CBI
THE VOICE OF BUSINESS

DEPARTMENT FOR BUSINESS INNOVATION AND SKILLS

THE FUTURE OF NARRATIVE REPORTING

CBI RESPONSE **October 2010**

I INTRODUCTION AND SUMMARY

1. The Confederation of British Industry (CBI) is pleased to respond to the BIS consultation.

2. There have been lots of initiatives concerning narrative reporting in recent years. Although much is made of the repeal of the statutory Operating and Financial Review (OFR) in 2005, this was soon substantially reinstated in the form of the Business Review in the Companies Act 2006. In addition, the Reporting Standard developed by the Accounting Standards Board in support of the statutory OFR, has remained in place as voluntary guidance. Other initiatives include the IASB proposals for Management Commentary.

3. Narrative reporting is also underpinned by UK Corporate Governance Code, where this has been good practice right from the outset of the first Cadbury Code of corporate governance. In the most recent UK Corporate Governance Code 2010, the importance of narrative reporting has been further underpinned with new recommendations for boards to report on their company's business model.

4. In addition to regulatory bodies, various organizations and stakeholders have produced their own guidance and suggestions in particular areas or topics of narrative reporting, such as environmental reporting.

5. Accordingly, narrative reporting has received much attention in recent years by a wide range of bodies, and on the face of it, there are no obvious gaps or weaknesses where further statutory intervention is required or justified. That does not mean that there is not scope for individual companies to improve their reporting, but pressure on them for improvement is best coming from their shareholders, to whom the annual report is addressed.

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6. We also mention a recent Deloitte / ACCA survey on narrative reporting. 74% of respondents wanted more discretion and less regulation on narrative reporting. Even our investor members acknowledge that there is a need for stability in the reporting framework. The Survey also found that the general level of disclosure of the statutory Business Review requirements was very good.

7. Therefore, if any change and improvement is sought, this is best in the form of guidance, such as any appropriate updating of the ASB Reporting Statement.

8. CBI members also acknowledge the work going on in providing guidance on the reporting of greenhouse gas emissions in response to Climate Change and the requirements of the Climate Change Act 2008. Whilst there is at present a lack of consistency and comparability in how companies report their greenhouse gas emissions, the Government should adopt a proportionate approach. Any carbon reporting mechanism must avoid policy overlap and be based on a methodology that is internationally recognized.

9. We also acknowledge the contribution made by Awards for Annual Reports, which helps to drive quality, best practice and improvements in reporting.

10. We comment further overleaf in response to the specific consultation questions.

II RESPONSES TO CONSULTATION QUESTIONS

Value of narrative reporting

Q.1. Are company directors providing useful and relevant information on the company's forward-looking strategy and risks and uncertainties ?

Subject to any specific legal requirements, such as the Business Review, companies and boards must generally be free to frame their narrative reports in the way they judge most appropriate.

At the time of the former statutory OFR, CBI members were very concerned at the lack of a safe harbour, i.e. some protection from legal liability, particularly if it involved disclosure of forward-looking information. CBI members were pleased that Section 463 Companies Act 2006 was enacted to mitigate these concerns. Subsequently following the Davies Report, HM Treasury instigated adoption by Parliament of additional safe harbour measures in other relevant UK Regulations concerned with the financial markets, which the CBI strongly supported.

Disclosure of risks and uncertainties is also required by the Business Review, and in compliance with EU Directive requirements, such as the EU Accounts Modernisation Directive and the EU Transparency Directive. Appropriate sanctions are available, if necessary, if any company fails to meet its legal obligations, and we trust that most companies do make the necessary disclosures in most material respects.

Since the provisions are relatively new, it will inevitably be the case that there is an element of some companies "feeling their way" in determining the style, nature and extent of the disclosures they make, including making comparisons with other companies, as good practice in this area develops.

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

See response to Q.1.

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

We would have thought so.

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

We would have thought so.

Q.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 ?

Primarily for investors and their representative bodies to comment on, but we would expect investors who have queries or concerns to do so as part of the engagement process.

Q.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) ?

For Investors and their representative bodies to comment.

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

There may be scope to draw together the regulatory requirements of the various bodies setting narrative reporting requirements, to make it easier for companies to know and to help them ensure compliance with their various obligations.

BIS might also review the various disclosure obligations in relation to the Directors' Report, and whether the requirements could be better structured and presented, since many of the requirements have grown piece-meal over the years to address various Government policy objectives of the day.

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

See response to Q.7.

Business Review

Q.9. Looking at an OFR 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?

We are not convinced that it is necessary to upgrade the existing ASB Reporting Statement, which is intended as good practice, to a formal Reporting Standard. This would seem only to add to the volume of existing regulatory requirements on narrative reporting, when what is needed is regularly updated guidance.

Accordingly some updating of the ASB Reporting Statement, as a good practice guidance document, may now be timely. However, if it became a mandatory Reporting Standard, it would just encourage boiler plate reporting for probably little additional benefit, whereas what should be encouraged is for companies and boards to report in the way they consider most appropriate and useful for their shareholders and stakeholders, and according to their company's particular situation, circumstances, objectives and priorities.

The Statutory OFR also placed some enhanced responsibilities on auditors. Specifically in respect of quoted companies, the auditors must state in their report both whether in their opinion the information given in the OFR is consistent with the audited accounts, and whether there is any information given in the OFR which is inconsistent with anything that came to their attention when carrying out the audit.

We strongly support the simplified provisions now contained in Section 496 Companies Act 2006 that the auditors state in their report whether in their opinion the information given in the directors' report is consistent with the audited accounts.

Audit firms do carry out their obligations in this area and do raise any matters with the company's board and management in the final stages of settling the form and content of the annual report and accounts.

We therefore see no need for additional regulatory intervention in this area.

Q.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**

Is this information useful to you? How do you use it?
Could disclosure be improved? If so, how?
Are there key issues which are missing? If so, please explain?

See our earlier comments.

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

See our earlier comments, such as the ASB Reporting Statement, which might the best medium for good practice guidance.

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

No. There is already a shareholder vote on the Annual Report and Accounts, and CBI members do not see a role for additional advisory votes.

Moreover for FTSE 350 companies, proceedings and voting at the AGM are already in the process of being significantly lengthened by the Governance Code recommendation for the annual election of every director of a FTSE 350 company. This therefore provides a mechanism to hold the performance of each individual director, and the board collectively, of such companies open to review and challenge at each AGM.

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

See our earlier comments.

We also support the contribution that Awards for company reports can play in encouraging the development of good, and often best, practice.

Directors' Remuneration Report

Q.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;**
- **the 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.

The CBI supports transparency around directors' remuneration, including the composition of pay and the link between pay and performance, as reflected in the existing statutory Remuneration Regulations.

These Regulations also include a requirement for listed companies to make a statement in the board's remuneration report on how pay and employment conditions of the workforce were taken into account when determining directors' remuneration for the relevant financial year.

However, we would caution that the UK should not set remuneration or taxation requirements that would place the UK at a competitive disadvantage internationally, either in causing talent to leave the UK who would otherwise be content to remain, or in failing to attract overseas personnel to the UK with the skills necessary to further UK growth and employment opportunities.

We would also caution against a league table approach to disclosure, which would have the unintended consequence of putting upward pressure on pay as individuals compete to be in the upper echelons of pay reward.

We believe that the existing Remuneration Regulations are very comprehensive in achieving the Government's disclosure objectives.

Potential Costs

Q.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.