CAFOD Submission to the Department for Business, Innovation & Skills on

The Future of Narrative Reporting

BIS Consultation response form: The Future of Narrative Reporting

A copy of the consultation is available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation to 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)

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
The Coalition government has emphasised the role of informed shareholder engagement in supporting accountability and good corporate governance. Existing requirements under the Companies Act 2006 for directors to report on environmental and social issues are intended to ensure investors are aware of risks and proposed mitigation strategies and thus able to actively engage with companies and drive up performance in these important areas. However currently many companies are not providing sufficient useful or relevant information within their narrative reporting. Research by the CORE coalition published in "The Reporting on Non-Financial Information in Annual Reports by the FTSE 100" provides evidence that even amongst the largest publicly-listed companies there is inadequate reporting on non-financial issues in Business Reviews. Companies also failed to highlight omissions in their Business Review when specified key factors had not been covered. This would seem to indicate a lack of compliance with the existing requirements of the Companies Act. Analysis of reports show that companies often cover social and environmental impacts and risks with very general statements, rather than identifying specific concerns relevant to the business and showing how that these issues has been incorporated into a forward-looking strategy. In relation to company reporting of principal risks and opportunities, performance to date in the UK shows significant omissions in narrative reporting of human rights-related risks. The issue of human rights-related risk is not new, however, it is not being adequately addressed by company directors under the current reporting regime. Since his mandate was first established in 2005, John Ruggie, UN Special Representative on Business and Human Rights, has stressed on a number of occasions that human rights-related risks can have significant costs for companies and their shareholders, as well as the impact on affected communities. In his report to the Human Rights Council of April 2010 John Ruggie highlighted "growing number of lawsuits against companies on human rights grounds, coupled with emerging evidence of significant costs triggered by

human rights-based grievances."

Here CAFOD supports the Special Representative's conclusion that governments need to use company law more effectively and that:

"Regulators should clarify that human rights impacts may be "material" and indicate when they should be disclosed under current financial reporting requirements."

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

Comments

In our view, these omissions are not primarily due to constraints on companies which actively prevent them from providing useful and relevant information. Rather, for a variety of reasons, balanced and comprehensive non-financial reporting is not being prioritised within companies.

Reasons for patchy and incomplete responses to the 2006 Act include:

- Lack of clarity in the law and insufficient guidance as to what adequate reporting requires. Although this does not necessarily have to be a constraint for a business which takes a pro-active approach to its legal reporting obligations, there might be a 'how to' question for other companies.
- Lack of comparability between companies' reporting means there is little incentive to provide accurate information which goes beyond PR.
- Unwillingness to provide a more in-depth level of information if competitors are not providing it.
- Perceived lack of interest from investors. If investors are not aware of potential social, environmental and human rights-related risks and these issues are absent from the Business Review, some shareholders may be less likely to engage with the business on these areas.
- Lack of enforcement if companies do not provide robust information on these issues. The Financial Reporting Review Panel (FRRP) has stated that it viewed the legal compliance of a number of narrative reports to be doubtful but does not appear to have taken enforcement action against any company.

In CAFOD's view the provision of a statutory reporting standard with clear guidance and an effective mechanism for enforcement in cases of non-compliance would help to address all the points identified above.

<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
Shareholders represent a very diverse group and the extent to which they press directors on key issues relating to strategy and risk varies considerably. Because of our strong partner organisations in the developing world and experience monitoring certain sectors such as mining and electronics, engaged investors have contacted CAFOD in order to gain a more detailed understanding of the social, human rights and environmental impacts attached to a particular company's operations. This kind of information is highly relevant to their business decisions but is not available from the company through existing non-financial reporting. In our experience the general nature of information provided under the existing reporting regime contributes to a climate of piecemeal engagement by shareholders. Active engagement depends very much on particular investors with specific interests who already have a sufficiently high level of knowledge to take the initiative in following up with the company. A culture of general statements or omissions of key factors without explaining of underlying assumptions encourages a reactive approach from less well-informed shareholders. For example, they may only begin to engage with the company once an environmental disaster has occurred or significant labour rights abuses have been uncovered. Relevant, robust and comparable data would help more investors to take a pro-active approach, focussed on prevention through identifying risks in advance.

<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
As cited in the previous answer, more engaged investors will attempt to gather evidence from other sources, e.g. NGOs, local experts and analysts, as well as engaging in face to face meetings with the companies involved. Shareholder resolution processes are also possible, although they are much more time and resource intensive in the UK than, for example, in the United States. In CAFOD's view a clearer mandated standard requiring full disclosure of environmental, social and human rights impacts and risks would help here. This would enable a much wider range of shareholders to access material information, as well as being of value to a broader range of stakeholders who are directed impacted by a company's activities. It is also important that the Government enforces legal reporting requirements adequately rather than leaving it purely to shareholders to challenge companies. As mentioned above the current system results in uneven engagement which is overly dependent on a small number of investors. Experience to date shows that a stronger regulator is needed in order to ensure that all companies meet their legal obligations and information about risks is available to the market as a whole.

<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
While they might provide an initial starting point, CAFOD would like to stress the qualitative difference between a financial report and a company CSR or sustainability report. As a development NGO we are frequently sent CSR reports from companies operating in a range of sectors, and asked for our feedback as an informed stakeholder. Nevertheless they are not regarded by civil society or indeed investors as particularly credible sources of data about a company – certainly not decision useful. A company can select what to include and what to omit, often it is very difficult to judge whether the information presented is inaccurate or biased and there are no repercussions if this is the case. This means that in practice such

reports are frequently more of a PR tool and not helpful for robust comparisons. The volume of information about high profile CSR projects can sometimes make it difficult to find salient points about risks linked to core business activities.

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

Comments
A greater priority at this time seems to be increasing the degree of confidence in the information which companies do provide and addressing issues of comparability. In our view, a statutory reporting standard and clear guidance could simplify the process for companies by bringing greater clarity to reporting requirements.

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

Comments
Concise reports with a format that enables companies' performance to be compared would be useful. It would make sense to consider how to link reporting with international standards already under discussion, e.g. corporate due diligence in relation to human rights-related risk.

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
There would be value in reinstating some elements of the OFR, in particular: • the enhanced audit – this would increase confidence in the data provided • an articulation of long-term risks and developments – this should be included to support a more long term approach to investment and corporate accountability • a robust framework for reporting on social and environmental issues to support comparability. A statutory reporting standard is essential in order to improve the quality of reporting.

<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
Human rights need to be explicitly mentioned. At the moment there seems to be an assumption that this issue is covered by the general term "social and community matters" however as so few companies are actually reporting on human rights impacts and risks, it is important that this category is spelt out explicitly in reporting requirements.

<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
A statutory reporting standard should be introduced, with accompanying guidance. This should be linked to non-financial Key Performance Indicators in order to ensure that reporting is useful and relevant, and that there is comparability between year-on-year performance.

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

Comments
This might be helpful tool for shareholders to highlight concerns which they feel have not been adequately addressed by the company.

<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
Non-regulatory solutions such as awards or league tables will not adequately address the primary challenge of laggard companies. Therefore this approach does not seem to be the best focus for resources. Better guidance will help to increase quality of reporting if it is coupled with a statutory reporting standard and an effective enforcement mechanism.

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
While there might be some initial costs involved in changing current approaches to reporting to meet clearer requirements, CAFOD's view is that these would be outweighed by long term financial benefits to the company. Clearer reporting requirements and effective enforcement would ensure that analysis of environmental, social and human rights impacts and risks was integrated into decision-making in relation to the core operations of the business. Relevant and useful information on risks would be available to the market not just to a small number of investors. A clearer standard might in fact reduce the costs associated with reporting because it would enable businesses to focus on the most salient issues and risks from the company's core activities.