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)** |

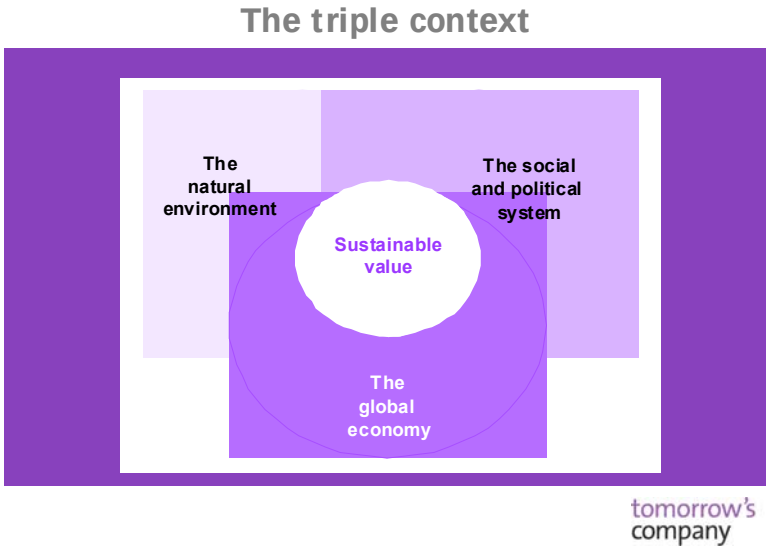
## TOMORROW'S COMPANY RESPONSE TO BIS CONSULTATION ON NARRATIVE REPORTING

The financial crises of the last decade have demonstrated serious shortcomings in the understanding of corporate business models, the alignment of incentives, and the management of risk. The current corporate reporting model has not highlighted where these shortcomings exist. This failing is exacerbated by the pace of change of business today, with a plethora of new challenges impacting long-term success, including a shift in the global balance of power, resource constraints and climate change.

Corporate reporting plays an essential role in the effective functioning of the market economy, enabling shareholders and investors to assess the performance of a business across all aspects of activity, establish its value and exercise effective oversight. By corporate reporting we mean all the mechanisms by which companies communicate their performance and activity to their stakeholders, with a particular emphasis on the flow of information into the investment community. It is clear that the present corporate reporting system is sub-optimal in this context.

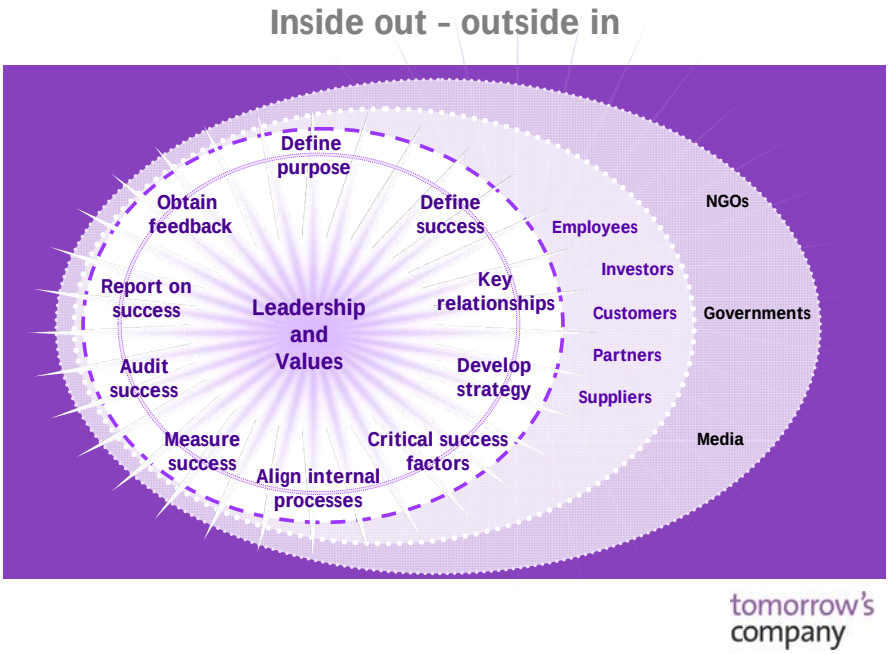
Tomorrow's Company has been working to describe the agenda for the improvement of corporate reporting since 1997.

- In 1998 we published our vision of the Annual Report of the future (Sooner Sharper Simpler).together with Prototype plc, an early example of a model annual report for an imaginary company.
- This early work was a forerunner of the thinking that was contained in the work of the Company Law Review. Mark Goyder was a member of the CLR working party that developed the proposal for the mandatory Operating and Financial Review (OFR). He was also a member of the working group that developed guidelines to help companies determine questions of materiality. Some recent responses to the OFR have linked it with social and environmental reporting: it is important to remember that the OFR was intended to give companies the opportunity to report on all factors that are material to present and future performance.
- We explored the issues of reporting and measurement as part of our 2004 study Restoring Trust, Investment in the twenty-first century.
- We developed 5 key criteria for the assessment of the treatment of strategy and governance in sustainability reports, as part of a collaboration with ACCA in 2007(Report of the Judges – ACCA Awards for Sustainability 2007)
- In our report Tomorrows' Global Company, a number of leaders of global businesses, along with representatives from NGOs and other key stakeholders, argued that companies need to 'redefine success' for their organizations in a way that recognizes that they operate in a context that needs to take into account the link between future economic success and social and environment factors (the triple context).



- Having redefined success in this broader way then it is vital that all organisational processes, including reporting are accordingly aligned. This approach builds on all the work of Tomorrow's Company from the original RSA Tomorrow's Company inquiry (published in 1995). We place the company's purpose, values and relationships at the heart of its leadership and governance.

- We therefore see measurement and reporting as part of a cycle which starts with the definitions of purpose, success and key relationships. It is a cycle that we describe as "inside out and outside in"




- It is a joined-up approach through which companies think deeply about what success means in the fast changing external operating environment ("*outside in*"). At the same time as the triple context is informing a company's action, the company also has continuing dialogue with its customers, employees, suppliers, community and its shareholders about what it stands for and what success looks like. It is this process of communication that we describe as "*inside out*" – making the purpose and values and success model come to life in all the stakeholder relationships. The company's narrative reporting is one part of this larger process.

- This is why companies find non-financial reporting difficult – because it forces them to be explicit about their individual definition of "success", and what the key drivers are to achieve it and to communicate these clearly. It also explains why those who grasp the nettle gain so much benefit.

- Central to the achievement of this joined up approach is strong leadership and values. In March this year, with the encouragement of and participation of BIS, Tomorrow's Company established a Good Governance Forum, which brings together a number of key businesses, organisations and individuals to explore what good governance means, to make practical recommendations to company boards and policy makers. The forum is developing a series of guides and toolkits for use by chairs, boards and advisors, to help achieve practical change. The first of these makes the case for a 'board mandate':

  > *A mandate captures the 'essence' of the 'character' and distinctiveness of the company, in terms of: its essential purpose; its aspirations; the values by which it intends to operate; its attitude to integrity, risk, safety and the environment; its culture; its value proposition to investors; and plans for development. It is about what the company stands for and how it wishes to be known to all of its stakeholders.*

  The process of creating a mandate requires deep and comprehensive discussion by the board, and is a prerequisite to encapsulating the board's fundamental sense of future direction and provides a source of understanding from which to draw to inform critical conversations with key interests, internally and externally. The mandate is therefore a critical element for a company in terms of redefining its success.

- In partnership with CIMA and PwC Tomorrows Company, is also in the process of undertaking research - Tomorrow's Corporate Reporting – which is exploring:

  > *What aspects of the system are preventing or supporting the effective development of corporate reporting? And what changes are needed to make the system fit for purpose for the future?*

  The focus is on the systems architecture and the behaviours and values of its stakeholders, not on the content of the 'ideal corporate report'. This enables policy makers to identify what aspects have prevented or could support the effective development of the reporting model. (www.tomorrowscorporatereporting.com).

It is against this wider understanding of the keys to successful leadership and governance that we have framed our response to the specific questions in the consultation.

## Value of narrative reporting

**Question 1: Are company directors providing useful and relevant information on the company's:**

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

| Comments |
| --- |
| **Overall the standard has improved. The major problem is that "more is less". Valuable description of strategy is in danger of being buried beneath a plethora of compliance requirements, losing the focus on what is material to the long-term success of the company.**<br><br>**Hence our view of the need for companies to be encouraged to develop an over-arching, short and readable statement that integrates the many different elements into a coherent account of where the company has come from, where it is going, and what it stands for.** |

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

| Comments |
| --- |

**A possible fear of litigation, especially in the USA resulting In boilerplate risk assessments rather than a focus on those risks that are material to the company.**

**A concern about releasing information that may be seen to be part of its competitive advantage**

**A lack of effective communication within companies. Typically when we ask companies asked who is responsible for producing the annual report, there seems to be a lack of overall leadership. The front end is the responsibility of public affairs; the back end belongs to the finance director, but clear leadership messages about purpose, values, success definition and mandate are too often lost in this division of labour.**

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

| Comments |
| --- |
| **On the whole the information provided follows a pattern set by previous annual reports.**<br><br>**We are developing the concept of a board mandate (described earlier). Properly used, this should prompt the board to shape more strategic discussions which would then be reflected in the report.** |

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

| Comments |
| --- |

**Our concern is that with so much volume of data, there is too little information.**

**Aggregation of data can also strip it of meaning. An employee of a global company can identify with information about the company's operations there. But if the data for Brazil has been aggregated into a figure for Latin America or the world, it ceases to have the same meaning. There is also a need to find a balance between aggregation to a global level across country operations and divisions and more meaningful reporting at local level.**

**Companies also need to be much better at charting trends over 5 years, and showing comparison with benchmark companies to help themselves and their investors identify the key issues.**

**Investors, particularly institutional investors, rely on information obtained direct from conversations with companies rather than what is provided to the public at large.**

**Many of the key risks for companies are related to non-financial aspects of the business, yet good non-financial data linked to financial data is still in the early stages of development in many 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 |
| --- |
| **In our own work with companies, often in the role of independent commentator, we do challenge companies. We find a particular reluctance to "tell it like it is" – for example in giving a full account of the cuts in the workforce that may have been made. Reports would gain much more credibility if their readers could recognise the real world of imperfection in their account of the past year. We recommend a more realistic approach. We would welcome a tone of report in which companies warned readers that the organisation is human and therefore exposed to human frailty; that mistakes have and will be made and so on. Of course we understand that the litigious climate promoted especially in the USA makes such authenticity harder, and government should be striving to do all it can to protect companies who choose to** |

**be frank and realistic from being exposed to litigation.**

**Companies also need to be much better at charting trends over 5 years, and showing comparison with benchmark companies to help themselves and their investors identify the key issues.**

**<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** |

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

| Comments |
| --- |
| **What is critical is for companies to identify those issues that are material to its continued and futures success.**<br><br>**The materiality guidelines produced by the Operating and Financial Review Working Group on Materiality, under the chairmanship of Rosemary Radcliffe and published by the DTI in September 2003 are helpful and BIS should consider updating and republishing these.**<br><br>**There is scope to simplify but the issues are complex. A better balance could be struck between the regulated (-primarily financial) and voluntary (primarily non-financial) elements that companies currently report on.**<br><br>**Any standards developed must give companies sufficient flexibility to report on their uniqueness. Comparability and benchmarking has its place but there are many significant indicators about a company's health or progress (for example attempts to measure awareness or application of corporate values) which there can be no inter-company comparability. Much of the innovation taking place in the reporting sphere is coming from the voluntary arena and as such is better able to keep up with changing market conditions.** |

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

| Comments |
| --- |
| **This needs to be left to companies but an integrated summary document of the kind set out in Sooner Sharper Simpler should be one option companies consider.**<br><br>**Proposals to develop an 'integrated report' will also be helpful.** |

## 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 |
| --- |
| **Yes. Once the "safe harbour" objections of companies have been properly dealt with, the statutory OFR and the materiality guidelines offer a good basis.**<br><br>**A statutory reporting standard would then be a necessary discipline on unquoted companies, although it should not necessarily apply with full force and effect to small companies.**<br><br>**OFRs should also be mandatory in the case of agreed mergers (a single OFR) or attempted take-overs (one OFR on each side to show the different prospective futures for the company). This would presently be a matter for the Takeover Panel, on whose future structure and functions we comment in our submission to the parallel Consultation Document (Cmnd 7874) issued by HM Treasury.** |

**<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 |
| --- |

**For reasons explained above companies should be required to state clearly their purpose and their values and demonstrate how they are adhering to them. This in our experience forces them to move from boilerplate to a real discussion of what makes them unique. Without this requirement too much of the related reporting on environmental issues, or matters of corporate responsibility will relapse into what we have in the past described as "compliance" rather than "conviction" corporate responsibility.**

**<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**

**Start by using the existing materiality guidelines. Update them in the light of more recent developments See how these work. Look also at the requirements set up by King III in South Africa and consider their applicability here.**

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

**Comments**

**Voting is a very crude instrument. It has its place as a sanction in the last resort but it is not a substitute for the improved dialogue and learning which effective reporting is intended to bring about.**

**If there is a statutory requirement to produce a Business Review, it seems damaging then to create a process where it can be voted down. There should be better ways of achieving a meaningful discussion of the company's strategy, progress, and prospects.**

**The obvious way forward is to encourage company innovation linked with the concept of the board mandate.**

**In the end, the point of the advisory vote would be to affirm that the company is operating within the implicit mandate set by the shareholders as a body. The first priority is to accentuate the positive -**

**strengthen the good practice around the quality of the conversation. At some later stage there may be a case to consider the advisory vote.**

**<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 |
| --- |
| **Tomorrow's Company has over 10 years experience in assessing the quality of reports against its Sooner Sharper Simpler criteria. The Strategic Planning Society awards provide another excellent way of assessing them. Government should leave the market place to deal with this, although it could draw attention to the assessments offered by non-profit organisations like TC and SPS.** |

## 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 |
| --- |
| **Companies should be encouraged to discuss their pay rationale across the entire workforce. A detailed standard might not be made mandatory until best practice has been developed., But there is a strong case for immediately placing in the public domain each company's general remuneration policies, and in particular the pattern of total remuneration across directors and employees, with particular reference to the respective amounts paid at each end of the spectrum.** |

## Costs

**Question 15:**
**If you can provide any information on costs associated either with the existing narrative reporting requirements e.g. 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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