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
✓	**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
i) Information on forward looking strategy tends to be, of necessity, generalities. However, companies generally provide useful information that sets the context for the company's progress during the year and future development. The length of the legal caveats that most companies include on forward looking statements is indicative of the concerns that many companies have about such disclosure and tends to lead to broad brush statements rather than specifics. **ii)** Reporting has improved in this area. There is still a tendency for companies to provide blanket coverage of risks without focusing on the key risks for their company. This makes an assessment of risks difficult. The ASB's publication 'Rising to the Challenge' has assisted with some useful points – for example that presenting risks in a table is helpful and encouraging companies to provide information on mitigating factors. The requirements of the new UK Corporate Governance Code will impact on the reporting both of strategy and risk as companies focus on both the strategic context for risk and the board appetite/tolerance of risk in their reporting.

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

Comments

i) It is difficult for companies to provide great detail on future developments a) to avoid making public confidential information and matters still under discussion; b) it is a constantly evolving area for companies which can change depending on circumstances.

ii) Risks and uncertainties – companies may feel it is safer to include a wide variety of all risks in order to cover themselves. It may also be easier for companies to include all risks rather than carry out the exercise of prioritising key risks. Companies with a process for regularly reviewing risk will find it easier to provide this information.

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

Comments
i) Strategy – In our experience, albeit based on FTSE350 companies, the disclosure on strategy set out in business review reflect the views of the board. Most quoted companies are pressed quite hard in investor meetings on strategy and therefore many are concerned to use the business review to support the information being discussed with investors. Boards are usually very focussed on this. ii) Risks – In the case of the companies we work with risk is regularly discussed and reviewed at Audit Committee meetings. Most companies prepare a risk matrix categorising the risks into high, medium and low and this forms the basis of reporting on risk.

<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
In our experience matters raised by investor relation bodies and major shareholders has focused in recent years on remuneration matters. However, following the credit crunch in 2008 much more attention has been paid to strategy, risk and corporate governance issues. We cannot comment on the extent to which this information helps shareholders in their dialogue with companies

<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
N/A

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

Comments
Yes. The Directors' Report in particular could be simplified. The current content is a mish mash of a wide variety of information of varying degrees of usefulness. Legacy issues from previous Companies Acts seem, increasingly, to be unnecessary. Examples are: - Substantial differences between market and balance sheet values of land – information could be provided in the form of a note to the accounts. - Details of research and development activities – we have yet to see any meaningful disclosures. For those companies involved in R&D this would form a large section of their Business Review in any case. - Details of the existence of branches outside of the UK – this is meaningless as it doesn't necessarily include areas of operation overseas. - Creditor payment days – information could be provided in the form of a note to the accounts - Large and medium sized companies and groups (Accounts and Reports) Regulations 2008 Part 6 – contains much information that is publicly and more properly presented elsewhere (eg the Company's Articles of Association). This includes information on structure of share capital, rights attaching to shares, restrictions on transfers, restrictions on voting rights, rules about appointment of directors. Disclosures tend to be legalistic and of little use to most shareholders. If companies must report on these issues then we suggest that cross-referencing to the most relevant documents should be allowable (and where the documents can be obtained from).

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

Comments
The current structure works well and as most companies follow a pattern it is easy to find your way around. A best practice structure would be: • Company highlights • Chairman's statement

- Chief Executive's statement
- Directors' Report incorporating:
  - Business Review
  - CSR report
  - Corporate Governance Report
  - Remuneration Report
  - Appendix with legal information
- Statement of Directors' responsibilities
- Auditors' Report
- Financial Statements
- Glossary
- Advisers
- Information for shareholders and financial calendar

We would support the use of tables, charts and maps where appropriate to provide the information in an easily understandable and more engaging format.

Greater clarity on the purpose, nature and role of CSR reporting would be helpful particularly given the ad hoc nature of some of the current requirements.

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 Business Review requirements are very similar to the OFR and a sizeable number of quoted companies already use the ASB's Reporting Statement as best practice reporting. Therefore if the OFR were to be introduced it would not place an additional burden for these companies. This is likely to be different for unquoted companies that do not currently report in the same level of detail. We believe that a statutory reporting standard would improve reporting as it would bring clarity to the level of reporting expected.

<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
i) This information is essential in order to help assess how the Directors of a company have fulfilled their obligation to promote the long term success of the company under s172 of the 2006 Companies Act (as required by s417 of the same Act). This includes consideration of the environment, employees and other stakeholders. ii) Disclosure could be improved by educating companies on the need to focus on key issues affecting that company. Therefore disclosure levels and

sort of information provided should vary between companies depending on whether, for example, their operations have a major impact on the environment (eg mining companies) or whether environmental impact is minimal

Reporting unnecessarily on CSR matters was highlighted n the ASB's report 'Rising to the Challenge' for producing clutter and information which for many companies is not relevant to their success.

In addition we don't believe that disclosing essential contractual and other relationships adds much value. This is very much a judgement call and disclosure is very patchy. If there was any risk involved with a major contractor or supplier than this should be disclosed under the companies key risks and uncertainties.

Guidance on the areas expected to be reported on under each heading would be useful which should also stress that reporting should be relevant to the company.

iii) Current requirements cover all the essential issues companies need to consider.

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

Comments
The ASB's Reporting Statement already widely used to inform best practice provides useful general guidance and examples of KPIs. Best practice examples and KPIs for companies from different sectors would help companies to understand the importance of focusing on issues relevant to their company. There is a danger that the guidance becomes too prescriptive so that companies are forced into a box ticking regime. FRRP's report 'Louder than Words' makes key recommendations which we would support on how to improve narrative reporting and how to reduce complexity. We would strongly recommend that this valuable work already carried out is taken on board.

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

Comments
There are plausible arguments both for and against an advisory vote on the Business Review. On the negative side, there are plenty of existing ways for shareholders to challenge the Board and engage in discussions and this would add to the burden and length of preparing for the AGM. However on the positive side it would ensure that the Business Review receives due attention and enable shareholders to flag up discontent with areas such as the environment, social and community issues.

<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
Better guidance and publicising excellence would assist. An issue for some companies in producing a coherent and non-repetitive set of report and accounts is the fact that the Business Review, CSR reports, compliance reports and the accounts will all be produced by different people. The front end can be seen by internal PR/IR as a marketing tool rather than a document fulfilling legal obligations to shareholders. Workshops and seminars for all members of the team, (PR, company secretarial and accountants) on narrative reporting best practice may prove invaluable in bringing these elements together.

This would be assisted if there were a statutory reporting standard to be reviewed by the auditors.

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
• The requirement for disclosure of directors' remuneration is very specific and therefore disclosure of all elements is generally good. • Disclosure on performance criteria is more variable in terms of detail given. Often there is no connection between performance criteria and the company's strategic objectives although this is improving due to pressure from investors. • The link between pay and performance is often not clear – eg percentages of targets received is often not given or any breakdown between different targets • Generally little information is given on how Remuneration Committees reach their decisions, the factors considered etc although again this has improved over recent years. Some companies chose to include a letter from the Chairman of the Remuneration Committee which helps to set the context in which the committee made its decisions. These areas can be improved by strengthening the reporting required by the regulations governing disclosures on remuneration which work well for disclosures on total remuneration.

Costs

Question 15:

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