quality may be uneven and may lean towards self selection of entrants.

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14. Do the current disclosure requirements (Directors' Remuneration) provide clear and usable information?

Current disclosure has become mired in a welter of regulation from both statute and corporate governance codes. In this process two trends seem to have been missed. Many organisations have proliferated the numbers of staff who are legally "directors". The disclosures of Directors' remuneration is actually confined to the small subset who sit on what is generically referred to as the Main Board. Secondly, and more importantly, this welter of regulation appears to have distracted investors from the prevailing "cult of the CEO" both here in the UK, and in the US. CEO remuneration, when compared to other members of the main board, to returns to shareholders, and to average levels of staff remuneration have been on a significantly divergent curve over the last decade. This has not helped the development of strong, stable boards providing leadership over time and delivering long term value to investors.

15. Costs and Benefits of increased narrative disclosure

This would be an area of useful research. We would emphasise that the value of long term shareholder loyalty to a company's market capitalisation cannot be overstated.

We hope that you find this response helpful. If you require further clarification of any of the points raised above please do not hesitate to contact me.

Yours sincerely

Dr. Steve Priddy
Head of Technical Research