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:**

**Organisation (if applicable): Environment Agency (Active Pension Fund)**

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**Please tick the box from the following list of options that best describes you:**

| | |
|---|---|
| | **Quoted company** |
| | **Other company** |
| x | **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 |
| --- |
| **Not in all cases. It is important that all companies recognise the impact they have on the environment, and the risks and opportunities this represents. It is only through clear disclosure of this information in their statutory annual report and accounts that investors and the wider stakeholder community can make fully informed decisions.**<br><br>**The high level results of our research into the environmental disclosures that may help inform this consultation are summarised below;**<br><br>- **67% of FTSE All-Share listed companies disclosing quantified information on one or more of the core environmental key performance indicators of carbon, water or waste in 2009-2010, an increase of 25% on our 2006-2007 survey**<br>- **however, only 28% are disclosing this information in accordance with Government guidance,**<br>- **focusing specifically on one of the most current issues, that of green house gas emissions and energy use, only 22% of companies in the FTSE All-Share index made a quantitative disclosure on this in line with Government guidance.** |

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

| Comments |
| --- |
| **Environmental impacts represent increasing financially material risks for many companies. Whilst there may be additional financial costs associated with measuring and reporting this information, evidence from both our own and others experiences indicates that the costs of active management and mitigation can be more than off-set by a reduction in the costs and risks associated with the impacts.** |

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

| Comments |
| --- |
| **No, not in all areas.**<br><br>**From our pension funds' experience, issues of concern to investors from an environmental, social and governance (ESG) perspective are often said to be discussed at board meetings and conveyed to investors via investor relations or at engagement meetings. However these issues and discussions are rarely then referred to in annual reports and accounts, despite being financially material investor concerns.** |

**<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 |
| --- |
| **No, too many companies are still not disclosing quantitative information on financially material environmental risks and opportunities.**<br><br>**As previously described environmental impacts are becoming increasingly financially material. As an example, the recently introduced CRC Energy Efficiency scheme places a financial cost on the carbon emissions associated with energy use for around 3,500 companies in the UK, this is in addition to those already within the scope of the EU emissions trading scheme.**<br><br>**Whilst performance against this will be made public (via published league tables), other environmental impacts, including the cost of waste disposal and water usage are not, and represent increasing financial and reputational risks that shareholders and the wider stakeholder community need to be fully informed of. Including this information in a company's statutory annual report and accounts will provide shareholders and other stakeholders with a clear, single source of this information on which to make decisions.** |

**<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. We undertake an annual assessment of all our equity holdings which identify those companies with the highest environmental impact. This is cross-referenced against the level of disclosures made. Where it is inadequate we use our pension fund managers to engage with the company in question on environmental issues to encourage them to consider their financial materiality.**

**<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 |
| --- |
| **The financial analysis we undertake of company annual reports focuses on the annual report and accounts. Whilst we welcome additional dialogue that other reports and briefings provide, it is important that key performance indicators, including environmental impacts, are published in statutory annual report and accounts.** |

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

| Comments |
| --- |
| **No. As investors we feel the information with which to gain an assessment of the company and key business risks is often inadequate. We feel any further simplification could reduce this further.** |

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

| Comments |
| --- |
| **Yes, in order to ensure consistency and comparability we feel that companies should report against the latest Department for Environment Food and Rural Affairs (Defra) environmental KPIs.** |

## 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, we believe there would be value in reinstating elements of the OFR.**<br><br>**In previous consultations and dialogue we have supported the introduction of a mandatory OFR. We support the spirit of 'disclose or explain' on environmental impacts that was part of the original OFR regulation.**<br><br>**We believe that all directors should have a statutory 'duty of care' toward the environment as they do for employees and customers. This should include the publication of disclosures that present past trends and also be forward-looking, supported by quantitative data.**<br><br>**We would welcome the reinstatement of the original audit requirement of the OFR. This would ensure that there is an independent assessment of the judgement of information that has been included under the "extent necessary" criteria. This should include consistency checks with other information within the report and published elsewhere, e.g. peer group performance on incidents, accidents or prosecutions.**<br><br>**Whilst we appreciate the concerns of the audit profession with regard to auditing sections of narrative reporting, we believe that this is critical in providing the rigour and assurance necessary, particularly with regard to environmental impacts. Working with the Institute of Chartered Accountants we produced guidance to support the work of auditors in this area.** |

**<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 |
| --- |
| **Yes the information is useful, we use it to inform the management of our pension fund. However, we still believe that too few companies are disclosing information on materially financial environmental risks and opportunities.**<br><br>**Please see our response to Q1 showing the current levels of disclosure on environmental matters made by companies listed on the FTSE All-Share index and our answer to Q9 with regard to audit and assurance.** |

**<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 |
| --- |
| **Yes, it would be of value to sign-post companies to relevant guidance on reporting environmental impacts. We welcome the work currently being undertaken by the Department for Food, Environment & Rural Affairs to update their existing guidance on environmental key performance indicators for business. We would welcome wider promotion and dissemination of both the existing guidance and following the update to help companies identify their significant environmental impacts.** |

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

| Comments |
| --- |
| **Yes we believe this would be useful. It would provide shareholders and analysts with the opportunity to question the board on the principal risks and opportunities highlighted in the business review or lack of, including those associated with ESG 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 |
| --- |
| **Whilst we welcome the Government's voluntary reporting guidance, our analysis of the environmental disclosures of the FTSE All-Share shows that only 28% of companies are following current guidance. So we question if non-regulatory solutions provide a level playing field of key information for investors.**<br><br>**We welcome voluntary initiatives that support narrative reporting on environmental issues for example through the use of environmental management systems or statements indicating compliance with legislative requirements.** |

## 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 |
| --- |
| **We think that Directors pay should also be linked to the delivery of quantified environmental targets.** |

## 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 |
| --- |
| **We estimate it costs us <£10k to produce our own business review in our annual report and accounts.** |