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

**Name: Robert Nash**

**Organisation (if applicable): WWF-UK**

**Address:**
WWF-UK
Panda House
Weyside Park
Godalming
Surrey GU7 1XR

**Email:**

**Return completed forms to:**
Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Tel: 020 7215 1686
Narrativereporting@bis.gsi.gov.uk

**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** |
| **X** | **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 |
| --- |
| **We believe that there is more that could be done in terms of forward looking strategy and principal risks and opportunities, particularly with reference to social and environmental impacts and risks. For example few companies where carbon emissions are significant (for example oil and gas companies) are discussing their future strategy on how they will manage the impact of carbon pricing or highlighting the potential risks related to these emissions. BP's carbon liabilities on its proved reserves would be around £42bn at a carbon price of £75 per tonne and Shell's could be £36bn.**<br>**Equally, companies who are investing in carbon intensive businesses are not disclosing the environmental impacts of their investments; nor are they disclosing in any detail the potential risk of investing in these businesses, and based on research undertaken by Mercer are not actively managing this risk (*Carbon Risks in UK Equity Funds, 2009, Trucost*) .**<br>**Too many companies are making a large number of generic 'boiler plate' disclosures about a large number of risks; whereas the type of information that is required is a more detailed and decision-useful range of information about a select range of key risks, combined with contextual information to clarify the choices made about which risk factors are highlighted.**<br><br>**In addition, information about specific environmental impacts or targets is sometimes out of step with strategic information provided on the same issues, which in turn can be inconsistent across the reports. For example, BP has provided information regarding its strategy with regard to climate change and carbon emissions – but the broad strategic statements are rarely if ever linked concretely to actual emissions performance of the company.**<br>**Furthermore, in its disclosures to investors in response to a shareholder resolution BP provided additional information which is inconsistent with a sustainable vision for energy. The company made a range of statements about future energy demand and supply. Every one of the statements, however, is based on the International Energy Association (IEA) 'Reference Scenario'. This assumes no new action to reduce emissions and mitigate climate change. It is extremely unlikely to occur and it also has startling implications which are not explained by BP:**<br>**• Rising fossil fuel use would see annual GHG emissions rise from** |

**29Gt in 2007 to over 40Gt in 2030.**
**• Atmospheric GHG concentrations more than double, reaching around 1,000ppm by the end of the century.**
**• This would result in an average global temperature rise of up to 6°C, with catastrophic consequences for people and the planet.**
**(For further details see *"Toxic Fuels: Toxic Investments – why we need greenhouse gas reporting", WWF-UK and The Co-operative Bank, Insurance and Investments, 2010)***
**This type of reporting demonstrates a serious lack of reliability, both in quantitative information and, crucially, in the relationship between statements about strategic direction and statements about specific risks.**

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

| Comments |
| --- |
| **Companies will sometimes assert that a risk is too remote and unquantifiable to be disclosed in the annual reports. However there may be opportunities where the risk is potentially significant for providing different scenarios to try to explain the potential impact. Disclosures could consider a range of plausible regulatory and economic scenarios. For example, there could be climate change/carbon risk assessments which incorporate low levels of carbon emissions, high price of carbon and shift away from fossil fuels necessary to limit atmospheric $CO_2$ at or below the level required to avoid dangerous climate change.**<br>**The lack of guidance on how to select key risks and what type and format of information (including the balance of quantitative and qualitative or contextualising information) it is useful to report to users makes it harder for companies to make important choices about these issues.**<br><br>**This is a case where clearer and more specific guidance has the potential to reduce the burden on companies and to produce more concise, simple and effective reporting; rather then introducing extra burdens and complexity – as is often assumed to be the case.**<br>**The profusion of competing reporting standards in key areas such as greenhouse gas (GHG) emissions can make it harder to report consistently and appropriately. Mandatory regulations for reporting of GHG emissions could provide the certainty and consistency in this area that businesses and investors need.**<br><br>**In relation to impacts on the freshwater environment, while information on internal water consumption is normally straightforward to obtain, the information needed to determine water use and related impacts in the** |

**supply chain is not always readily available.**

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

| Comments |
| --- |
| **No Comment.** |

**<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 |
| --- |
| **Investors should be using this information to challenge directors, and we believe that investors need more information particularly in connection with environmental and social issues. For example BP lost 50% of its stock market value in 2010 and investors also lost out in terms of dividend. Were investors fully aware of the potential risks? More and deeper engagement with institutional investors in particular improves investors' ability to assess risk and opportunities and enhances their ability to influence the strategy of companies to manage those risks and opportunities.**<br><br>**A report recently published by the charity FairPensions (*Preparing for the storm? UK Fund Managers and the Risks & Opportunities of Climate Change, FairPensions, Oct 2009*) found that 86% of fund managers surveyed stated that they would welcome mandatory reporting requirements for companies to report their GHG emissions and 78% would welcome stock exchange listing rules requiring companies to disclose risks related to climate change.**<br><br>**More than half the respondents said that poor quality data on GHG emissions disclosed by firms and a lack of regulatory requirements for** |

**investee companies were barriers to incorporating climate risks and opportunities into their analysis and decision making**

**Company reporting need not provide all of the information needed to make a full assessment of the likely success of the business in the future. However, it must at a minimum provide shareholders with sufficient information to identify key issues of concern in order that they can conduct their own analysis and press directors and management on their strategy and processes. This minimum standard is not currently being met.**

**One example of this is the recent 2010 shareholder resolutions on tar sands at BP and Shell. In this case significant investor action and direct engagement was required even to gain access to the basic information about the basis of investment decisions and assumptions on key environmental and social risks, including carbon risk and the cost of cleaning up and restoring the local environment in areas disturbed by extraction and processing of bitumen. The disclosures that were made in response to the resolution revealed information about these businesses that should be available as a matter of course in company reports.**

**When pressed, companies often point to information that is provided elsewhere in other publications or on their websites. This information is frequently found to be confusingly presented, incomplete, inconsistent, and extremely difficult and time-consuming to locate. It is also largely unverified. This does not facilitate investor or stakeholder engagement.**

**For more details on the resolutions and their significance in this context, see the report *"Toxic Fuels: Toxic Investments – why we need greenhouse gas reporting", WWF-UK and The Co-operative Bank, Insurance and Investments, 2010.***

**Understanding the risks derived from impacts on the water environment requires not only knowledge of the direct impacts of a company's operations on water resources and water quality but also its indirect impacts that are created through the supply chain. To ensure that shareholders have sufficient information to press directors on risk issues, and business decisions are properly informed, reporting on water-related impacts needs to include, but go beyond, simple metrics of water consumption and direct water quality impacts, to include impacts through the supply chain, This could be achieved with tools such as water footprinting.**

**<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 |
| --- |
| **Yes – WWF have used the shareholder resolution route to demand greater levels of transparency from companies (for example Shell and BP). The resolution process, increased investor awareness and interest, and public interest triggered a level of disclosure which was previously absent. Additional powers for investors and other stakeholders to raise concerns about disclosures and to request additional clarification would be useful. This could include a vote on the OFR/Directors' Report at the AGM. We believe that the use of shareholder resolutions as a tool for greater dialogue and accountability should be encouraged – resolutions should not be considered only as a 'nuclear option' that is too extreme for normal usage, but rather as one of the many tools investors have to engage with investee companies.**<br><br>**Legislation which requires full disclosure of environmental and social risks, and the financial implications of those risks, is essential. As explained in the above response to Question 4, the bare minimum that investors and other stakeholders require is sufficient information to make an assessment of the key risks and issues upon which they need to engage directly with a company. Enforcement/implementation mechanisms should also seek to empower investors and other key stakeholders to obtain adequate disclosures.** |

**<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, and dialogue with the company, corporate social responsibility report)?**

| Comments |
| --- |
| **We would use the report and accounts, website, analysts' briefings, CSR reports and where appropriate dialogue with the company. We find that the CSR reports are sometimes of limited value in assessing the relationship between ESG factors and business/financial performance, and it is commonly stated that investors do not use them. Some important information is only disclosed in analysts' briefings or even in private meetings. It is important that information be disclosed in an effective, connected, and coherent manner, which facilitates analysis of** |

**key issues, rather than confusing shareholders and other users and obscuring the links between interrelated factors.**

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

| Comments |
| --- |
| **We believe that greater clarity and more effective guidance in the form of enhanced Government regulation will help make narrative reporting simpler, more consistent and more useful. Certainty in the principles, processes, requirements and reporting standards need not make the job of preparing or understanding reports more difficult or expensive. On the contrary, company reporting of the type we have advocated does not significantly increase the amount of information which companies need to collect. It simply implies drawing this information together in a form which is more systematic and useful, and enables users to be assured that all the relevant information is included.** |

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

| Comments |
| --- |
| **We believe that it would be helpful to provide a level of quantitative information alongside the narrative reporting. Consistency of presentation can be enhanced by providing guidance, for example on the presentation of Key Performance Indicators (KPIs) and explanation of their context and assumptions.**<br><br>**A recent report which provides useful practical advice on how to achieve better disclosure on key issues is: '*From Transparency to Performance: Industry-based Sustainability Reporting in Key Issues', Steve Lydenberg et al, Harvard University, June 2010.***<br>**This report, prepared by Arup in partnership with Harvard University, makes a strong case for mandatory reporting on environmental and social impacts. It also proposes that a standardised format for reporting, including on KPIs that will vary for specific industries, is vital.**<br>**The report proposes a framework for developing KPIs that relies on the principles of simplicity, materiality and transparency. It also proposes a** |

**method six-step method (building on broad disclosure frameworks like the Global Reporting Initiative (GRI) for identifying KPIs by industry sector, and tests the method on six sub-sectors.**
**The aim, which we support, is, "*the development of concise guidance on key material sustainability issues for each sector that should be disclosed by all companies at a minimum*".**

## 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 |
| --- |
| **We would support reinstating elements of the OFR. In particular we support the need for the information to be independently verified by the auditors.**<br><br>**We would also support the reintroduction of statutory reporting requirements to provide greater clarity on the content, principles, and process of narrative reporting.**<br><br>**The OFR also focuses on future development of the company, which we support. There should be an appropriate focus on strategic factors and risks, and on the way in which environmental and social factors affect them.** |

**<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 |
| --- |

**We strongly support the need for this information and believe it can be strengthened by the inclusion of more quantitative data, including scenarios. In particular we would wish to see more forward-looking information, for example on carbon costs and other risks associated with climate change, such as risks to water supply, and to explain their emissions reduction strategy**

**Please see above answers for details on usage of information and improvements required.**

**In addition, disclosure could be improved by providing clear guidance on both the principles and the process of preparing narrative reporting. This should include guidance (ideally industry sector-specific) on the types of factors that should be covered, on how to make decisions about which specific factors to include and how to make useful disclosures about them. In particular, disclosure could be improved by achieving a much clearer and more useful range of information on the way in which environmental and social issues relate to risks to the success of the business, now and into the future.**

**As discussed above, guidance on the reporting on financial and non-financial KPIs would be of significant value.**

**A key overarching principle to be considered is the way in which better regulation and more detailed rules and guidance can improve disclosures. In particular, disclosures at the moment are often inconsistent and incomplete, and yet simultaneously lengthy, repetitive and confusing. An improved and more precise regulatory framework can help disclosure to be, instead, more consistent, more concise, more comprehensive and more useful. This has the potential to make reporting work better for companies and their stakeholders alike.**

**<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 |
| --- |
| **We believe more guidance and examples would be useful. A good example of the type of guidance that might be helpful has been issued by the Carbon Disclosure Project, with worked examples and more specific advice on levels of disclosure.** |

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

| Comments |
| --- |
| **We support the introduction of a shareholder's advisory vote on the Business Review / OFR.** |

**<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 |
| --- |
| **There are some good examples of non-regulatory examples which aim in improve disclosure, for example the Carbon Disclosure Project and their linked initiative on water disclosure. However it is clear that voluntary disclosure does not achieve the levels of transparency needed and that a regulatory approach is required to deliver effective results in many aspects of narrative reporting, as detailed elsewhere in this response.** |

## 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?**

| Comments |
| --- |
| **No comment** |

## 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 |
| --- |
| **No comment** |