The future of narrative reporting: consulting on a new reporting framework. Response form

Please send your response by: 25 Nov 2011

About You	
Name: Christine Berry	Organisation (if applicable): FairPensions
Email: christine.berry@fairpensions.org.uk	Address: Trowbray House, 108 Weston St, London SE1 3QB

I am responding on behalf of (please tick)	
	Quoted company
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
x	**Non governmental organisation (NGO)**
	Trade Union
	Lawyer or accountant
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Questions

Question 1

Do you agree in principle with restructuring the current reporting framework into a Strategic Report and an Annual Directors' Statement?

<table>
<tr><th>Yes</th><th>No</th></tr>
<tr><td>x</td><td></td></tr>
<tr><th colspan="2">Comments</th></tr>
<tr><td colspan="2">
We support the aim of ensuring that companies provide a clear, concise overview of the business which strips out much of the clutter which currently lengthens Annual Reports. However, we are concerned that the objective of simplification seems to have replaced the original purpose of this process, ie. to improve the quality of social and environmental reporting. Undue complexity is not the only factor behind inadequate reporting. Moreover, our experience suggests that increasing complexity may itself not always be driven by the regulatory framework governing reporting, but rather by company priorities or even by a desire to obfuscate. As such, we are sceptical of whether this change in the structure of the reporting framework will, without more, deliver its objective of producing simpler, clearer reports.
We therefore have reservations about the extent to which this core proposal will improve company reporting. We do not believe that it addresses the key problem identified in the earlier consultation – indeed, the problem which the original coalition commitment sought to address – that narrative reports are insufficiently balanced and forward-looking, particularly with regards to social and environmental risks. The proposed Strategic Report effectively replicates the requirements of the business review. The problem, however, is that these requirements are at present not being substantively met. It is unclear to us why the new framework should be expected to resolve this problem without further action – for example on:

Verification (please see our response to Question 29)
Enforcement (please see our response to Question 35)
Better and firmer guidance (please see our response to Questions 33 & 34)

We are also disappointed that the government has not taken this opportunity to explore and endorse the concept of integrated reporting.
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Question 2

Do you agree that the Strategic Report should include information on:

- company performance
- principal risks and uncertainties
- key performance indicators
- key financial information (similar to that currently required for the Summary Financial Statements)

and for quoted companies should include:

- strategy
- business model
- environmental and social information,
- key information on executive remuneration and its link to performance?

Yes	No
x	
Comments	
Yes, we agree. However, as indicated in our response to Question 1, we note that these requirements are essentially unchanged from those in the business review. We would therefore ask what further steps the government proposes to take to ensure that the new framework delivers better quality reporting than the business review currently does. Without more, we do not believe that this proposal substantively meets the coalition commitment to "ensure that directors' social and environmental duties have to be covered in company reporting".	

Question 3

Do you agree that the proposed Strategic Report should replace the Summary Financial Statements?

Yes	No
Comments	
No comment.	

Question 4

Do you agree that the Strategic Report should be signed off by each director individually?

Yes	No

Comments
No comment.

Question 5

Do you agree that the Annual Directors' Statement for quoted companies should include:

- disclosures required, regardless of materiality, by the Companies Act, the Listing Rules etc.
- the Corporate Governance Statement
- the Directors Remuneration Report
- financial information (for example, post-balance sheet events etc)
- information provided voluntarily by companies (for example, additional environmental and social disclosures)?

Yes	No

Comments
There appears to be some confusion over the content and purpose of the Annual Directors' Statement. We support the aim stated in the consultation paper to supplement a concise strategic report with detailed, comparable information which analysts can use to make finer judgements about specific issues. However, this differs from the impression given on page 19 of the consultation paper that the Strategic Report is for material issues and the Annual Directors' Statement is a repository for 'everything else'. Detailed information is not the same thing as information which is not material: for example, we would expect the ADS to include more detailed information about material issues covered in the Strategic Report. If the Strategic Report is expected to include *all* information material to the business as a whole, it seems likely that it will either fail in its objective of being short and concise, or that reporting of such information will be radically incomplete. Moreover, making this distinction too rigidly risks implying that only the Strategic Report is of relevance to investors, while the information contained in the ADS is not

material and can be safely ignored.

We are also concerned at the possibility that environmental and social issues will simply be ‘dumped’ in the ADS. We support the basic principle of the new framework whereby, ideally, material environmental and social risks would be covered in the Strategic Report while the type of information currently disclosed in CSR reports would be included in the ADS. However, we are not confident that this will be the outcome in practice. There is a real risk that existing environmental and social reporting – which the previous consultation exposed as inadequate and insufficiently material – will simply be shifted into the ADS, without any improvement to the disclosure of material environmental and social issues through the Strategic Report. The current framing of the Annual Directors' Statement risks perpetuating the perception of social and environmental reporting as an optional extra with no relevance to the company's core business - for example, through the reference to “information provided voluntarily by companies (for example, additional environmental and social disclosures)”.

Question 6

Do you agree that companies should be able to include material in the Annual Directors’ Report (for example information on policies and procedures) by cross reference to information published elsewhere (for example on the company’s website)?

Yes	No
x	

Comments

Yes in principle, but it is important that policies and procedures remain live documents and not one-off disclosures which are subsequently forgotten about. Consideration should be given where appropriate to reporting on the *implementation* of policies, rather than simply a statement that the policy has been reviewed.

We note that the impact assessment makes no attempt to quantify the savings that might be achieved by allowing companies to include information by cross-reference.

Question 7

If companies are able to include material in the Annual Directors’ Statement by cross reference (question 6), do you agree that they should make an annual statement confirming it has reviewed that information and noting any significant changes?

Yes	No
x	

Comments
Please see our response to Question 6.

Question 8

Do you agree that the Annual Directors' Statement should be presented online with a hard copy available to shareholders only on request?

Yes	No
x	

Comments
We agree. We are surprised that no attempt has been made in the impact assessment to quantify the savings attached to this proposal in the form of lower printing and postage costs. More generally, we are concerned that the absence of any quantification of the benefits of the government's proposals leaves little scope to implement the measures which would substantively meet the coalition commitment to 'reinstate an Operating and Financial Review to ensure that directors' social and environmental duties have to be covered in company reporting'. As the government itself has previously indicated, these savings could be considerable. This should create scope to, for example, improve the verification regime for narrative reports (see our response to Question 29) as part of a package of measures which are cost neutral for business.

Question 9

Do you support removal of the disclosure requirements, arising from company law, identified in Table 1? If not, please provide evidence of their relevance to users, including why disclosure in the Annual Directors' Statement is necessary for meeting their needs.

Are there any other disclosure requirements arising from company law that in your view could be simplified or removed?

Yes	No

Comments

No comment.

Question 10

Are there areas where the Listing Rules, IFRS, company law and the Corporate Governance Code are inconsistent or require similar disclosures? If so, how could these best be resolved?

Yes	No
Comments	
No comment.	

Question 11

Should quoted companies be explicitly required to include information about human rights (to the extent necessary for an understanding of the development, performance or position of the company's business) in the Strategic Report?

Yes	No
x	
Comments	
Yes. We support improved company reporting of human rights impacts in line with the Ruggie Principles. We believe that this is already implicit in the business review's requirement to report on social and environmental impacts, in the context of directors' duty under section 172 of the Companies Act to have regard to 'the impact of the company's operations on the community and the environment'. As such, this requirement should not amount to an additional regulatory burden. However, explicit reference would nonetheless be helpful to encourage companies to report on these impacts and clarify that they fall within the scope of reporting requirements.	

Question 12

Do you support the Government's proposals for company disclosure of the proportion of women on boards and in companies as a whole?

Yes	No
x	

Comments
Yes. However, we would caution against the danger of the new framework becoming a jumble of requirements relating to issues that happen to be topical during the consultation period (eg. gender diversity, human rights) rather than, as was intended, a coherent framework rebuilt from first principles. To be clear, we do not disagree that gender diversity and human rights are important issues on which information should be available. Rather, we would urge the government to adopt a broader and more considered approach, considering the key areas and indicators which a good reporting framework should cover (for instance, water usage or biodiversity impacts).

Question 13

Do you agree that the current UK liability regime does not discourage companies from making meaningful forward looking statements? If you believe that there are issues with the current regime, do these relate to:

- companies listing in the US as well as in the UK,
- companies contemplating a prospectus,
- common misunderstandings about the UK liability regimes.
- other concerns?

Yes	No
x	

Comments
We agree that the current UK liability regime does not impede meaningful reporting. We recognise the difficulties faced by multi-national corporations which may be subject to liability in other jurisdictions, such as the US, and we are aware that this danger has sometimes led companies to avoid reporting on certain material issues altogether. Nonetheless, we are unconvinced by the argument that liability concerns are a key factor in the proliferation of inadequate reports. As detailed in our previous consultation response, in many cases reporting is inadequate not because companies make no statement at all on a given issue (as would be expected if liability concerns were the problem) but rather because the statements they do make present an inappropriately rosy picture of the

business, or are based on undisclosed assumptions which are likely to mislead investors. This problem clearly does not arise from liability concerns, and we therefore do not believe it can be dealt with solely by attempts to give directors further comfort on the question of liability.

Question 14

Would improved understanding and awareness of the UK liability regime help encourage more meaningful, formal looking statements? Are there other activities or changes that the UK Government could make that you believe may be necessary?

Yes	No
	x
Comments	
Please see our response to Question 13 above.	

Question 15

Do you agree that the key information on remuneration should be included in the new Strategic Report? If so, would a standard format for this information be helpful?

Yes	No
x	
Comments	
A standard format for information on remuneration would make it easier for shareholders and other report users to make comparisons between companies. This would not seem likely to increase burdens on businesses in preparing reports – on the contrary, having a pre-determined structure into which to deposit the relevant information should make reporting simpler, provided that the structure is clear. Concerns about 'tick-box' or 'boiler-plate' reporting are also clearly not relevant in this context, since the information in question is purely factual.	

Question 16

Which elements of the current disclosure requirements could be moved to the Annual Director’s Statement, or removed entirely?

Yes	No

Comments
No comment.

Question 17

Do you agree that quoted companies should be required to disclose the total remuneration of each director in a single cumulative figure?

If so, how should be calculated so that it accounts appropriately for the various elements of remuneration packages, including share options, LTIPs and pensions?

Yes	No
x	

Comments
The absence of a requirement to provide an aggregate figure for a director's total remuneration, or for board remuneration as a whole, is clearly a gap in the current disclosure framework which should be rectified. We make no comment on how this should be calculated, except to say that some framework must be imposed in order to ensure consistency across companies – if the decision is left to companies' discretion, this will create an incentive to use confusing methods of calculation which a) are not transparent to investors and b) lead to the lowest possible headline figure. The framework used should be fair and comprehensive, as far as possible covering all elements of directors' remuneration packages.

Question 18

Would there be benefits in introducing a requirement to disclose the pay of the highest earning executive officers below board level and, if so, to which companies and individuals should such an obligation be extended?

Are there alternative ways of improving shareholder oversight of the performance and pay of influential non-board executive officers?

Yes	No
x	

Comments
We are pleased that the government has brought this proposal forward. As the consultation paper notes, senior managers in many companies may earn as much or more than the executive directors, and may fulfil roles which are highly strategically important. Expressing such a requirement in terms of those earning more than a specified proportion of CEO pay would seem more sensible than setting an arbitrary absolute threshold. It would also remove the need to set down prescriptive requirements as to which companies or sectors the requirement should apply to: senior managers earning rewards comparable to that of directors are likely to be of interest to shareholders whatever industry they are in. Moreover, any attempt to prescribe which sectors such a requirement is relevant to would likely prove insufficiently flexible to adapt to changes in the business environment and in the nature of significant risks at both company and systemic level. We would therefore suggest that such a requirement should apply to all companies. We would suggest that, in order to enable shareholders to assess the potential risks posed by remuneration policies, the information reported should encompass the incentive structures which determine these senior managers' remuneration, rather than simply the quantum of pay. Additional measures that could be considered include expanding the remit of the remuneration committee to include significant non-board executive officers, thereby giving shareholders oversight of this aspect of remuneration through the remuneration report.

Question 19

Do you agree that quoted companies should be required to disclose how remuneration awarded relates to performance in the relevant financial year and to the company's strategic objectives?

Yes	No
x	

Comments
We agree, subject to our remarks in the consultation on executive pay that care must be taken in the way 'performance' is defined and measured, in order to avoid any new measures creating additional perverse incentives to maximise the share price in the short-term regardless of its impact on the

long-term sustainable success of the company.

Question 20

Should quoted companies be required to illustrate performance and the total remuneration of the CEO for the last five financial years, to enable shareholders to assess the relationship between total pay and performance over time?

If so, which performance measure would be the most appropriate?

Yes	No
x	
Comments	
No comment.	

Question 21

Should quoted companies be required to explain how the performance criteria for remuneration policy for the year ahead relates to the company's strategic objectives, as set out in the new Strategic Report?

Yes	No
x	
Comments	
Yes – please see also our response to Question 19.	

Question 22

Should quoted companies be required to provide estimates of the total future remuneration of executive directors if they exceed, meet or do not meet their performance criteria?

Yes	No
x	
Comments	

Yes, although again please see our response to Question 19.

Question 23

Should quoted companies be required to disclose the performance criteria for annual bonuses?

If so, should companies be permitted to delay the publication of commercially sensitive performance criteria for up to two years?

Yes	No
x	
Comments	
We make no comment on the second question regarding commercially sensitive performance criteria.	

Question 24

Would disclosure by quoted companies of the ratio between the pay of the company's Chief Executive and the median earnings of the organisation's workforce provide useful information to shareholders?

If so, how should the ratio be calculated?

Yes	No
x	
Comments	
Disclosure of this ratio would help shareholders to hold boards to account against the requirement in the Corporate Governance Code to have regard to pay and conditions elsewhere in the company. Currently this requirement appears to be poorly implemented, and without accurate information it is difficult to see how shareholders can judge adherence to this principle.	

Question 25

Do you agree that quoted companies should be required to disclose the total spend on directors' remuneration as a proportion of profit for the relevant financial year?

Yes	No

Comments	
No comment.	

Question 26

Should the amount of fees paid by companies to remuneration consultants be disclosed, and is there any further information which should be disclosed by companies in relation to the procedure for setting directors' remuneration?

Yes	No
x	
Comments	
Yes. In our response to the consultation on executive pay, we have suggested that more robust measures are needed to prevent conflicts of interest from arising in setting directors' remuneration. However, in the absence of such measures, as a minimum disclosure should be required of any conflicts of interest arising (for example, a remuneration consultant engaged by both the company and the director in question, along with fees paid; a non-executive director whose own remuneration on another company board is determined by the director in question), along with the measures taken by the remuneration committee to ensure that these conflicts were fully addressed.	

Question 27

Do you agree that company law and the Listing Rule disclosure requirements on remuneration should be made fully consistent?

Yes	No
Comments	
No comment.	

Question 28

Would reporting under International Financial Reporting Standards provide an appropriate basis for disclosure of remuneration in the preceding financial year if this were required on both an aggregate and individual basis?

Yes	No
Comments	
No comment.	

Question 29

Do you agree that the current legislative regime for audit and assurance for narrative reporting is adequate for your needs?

If you support assurance beyond the consistency of the Strategic Report and the Annual Directors' Statement with the accounts, then please explain what you believe assurance should be provided on and the benefits that you believe will ensue.

Yes	No
	x
Comments	
As we indicated in our response to the previous consultation, one of the key differences between the Operating and Financial Review and the business review was the enhanced audit, which required auditors to state anything which had come to their attention which was inconsistent with the narrative information published in the Annual Report. Recognition of the value of this requirement was a key part of the rationale behind the coalition commitment on company reporting. As such, we find it difficult to see how the spirit of the commitment can be said to have been met if the question of verification and reliability is not addressed. If investors are to be expected to price in environmental and social risks and opportunities, information on these issues must be treated as far as possible in the same way as financial information. This is the goal of current initiatives on integrated reporting: we are disappointed that the consultation paper makes no mention of this work, which is likely to render its approach outdated in the very near future. As we argued in our previous consultation response: "In our experience, one of the key reasons investors do not make use of narrative reporting is lack of verifiability. At present, the FRRP does not have anything approaching the capacity to verify all company reports. In the absence of regulatory enforcement, the only solution that has yet been	

suggested is the enhanced audit requirement."

We refer again to ClientEarth's complaint to the FRRP regarding BP's Annual Report. This is one example where information - in this case, oil demand projections – was presented as justification for company strategy without adequate contextualisation. In fact, the projections were based on assumptions (no government action on climate change and a consequent 6 degree global temperature rise) which were a) not intended as actual predictions but as a 'reference scenario', and b) inconsistent with statements elsewhere in BP's reporting about the company's strategy on climate change. A crucial test of any new reporting regime must be whether it would prevent the publication of unbalanced or incomplete information of this kind. An enhanced audit requirement would go some way towards achieving this. The only obvious alternatives are:

a) a more robust approach to enforcement, such that investors can have confidence that reported information meets minimum legal requirements and is fair, balanced and comprehensive; or

b) more prescriptive requirements on companies themselves, for example to disclose the assumptions behind figures and projections published in narrative reports.

If none of these alternatives are pursued, narrative information will continue to be insufficiently reliable and the key objective of the coalition commitment will not have been met.

We are disappointed that the impact assessment presents enhanced audit solely as an "NGO request" and fails to mention any of the non-monetised benefits listed for Option 2 (improved quality of information, improved comparability, improved investor engagement, better run companies, better returns). This is particularly puzzling since, as discussed above in our response to Question 1, we are sceptical that the current package of proposals can, by itself, achieve these benefits.

Question 30

Are there any actions that the Government could take to make the process of obtaining additional assurance on specific information in company narrative reports easier or less costly?

Yes	No
Comments	

We have two comments to make in this regard. Firstly, in relation to practical difficulties with auditing of narrative information, it has been noted that there may be no intrinsic reason why such assurance need be provided by accountancy firms. Indeed, in some cases it might be more appropriate for reports to receive assurance from an independent expert in the company's core business – since, in effect, what they are auditing is the completeness and accuracy of the picture presented. Secondly, if one accepts the principle that information must be reliable in order to be useful, the costs of that reliability must be borne somewhere. Enhanced audit requirements create costs for companies. Robust enforcement – another approach to guaranteeing reliability – creates costs for regulators. But if neither approach is taken, these costs do not simply disappear. They are either borne by investors, who must themselves verify the information to their satisfaction; or, if investors do not do this, they are borne by society and the economy at large, through imperfect risk management. The impact assessment's methodology does not accurately reflect the implications of different policy options in this respect.

Question 31

Do you agree that the Audit Committee Report should contain, in addition to existing requirements:

- How long the current auditor has been in post; and when a tender was last conducted.
- The length of time since the directors, including members of the audit committee, have held discussions with principal shareholders about the company's relationship with its auditors, including the quality of service provided?

Yes	**No**
x	
Comments	

Question 32

The Government would also welcome views on the impact of these proposals, both on the cost of preparation of the Audit Committee Report, and of the benefits to investors of having access to this information.

Yes	**No**

Comments	
No comment.	

Question 33

What guidance should be provided for preparers of the Strategic Report and the Annual Directors Statement? For example, what form should the guidance take (case studies, best practice, minimum compliance requirements), how should it be disseminated and should it be high-level and principles-based or more detailed and specific?

Yes	**No**
Comments	
As we have previously argued, 'best practice' examples may be of limited value in driving up reporting standards given the ubiquity of poor practice. Some of the UK companies whose reporting has been judged among the best by independent research – such as BP and Rio Tinto – have themselves been subject to complaints to the FRRP, which in Rio Tinto's case led to recommendations for changes to the Annual Report. We would therefore suggest that the most helpful guidance would be minimum compliance requirements, along with case studies (based on the ASB's research) of reporting which would be 'non-compliant' or which would 'fall short' of requirements. We are not convinced by claims that greater prescription will encourage boiler-plate. Indeed, well-designed reporting standards and guidance should help to clarify that boiler-plate reporting will not be sufficient to meet requirements. The Stewardship Code has been designed to be as 'principles-based' and flexible as possible, and applies on a 'comply-or-explain' basis. According to the argument that greater prescription means more boiler-plating, this should produce exceptionally high quality disclosures. However, when we surveyed asset managers' disclosures under the Code last year, we found that many of their disclosures were perfunctory and simply repeated the wording of the Code's high-level Principles rather than providing any meaningful information about the asset manager's approach. We do not suggest that detailed guidance or statutory standards would fully resolve the problem of boiler-plate reporting, but we see no evidence whatsoever for the frequently-cited assumption that it will exacerbate it. Please see also our response to Question 34.	

Question 34

Do you agree with the Government's proposal that the reporting statement and supporting guidance should remain voluntary? If you support a mandatory statement, please explain why that is necessary for your requirements.

Yes	No
	x

Comments
We support the introduction of a reporting standard setting out in more detail the content and quality of information that directors must provide. In particular, the government's stated aim to "ensure that directors' social and environmental duties have to be covered in company reporting" would seem to require further statutory clarification as to what constitutes adequate environmental and social reporting. There is a particular need to clarify the nature and quality of information to be provided: for instance, that information must be forward-looking and strategic, that the assumptions underlying key statements should be disclosed, and that all relevant risks should be covered. The level of compliance with current requirements, as measured by the Accounting Standards Board, is startlingly poor (see response to Question 35). This suggests that current voluntary guidance is insufficient and there is a need for more detailed statutory standards and/or more robust enforcement. As an aside, we are concerned that the impact assessment states that a mandatory reporting standard would "meet NGO requests for greater legal requirements for companies to provide standardised information on Corporate Social Responsibility (CSR)". This suggests either a continued failure to distinguish between material environmental and social information and 'CSR', or an implication that NGOs are concerned only with the latter. This is disappointing, since the failure of company reports to recognise this distinction was a key problem identified in our previous consultation responses as contributing to inadequate social and environmental reporting. We would like to see the government endorsing the concept of 'integrated reporting' and drawing on the work of the International Integrated Reporting Committee, rather than characterising social and environmental concerns in outdated 'CSR' terminology.

Question 35

Do you agree that understanding of the profile and working practices of the FRRP should be enhanced, but that the remit of the FRRP should remain unchanged?

Yes	No
	x

Comments

We disagree with the government's conclusion that “the FRRP has been able to achieve appropriate action by companies without having resort to the courts.” A recent analysis by the Accounting Standards Board found that 66% of companies fell short in relation to principle risks, 44% fell short in relation to strategy, and 32% were in outright non-compliance with requirements on non-financial KPIs. Based on these figures, it seems beyond dispute that current requirements are not being effectively implemented or enforced. Once again, we find it difficult to see why any improvement in this state of affairs should be expected under the government's proposed new reporting framework, unless the underlying issues are addressed.

We agree that the remit of the FRRP need not change, since it is already responsible for overseeing narrative reporting. However, we do believe that a radical step-change in the FRRP's approach to fulfilling that role is needed. Apparent expectations that investors will be able to police the reporting of every company in their portfolio, in addition to policing the management of risks which that reporting is intended to inform them about, are misplaced. Ensuring the quality of reports is the role of the regulator.

As part of the current review of the FRC’s responsibilities, we would therefore suggest that the FRRP’s function should be allocated additional resource in the form of permanent regulatory staff. Indeed, it may be that the FRRP will cease to exist in its current form and should not be transposed as one of the ‘Advisory Panels’ under the proposed new FRC structure. Excessive reliance on the voluntary capacity of potentially conflicted panel members, who tend to be drawn from a very small pool, may not be conducive to robust enforcement.

We are puzzled by the argument that “significant changes to the enforcement framework could impair innovative reporting and encourage more bland 'boiler plate' narrative statements.” On the contrary, a more robust enforcement approach would seem likely to focus companies' minds on ensuring that the information they publish is indeed fair, balanced and comprehensive. It is difficult to imagine any other sphere of life where one would accept the argument that proper enforcement of the law is undesirable on grounds that it would discourage adherence to the law.

As indicated above, a more proactive approach to enforcement becomes even more crucial if the government does not intend to enhance the audit framework.

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