Grant Thornton

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Dear Ms Leavens

## The Future of Narrative Reporting – A Consultation

Grant Thornton UK LLP welcomes the opportunity to comment on the consultation document *The Future of Narrative Reporting*.

We actively welcome the debate on the statutory Business Review (Operating and Financial Review) requirement and the attempt by the incoming Government to re-energise this part of the 'front end' of financial statements. We also believe that the debate is relevant in light of the feedback that the profession has had following the financial crisis about evolving shareholders' needs relating to information flows from companies and the role of audit firms in providing assurance over those information flows. Grant Thornton agrees that there is scope for enhancing the quality of the business review section of the financial statements, but this represents only one aspect of a much wider debate regarding the complexity of corporate reporting.

As part of our commitment to this wider debate Grant Thornton has also commented on the Financial Reporting Council's *Louder than Words* discussion paper and the discussion document issued by the Institute of Chartered Accountants of Scotland *Making Corporate Reports Readable - time to cut to the chase*. We enclose for your information our comment letters on these consultations. At an international level, Grant Thornton International has also been active in the debate. For example Grant Thornton International has published a book titled *One Report: Integrated Reporting for a Sustainable Strategy*, which was co-authored with the Harvard Business School. The book advocates the integration of financial and non financial information into "One Report" to promote greater transparency and improve corporate reporting.

In the context of the business review, the key areas where we believe users are looking for enhanced disclosures are:

- the business model including key success drivers and strategies for achieving success
- the specific key risks that arise from that model (not just generic sector related risks) including the identification of risks by management and steps taken to mitigate those risks
- the critical judgements and estimates (including use of accounting policies) adopted by management and the reasons for and the impact of those judgements

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## The need for change and short term solutions

Our overall view is that much of the legislation, regulation and standards are already in existence. We therefore do not advocate the creation of extensive additional layers of guidance in the short term. More emphasis is needed on the promotion of good reporting within the existing framework, through external monitoring for example, and encouraging more stakeholder interest and, if necessary, stakeholder action. However, we recognise that fresh guidance could be required in respect of transparency of critical judgements and estimates together with a report by an audit firm on these front end disclosures.

We recognise that there are already mechanisms in place that could bring about short term improvements in reporting. We would also encourage BIS to engage with the FRC's advisory group which is currently looking at the future of narrative reporting and the role of the auditor.

We are pleased to see that as part of their review of financial statements, the Financial Reporting Review Panel (FRRP) is giving specific emphasis to matters disclosed in the directors' report, including the business review. This will help raise the profile of what goes into the front end of an annual report and accounts and should encourage directors to think carefully about the information they include and how they present it. We would therefore encourage more communication of the matters which the FRRP, and indeed the Accounting Standards Board (ASB), are finding from their reviews.

Another short-term measure would be to consider whether the guidance in the current ASB Reporting Statement on the OFR should be updated or revised in the light of the International Accounting Standards Board's IFRS Practice Statement *Management Commentary* expected to be published shortly.

The FRC could also intervene with targeted guidance. In the past, the FRC has issued guidance in respect of going concern and liquidity risk and goodwill impairment disclosure. In our detailed response we refer to areas which, from our experience, are not well addressed or where there may be some confusion as to what is actually required. The FRRP and ASB have also highlighted in the results of their reviews areas which are commonly seen as being deficient, from which additional guidance could be formulated.

## The role of assurance providers

We believe that the role of assurance providers in relation to narrative reports, and in particular the business review, should be explored further. We believe that improved reporting might be encouraged by creating a specific requirement for the auditor to provide assurance over the enhanced narrative areas. For example there may be scope for a report on whether the business review is balanced and comprehensive.

However, directors may only be encouraged to give meaningful disclosures if they have an incentive to do so without the threat of litigation. We suggested in our response to the *Louder than Words* discussion paper that more safe harbours for directors may encourage better quality communication. Liability safe harbours would also be appropriate for assurance providers, for the provision of assurance that was neither negligent nor fraudulent. The new UK Corporate Governance Code may also have a role to play. The role of non executives has been enhanced such that they will be required to "constructively challenge and help develop proposals on strategy". We hope that non executive directors will therefore use their role to ensure that matters reported in the financial statements relating to strategy correlate with the key matters discussed at board level.

**Presentation of narrative information**

Thinking more broadly, we believe it is time to look beyond the constraints of the annual report and accounts with regard to narrative reporting, for example by making more effective use of information technology and different ways of communicating information. One potential approach is for the annual report to provide a summary of key points with readers being directed to other sources of more detailed information on particular issues. Another possibility could be to extend the scope of the existing statutory summary financial statements to include summary narrative reporting information. Not all sections of narrative reporting are relevant to all users of the accounts, and with continuing pressure from many sources to provide more and more information, readers can be overwhelmed with the volume of information presented.

In summary we agree that there is scope for enhancing the quality of the business review. There are many factors that could contribute to the achievement of this goal including continued external monitoring with the publication of key findings, targeted guidance and more general guidance as long as it is kept up to date, and auditor assurance given over certain aspects of the business review.

Our detailed responses to each question within the consultation are set out in Appendix A on the following pages.

Yours sincerely

cc Financial Reporting Council

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## Responses to specific consultation questions

### Question 1: Are company directors providing useful and relevant information on the company's:
### i) forward-looking strategy and
### ii) principal risks and opportunities?

### i) Forward-looking strategy

The Companies Act 2006 (CA 2006) requires quoted companies to disclose, "the main trends and factors likely to affect the future development, performance and position of the company's business". In our experience, this requirement is not generally interpreted to include comments regarding forward looking strategy and therefore at present this area is not well addressed by directors. Often whilst very general statements are made about future activity, such as in relation to 'plans to increase revenue', 'plans to increase sales of a particular product line', 'plans to increase business overseas' there is often very little in the way of detail regarding how these strategies are to be achieved. This is also borne out by findings of the ninth *Corporate Governance Report* produced by Grant Thornton, due to be published at the end of the year. This review looks at the quality of narrative reporting disclosures in the FTSE 350 (303 companies excluding investment trusts). The findings of the review will show that less than half of the companies reviewed gave detailed disclosures on the strategy and future direction of the business, even though this information is often publicly available outside of the annual report, such as on company websites.

In our view, there is little point in discussing strategies without a corresponding analysis of the plans to achieve those strategies, but we sense that this is likely to be an area of disclosure where there is some reluctance on the part of directors, for example directors are likely to be reticent with regards to how freely they comment on future plans due the risk of legal action and of providing information that may be of use to competitors. In addition, if other companies are not doing this, directors may be disinclined to be the first to provide such descriptive information.

However for the key users of the financial statements, the investors, this is likely to be a significant piece of information, in which case there is clearly a need to balance the provision of useful information with the need to safeguard the external interests of the business.

We put forward the idea in our response to the Financial Reporting Council's (FRC's) recent *Louder than Words* discussion paper that more 'safe harbours' could be created to encourage better quality communication in respect of forward looking information. This may therefore be an area to consider.

The new UK Corporate Governance Code requires non-executive directors to constructively challenge and help develop proposals on strategy, and as part of this function they can encourage directors to convey the key messages in the accounts.

### ii) Principal risks and opportunities

#### Principal risks

The Companies Act 2006 requirement is to give a description of the principal risks and uncertainties facing the company. Further disclosure of the financial risk management objectives and policies is also required.

In our experience, the quality of disclosure of principal risks and uncertainties is mixed. For example, whilst some companies give high quality disclosures others often give generic risk disclosures without making it clear as to how these are particularly pertinent to the entity. Furthermore, companies sometimes give examples of principal risks without explaining how they are attempting to mitigate the impact of these risks and how the risks have changed from one accounting period to the next. This could be due to the wording of the legislation which simply asks for a description of principal risks, rather than an analysis of their impact. There is also a tendency on the part of some companies to list a wide range of risks rather than concentrate on the principal risks. Companies also need to disclose how they assess the principal risks facing the business, for example, risks that are relevant to the business and if they were to materialise would make a difference to the decisions made by its users.

This area of disclosure was picked up by the Accounting Standards Board (ASB) as not being well communicated in their review of narrative reporting published at the end of 2009. Similar findings were outlined by the Financial Reporting Review Panel (FRRP) in their Annual Report published in August 2010.

### Principal opportunities

There is no specific requirement in legislation to address 'opportunities'. However, companies are generally keen to give the 'good news' which often amounts to describing the opportunities that either exist or are being pursued by the company, in which case this is probably an area that directors are likely to address.

In respect of the disclosure of financial risk management objectives and policies, companies generally fare better, possibly due to the fact that there is some overlap with IFRS 7 *Financial Instruments: Disclosures*.

## Question 2: What are the constraints on companies providing information on these issues?

The possible constraints or reasons why such information is not always well given are that companies may consider that to disclose such information would be commercially sensitive or that information would not be material to a user's understanding of the annual report and accounts. However, where detail is omitted, it is not possible for a reader of the accounts to tell whether the detail has simply not been given or has not been given for a specific reason.

We set out in our response to the FRC *Louder than Words* consultation, our views of the barriers to effective communication and these apply to this question too. We stated:

"We believe that a key barrier is a lack of communication between regulators, companies and users of corporate reports. Another barrier is the unwillingness of management to say anything meaningful when they do not see others doing so, or when they believe that the risk of litigation or shareholder criticism is greater than the potential advantages of clear communication. Management are often reluctant to be perceived as market leaders in this area, which leads to bland, unimaginative and therefore uninformative disclosure. We also see lack of challenge at board level as a potential barrier. For example, non-executive directors may not be afforded the scope or not be strong enough to challenge whether communication is effective."

We note that the publication of the Stewardship Code may help with regard to communication between companies and users of corporate reports. The new UK Corporate Governance Code may help with regard to the role of non-executive directors and the current review of the Higgs Guidance - Improving Board Effectiveness provides an opportunity to address all key Board roles.

A further point is that companies may not have the systems to fully capture all relevant information associated with narrative information, for example environmental and social information.

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

It is not possible for a user of the financial statements to know whether disclosures reflect matters discussed internally at board meetings. It is therefore the responsibility of those who participate in those meetings to ensure that matters that are relevant to the key users of the accounts are reflected in the disclosures. This is most likely to be the responsibility of the non-executive directors. Their role has been enhanced by the new UK Corporate Governance Code through a new principle (A.4). This will require that "non executive directors should constructively challenge and help develop proposals on strategy". The board are required to explain in the accounts how the Code principles have been complied with and whilst not explicit, as part of this requirement the non-executive directors should be satisfied that there is some correlation between the matters reported in the accounts and the matters discussed at board level.

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

This question appears to be relevant principally to shareholders. From our experience, there is an expectation gap between the information that investors would like to see and what companies are providing not least because the annual report is in the main backward looking and all evidence suggests a reluctance to include forward looking information.

To a certain extent the Stewardship Code should help to address this, particularly in the case of larger institutional investors. The intention is that disclosures made by institutions under the Stewardship Code should assist companies to understand the approach and expectations of their major shareholders and in doing so should enable them to provide information that will help meet such expectations.

**Question 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?**

The statutory narrative reporting disclosure requirements are outside the scope of the audit opinion on the truth and fairness of the financial statements. However, as auditors we would challenge disclosures that we considered were either missing or deficient. Where possible, we would refer directors to best practice guidance and findings of reports such as the ASB's review of narrative reporting and the FRRP's annual report referred to above.

However, the response from directors is often that in their view they have given sufficient information in the annual report and accounts and have adequately addressed the statutory disclosures. It is then difficult to force the issue, particularly as there is no real external precedent for dealing with poorly communicated narrative reports.

The FRRP have historically concentrated their efforts on the application of accounting standards and related disclosures (which is largely mirrored in their letters to individual companies), in particular when issuing Press Notices on the findings of individual companies. This can be a useful tool when encouraging directors to enhance their disclosures or to reconsider their accounting practices.

Whilst the remit of the FRRP was extended to cover directors' reports relating to periods commencing on or after 1 April 2006, there has been little in the way of specific individual examples that have come to the attention of the FRRP. However, the area of narrative reporting was given significantly greater attention in the FRRP's 2010 Annual Report and we understand that the FRRP intends to look more closely at directors' reports, including the business review, and we would therefore encourage more communication of the matters which they are finding, such as through their annual report.

One further observation regarding the provision of material information is that directors of quoted companies are required under the Disclosure and Transparency Rules to disclose likely price significant information, where the information in question would be likely to be used by a reasonable investor as part of the basis of his investment decisions and would therefore be likely to have a significant effect on the issuer's share price. Therefore a mechanism is already in place to ensure that material information is disclosed.

**Question 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 report)?**

This question appears to be directed at external users of company information.

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

In so far as the statutory business review is concerned, which is the main focus of the consultation, we do not consider that there is a need to simplify the requirements. The focus should be on ensuring that there is a high quality of disclosure surrounding the business review requirement and that this is being externally monitored.

There is however a wider question stemming from the fact that narrative reporting disclosure requirements have to be pulled from a wide number of sources, of which the statutory business review requirements form only one part. It may therefore be that part of the problem lies in the fact that there are so many sources of guidance and regulation that companies have to remember to address that they fail to allocate sufficient time to the words they intend to use. There is also some perceived and actual overlap and repetition amongst the various requirements. The development of a framework for integrating the various requirements on which companies report may help to address this issue.

**Question 8: Is there scope to arrange the information in a more useful way?**

We agree that there is scope to arrange information in a more useful way, but it could be counterproductive to prescribe the way in which information should be arranged. Companies should be trusted to organise the information in a logical manner. However from experience this does not always happen.

Furthermore, the fact that companies do present their front-end narrative reports in different ways can often obscure the messages. For example, some companies do not present the business review information in the directors' report, and cross refer to another statement where it is often not clear that the requirements have been addressed. Other companies might include certain parts of the business review in the directors' report with other parts outside of the report whilst others present the business review information in the directors' report and it is clearly labelled as such.

At present, there are varying practices with the way in which information is disclosed, but we consider that companies should be given some flexibility in the way in which they present this part of the annual report and accounts, although presentation of the accounts themselves tends to be more clearly defined and consistent across companies.

Thinking more broadly, we believe it is time to look beyond the constraints of the annual report and accounts with regard to narrative reporting, for example by making more effective use of information technology and different ways of communicating information. Rather than clutter up the annual report with ever-increasing amounts of narrative, one potential approach is for the annual report to provide a summary of key points and direct readers to other sources of more detailed information on particular issues. As the annual report is produced primarily to meet the needs of investors, the key points could be restricted to those that are likely to be of most concern to that investor group. Such other sources could then be freed from the communication constraints that apply to the annual report and accounts and could be provided on a more timely basis and in more depth, for example through the company's website. Users could then select the areas and information of particular interest to them.

Another possibility could be to make more use of statutory summary financial statements for the provision of certain (summary) narrative information. Again, users could then refer to other sources for more detailed information, whether that be the full annual accounts or the company website.

**Business Review**

**Question 9: 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?**

The content of the Business Review section (s417) of the Companies Act 2006 largely deals with matters that were formerly contained in the OFR Regulations 2005. The main difference is that the 2005 regulations required a statement as to whether the OFR had been prepared in accordance with what became the ASB Reporting Standard and to give particulars of departures with reasons. After the repeal of the 2005 regulations, the ASB reissued its Reporting Standard as a non-mandatory Reporting Statement, largely retaining the same material as guidance.

The 2005 regulations did contain a specific requirement for a statement of the business, objectives and strategies of the company and a description of the resources available. However the general statement in s417(2) CA 2006 to a certain extent covers this.

There was an auditor's duty under the 2005 regulations to state whether matters had come to their attention which in their opinion were inconsistent with the OFR, but this area is addressed by the statutory requirement for auditors to report on the consistency of the directors' report (including the business review) with the financial statements and in more general terms by International Standards on Auditing.

The 2005 OFR regulations applied only to quoted companies (as defined in legislation) and in our view the scope of any future mandatory OFR should remain the same. Our view is that the promotion of good reporting within the existing framework and encouraging more stakeholder interest and, if necessary, stakeholder action would be more useful.

We do not favour reinstating the ASB's Reporting Standard together with a statement as to whether it has been followed. Rather, we believe it would be useful to consider whether the guidance in the current ASB Reporting Statement should be updated or revised in the light of the International Accounting Standards Board's forthcoming IFRS Practice Statement *Management Commentary*.

We believe that the role of assurance providers in relation to narrative reports, and in particular the business review, should be explored further. For example, the current legal requirement is for the business review to be a balanced and comprehensive analysis of the development and performance of the company's business during the financial year and the position at the year end, consistent with the size and complexity of the business. There may be scope for the company's auditors to provide some form of assurance regarding whether the review is balanced and comprehensive, given their knowledge and understanding of the business in their role as auditor. However, we believe that this could only be achieved if there were appropriate safe harbours for auditors, given the subjective nature of narrative reports.

**Question 10: 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?**

**i Is this information useful to you? How do you use it?**

This question appears to be directed at users of the annual report and accounts.

**ii Could disclosure be improved? If so, how?**

The ASB's 2009 report on narrative reporting contained some detailed discussion of the business review disclosures given by companies. This included the observation that companies need to provide better disclosures of their business model and what the company does to generate cash. This is reflected in the ASB Reporting Statement (paragraph 31) which states "A description of the business is recommended in order to provide members with an understanding of the industry or industries in which the entity operates, its main products, services, customers, business processes and distribution methods, the structure of the business, and its economic model, including an overview of the main operating facilities and their location." Further, the FRC has recently strengthened the UK Corporate Governance Code in the areas of the business model and risk disclosures.

Research carried out by Grant Thornton in the preparation of the annual *Corporate Governance Review* show that very few FTSE 350 companies are currently linking strategy through objectives and risks to Key Performance Indicators. We also note that risk disclosures are generally in the business review, whilst internal controls are discussed in the governance section. This supports the point that annual reports would benefit from a more joined up and integrated approach.

**Environmental matters, employee information, social and community matters and essential contractual relationships – general comment**

In our experience as auditors, and as highlighted by the ASB review of narrative reporting, the quality of reporting in these areas is variable. This is possibly due to wording of the legislation "to the extent necessary" which involves a degree of subjectivity. When challenged, directors will often state that in their view they have applied the requirements to the "extent necessary".

Environmental, employee and social matters are increasingly disclosed outside of the annual report in a separate Corporate Social Responsibility report with more detailed disclosures. We therefore think there is a question to be asked as to whether the annual report is the best place to include such information. For example, if these disclosures are not essential to understanding the business, is it right that they should be included within the business review, and would separate disclosure be more appropriate? We discuss the scope of the annual report in our response to question 8.

We believe that, where non-financial key performance indicators are important to companies, assurance provided by independent bodies is necessary to give comfort over the consistency, reliability and comparability of data. The Grant Thornton Corporate Governance Review shows that a very small number of companies are currently obtaining such external assurance.

**Information on environmental matters**

We believe that this is an area which could be improved, but it is an area that varies in significance depending on the nature of the business and its size. Certain companies clearly have much to say on the subject but there is sometimes a tendency for companies to go into great lengths about such matters even though they are not significant in the context of the financial statements or the development of the company's business.

**Integrated reporting**

We note the recent formation of the International Integrated Reporting Committee (IIRC). The IIRC's remit is to create a globally accepted framework for accounting for sustainability: a framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format, ie. an integrated format. We strongly support the IIRC's aim to help with the development of more comprehensive and comprehensible information about an organisation's total performance, prospective as well as retrospective, to meet the needs of the emerging, more sustainable, global economic model. We believe that the development of integrated reporting is an essential part of the evolution of corporate reporting over the next decade and that future developments in requirements and guidance must take into account this issue. However, the clarity of reporting must be one of the key drivers.

**Information on employees**

We consider that there is some confusion here in terms of what is actually required by this disclosure, particularly as there is a separate requirement to disclose employee involvement in the company. Better guidance as to what sort of matters are to be covered here might be helpful as we believe that a number of companies are not aware that there is a distinction between the two employee-related disclosures.

**iii Are there key issues which are missing? If so, please explain?**

See above regarding integrated reporting. We do not consider that any other key issues are missing.

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

Guidance would potentially be helpful in areas that are commonly seen as being deficient by regulators such as the FRRP and ASB. However it would be preferable to build on guidance which already exists rather than to create a further source, for example by making use of the ASB Reporting Standard or the IASB's IFRS Practice Statement.

A best practice example could be useful but may discourage companies from thinking for themselves. In the context of disclosures in the financial statements themselves, we have seen examples of companies inappropriately copying accounting policies of other companies, and using example wording from accounts packages without tailoring to their circumstances. Best practice examples may lead to similar behaviour in relation to narrative reporting. An alternative might be some sort of checklist structured in such a way to make directors think about the information and explanations they have given, the way in which this has been presented and whether it conveys the intended message. Not simply a yes/no compliance checklist but one requiring more reflection.

In terms of sample key performance indicators, directors should know what their key performance indicators are without resorting to a list of KPIs to select from and disclose. Such lists can all too easily lead to large numbers of indicators being presented, without any clarity as to which ones are really key to how the directors manage the company's business. Again we would make the point that where key performance indicators are important to companies, assurance provided by independent bodies would give comfort over the consistency, reliability and comparability of data.

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

We are not convinced that such a shareholder vote would achieve any real purpose as shareholders are already required to approve the annual report as a whole which includes the business review. However, introducing such a requirement for quoted companies would at least ensure that the business review was on the agenda for the company's annual general meeting.

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

We consider that guidance already exists in the form of the ASB Reporting Statement. When issued as a Reporting Standard, this was originally intended to support the statutory OFR which was subsequently removed. However, much of the content of the proposed statutory OFR has found its way into legislation anyway through the business review and enhanced business review requirements for quoted companies, such that a Reporting Standard may still serve a purpose – as long as it is updated for recent developments and evolving best practice. This guidance has remained available in the form of the Reporting Statement, but we do not know how many companies actually refer to it for guidance. As noted above, we believe it would be useful to consider whether the current ASB guidance should be updated or revised in the light of the International Accounting Standards Board's forthcoming IFRS Practice Statement *Management Commentary*.

We do not have strong views on the promotion of excellence in business reports, as companies are different and should be encouraged to tell their own story. However what might be useful is the continued emphasis on good practice through reports published by the ASB and FRRP, for example.

The FRRP issued their annual report in August 2010 and in that report they set out what a good set of accounts and report might look like in their view. The points made could easily form a series of questions that directors should ask themselves in deciding whether or not they have prepared a report that will be meaningful to users. We are pleased to see that the FRRP is giving specific emphasis to matters disclosed in the directors' report. This will help raise the profile of what goes into the front end of an annual report and accounts and should encourage directors to think carefully about the information they include and how they present it.

It is sometimes evident that directors have simply updated narrative from the previous year. They should be encouraged to start with a blank sheet each year although cost and time are likely to be relevant factors preventing this. However there is a role here for shareholder engagement (institutional investors) in demanding improved disclosures from investee companies. The FRC has emphasised the importance of shareholder engagement in companies' corporate governance practice with the release of the Stewardship Code for Institutional Investors. The Grant Thornton Corporate Governance review has shown that the number of FTSE 350 companies providing detailed disclosures has steadily increased in recent years.

**Directors' Remuneration Report**

**Question 14: 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?**

In our view the current directors' remuneration report legislation provides for adequate disclosure of the amount of remuneration paid and how that remuneration is made up and from our experience this information is nearly always disclosed in an appropriate tabular format.

The legislative requirements are already detailed in relation to the disclosure of performance criteria for payments to directors. They require a statement of the company's policy on directors' remuneration including an explanation of the relative importance of those elements which are and are not related to performance. However the statutory requirement is for policy details to be given for the following and subsequent financial periods and we do not believe that this is always being addressed. It is not clear whether companies are misreading or misunderstanding the requirements. For example, companies will often include a policy discussion that relates to the historic figures presented, but it is not always clear as to the policy going forward. As a result, there is a lack of linkage to the company's strategic objectives.

There is often a disconnect between performance-related elements of pay as disclosed in the table referred to above, the explanation given of the policy for performance related elements of pay and actual events or activities that have determined the payment of such amounts. We encourage companies to explain the link where it is not obvious, but we are aware that this is not always well done. Furthermore, the current (and future) Corporate Governance Code requires "a significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance." This balance is not always evident.

With regards to the process by which directors' remuneration is decided, boilerplate disclosures are often given here. For example there are often references to having regard to the pay of directors of companies of a similar size and in the same industry, but without explanation of the criteria for making such comparisons. Similarly boilerplate descriptions are often given of the activities of the remuneration committee with little specific company detail.

In our response to the FRC's *Louder than Words* consultation, we noted that for listed companies there are currently two sets of regulations governing disclosure of directors' remuneration: regulations made under the Companies Act 2006 and the FSA Listing Rules. There is a large measure of overlap between the two but differences remain, meaning that companies have to apply two sets of regulations where one would suffice. In our view, this adds unnecessary complexity.

More generally, we note that the current statutory requirements for the directors' remuneration report are highly prescriptive. Whilst this might contribute towards consistency of reporting, it is possible that the resulting focus on the detail means that companies lose sight of the broader messages, for example relating to the linkage between the company's business model and directors' remuneration. As the current law has been in place largely unchanged since 2002, it may be opportune to review its operation and whether it is still fit for purpose.

**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.**

This question is more relevant to preparers.

In our view, one of the main costs involved is the time that it takes to ensure that all the strands of regulation and guidance have been complied with, often at the expense of good quality reporting.