Investment Management Association

19 October 2010

Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
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Dear Ms Leavens

**The Future of Narrative Reporting**

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that in 2009 IMA members managed holdings amounting to 40% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the standards governing how such companies prepare their accounts as users of the information. Thus we welcome the Department for Business Innovation & Skills (BIS) undertaking this consultation and giving us the opportunity to comment.

Reporting has become increasingly complex and the Business Review, in reporting both financial and non-financial information, has a vital role to play in helping shareholders understand a company and its forward strategies. The audited financial accounts on their own do not provide adequate qualitative and forward-looking information to enable shareholders to make an informed assessment of a company and a well drafted Business Review should explain to them the possible risks to, and issues that will impact, a company's business and how it delivers value. However, whilst we support the Government seeking to drive up the quality and improve the coherence of narrative reporting, we do not consider there is a need for further regulation in this area for the reasons set out below.

- It is not clear what problem the current consultation is necessarily seeking to address. Although the statutory Operating and Financial Review (OFR) was repealed in 2005, it was soon substantially reinstated in the form of the Business Review in the Companies Act 2006. The Accounting Standards Board's Reporting

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Standard on the OFR has remained as voluntary guidance and the IASB also has proposals for guidance entitled Management Commentary. In addition, the most recent UK Corporate Governance Code, which has replaced the UK's Combined Code, has provisions for boards to report on the company's business model. We consider this framework is still relatively new and should be given more time to bed down before it is reviewed.

- Moreover, the framework has delivered significant improvements in recent years to the quality of narrative reports, and more recently the remit of the Financial Reporting Review Panel (FRRP) was extended to include these disclosures in its review of accounts. We believe the detail of any narrative reporting is best developed by market practitioners and discussed between the preparers and users of the information, the shareholders. Revising disclosure requirements or making them more prescriptive could engender a mechanistic, box ticking approach aimed at ensuring compliance as opposed to allowing companies to produce meaningful reports tailored to their own circumstances.

- The main area where there were differences between the requirements relating to the OFR and the Buisness Review was that under the former the auditors of quoted companies were required to report both whether the information in the OFR is consistent with the audited accounts, and whether there is any information in the OFR that is inconsistent with anything that came to their attention during the audit. The Companies Act 2006 only required auditors to state whether in their opinion the information in the directors' report is consistent with the audited accounts. The current consultation is silent on this matter and investors views are divided in that some would welcome additional audit assurance in that it could enhance the reliability of the information whereas others fear that requiring narrative reporting to be audited could result in boilerplate reporting and dumb down the information disclosed.

- Investors would, however, welcome a more cohesive approach to corporate reporting in that for example, strategies and risk management practices can be disclosed in the Chief Executive's statement, the financial review, the Directors' Report and the notes to the financial statements. In addition, the recent UK Corporate Governance Code, which has replaced the UK's Combined Code, has provisions for boards to report on the company's business model. In the front of the accounts some of the disclosures are 'audited' and it is left to the reader to ascertain where the audited disclosures end and the unaudited begin in pages of narrative

I set out in the attached our comments on the detailed questions raised. Please contact me if you would like clarification on any of the points in this letter or the attached, or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall
Director, Corporate Governance and Reporting

**ANNEX**

**IMA'S COMMENTS ON THE DETAILED QUESTIONS RAISED**

IMA's responses to the questions raised are outlined below.

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

Within the current reporting framework, there have been significant improvements in recent years to the quality of narrative reports, and more recently the remit of the Financial Reporting Review Panel (FRRP) was extended to include these disclosures in its review of company accounts. We believe the detail of any narrative reporting is best developed by market practitioners and discussed between the preparers and users of the information, the shareholders. Revising disclosure requirements or making them more prescriptive could engender a mechanistic, box ticking approach aimed at ensuring compliance as opposed to allowing companies to produce meaningful reports tailored to their own circumstances. The existing framework is still relatively new and should be given more time to bed down.

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

One of the key constraints on companies providing useful information on these issues is that the disclosures are often in different sections of the annual report. For example, strategies and risk management practices can be disclosed in the Chief Executive's statement, the financial review, the Directors' Report and the notes to the financial statements. In addition, the recent UK Corporate Governance Code, which has replaced the UK's Combined Code, has provisions for boards to report on the company's business model. In the front of the document some of the disclosures are 'audited' and it is left to the reader to ascertain where the audited disclosures end and the unaudited begin in pages of narrative. A more cohesive approach to reporting and clarity as regards the matters that are subject to audit assurance would help.

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

We are not aware of the detail of the discussion in board meetings and are unable to comment on this aspect. We consider narrative reporting should reflect the director's assessment of the strategy of the business and the main risks to that strategy. This does not necessarily follow the agenda at board meetings.

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

Investors do not necessarily use accounts to make decisions on buying, selling or holding shares or to press directors on key issues in that they are more likely to use preliminary announcements, external analysis, information from their dialogue with companies, market prices, perceived outlook, etc when doing so. Accounts are prepared primarily for investors, the holders of ordinary shares, as the providers of the risk capital and bearers of residual risk, but they are essentially a confirmatory document published some time after the events to which they relate. Thus they facilitate investors' assessment of management's stewardship of the resources under its control, and the accountability of directors for their

past actions. They are vital for the operation of the markets in that markets need to have confidence in the information reported, especially in the current economic climate.

***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 main requirements for companies to provide "material information" to the markets are enshrined in the listing rules in that listed companies have an obligation to report to the market "information that is likely to have a significant effect on the [share] price". Undoubtedly, investors have a role in encouraging better reporting in the accounts and may challenge disclosures if they do not consider them sufficient but they are not consulted on their preparation in that, as noted above, the accounts are published some time after the events to which they relate and are a confirmatory document that facilitate an assessment of management's stewardship of the resources under its control, and the accountability of directors for their past actions.

***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)?***

As noted under question 4, investors use a variety of sources of information in making their investment decisions, including websites, analysts' briefings, market prices and dialogue with the company.

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

IMA supports such requirements being maintained as high level principles and that the existing framework, which is still relatively new, should be given more time to bed down before requirements are reviewed.

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

See answer to question 2.

**Business Review**

***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?***

Although the statutory Operating and Financial Review (OFR) was repealed in 2005, it was soon substantially reinstated in the form of the Business Review in the Companies Act 2006. The Accounting Standards Board's Reporting Standard on the OFR has remained as voluntary guidance and the IASB also has proposals for guidance entitled Management Commentary. We consider these should remain as guidance and provide a basic framework for directors to apply flexibly in structuring their Business Review to meet the particular circumstances of the business. This flexibility is important to avoid mechanical reporting and narrative that comprises a series of bland standard phrases and caveats as opposed to useful forward-looking information that reflect the unique nature of the business.

**IMA'S COMMENTS ON THE DETAILED QUESTIONS RAISED**

The main area where there were differences between the requirements relating to the OFR and the Buisness Review was that under the former the auditors of quoted companies were required to report both whether the information in the OFR is consistent with the audited accounts, and whether there is any information in the OFR that is inconsistent with anything that came to their attention during the audit. The Companies Act 2006 only required auditors to state whether in their opinion the information in the directors' report is consistent with the audited accounts. The current consultation is silent on this matter and investors views are divided in that some would welcome additional audit assurance in that it could enhance the reliability of the information whereas others fear that requiring narrative reporting to be audited could result in boilerplate reporting and dumb down the information disclosed.

***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?***

This information is useful in that reporting has become increasingly complex and the Business Review, in reporting both financial and non-financial information, has a vital role to play in helping investors understand a company and its forward strategies. The audited financial accounts on their own do not provide adequate qualitative and forward-looking information to enable shareholders make an informed assessment of a company and a well drafted Business Review, in accordance with the above requirements, should explain to them the possible risks to, and issues that will impact, a company's business and how it will deliver value.

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

There have been significant improvements in recent years to the quality of narrative reports and as the existing framework is still relatively new, we consider it should be given time to bed down before requirements in this area are reviewed.

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

We do not believe there are any key issues that are missing.

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

No. Please see answer to question 9.

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

Shareholders already have a vote on the annual report and accounts, and we do not see any added benefit in a future advisory vote on the Buisness Review in that:

- it is not clear what an advisory vote against the Review would mean in practice;
- a vote would not necessarily improve the quality of reporting - indeed it could potentially encourage more boilerplate reporting which would be a retrograde step; and
- we question what such a measure would achieve in that investors already engage with companies and do not necessarily have to vote on a matter before they do so.

In addition, the recent review of the UK's Corporate Governance Code has already lengthened proceedings at AGMs in that it recommends that each director of a FTSE 350 company should stand for re-election each year providing a means to hold each individual director, and the board collectively, to account at each AGM.

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

As noted in question 9, we do not see any value in upgrading existing guidance in that the existing framework, which is still relatively new, should be given time to bed down before it is reviewed. However, measures that publicise excellence in business reports are welcome in that they encourage best practice to develop and there may be merit in such measures being used to highlight reports that fall short of what is needed and which should improve.

**Directors' Remuneration Report**

***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?***

***If not, please explain including any views on how this might be improved***

Current requirements ensure there are full and comprehensive disclosures, albeit that the complexity of many remuneration schemes results in complex and lengthy disclosures. We consider it would be helpful if requirements in this area were reviewed to simplify them and consideration given to the possibility of disclosing some of the information on a company's website.

***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 outside IMA's remit.