

The Future of Narrative Reporting: Consulting on a new framework

**A response by the National
Association of Pension Funds**

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About the NAPF

The National Association of Pension Funds (NAPF) is the UK's leading voice for workplace pensions. We represent all types of workplace pension scheme, including defined benefit, defined contribution, group personal pensions and statutory schemes such as those in local government.

Between them, our members have combined assets of approximately £700 billion, and operate some 1,200 pension schemes. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

Introduction

The NAPF is grateful for the opportunity to respond to the Department for Business, Innovation and Skills' consultation, *The Future of Narrative Reporting: Consulting on a new framework*.

We believe a company's narrative report should be just that – a narrative which effectively tells the story of the company. It should clearly set out what the company had expected to happen during the year; what actually did happen; what went well; what didn't go well; and a forward-look for the coming year/s.

The NAPF generally agrees with the proposals in the consultation and, in particular, we wish to highlight the importance of clearly reporting information that is relevant and material to the company and its shareholders; the importance of having information (both current and historical) that is easy to access; and the need for improved reporting on executive remuneration.

We welcome the Government's commitment to improving the reporting framework, and we hope the comments provided in our response are helpful.

Response to consultation questions

Question 1: Do you agree in principle with restructuring the current reporting framework into a Strategic Report and an Annual Directors' Statement?

We agree that in principle it would be effective to have a more simplified reporting framework, such as that suggested in the consultation paper.

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, we agree that this information should be included in the Strategic Report. We would also add that the company's objectives should also be included.

However the Government should place an emphasis on the importance of the information being clear, concise and relevant to the company. There is a risk that being too prescriptive about the information to be included in the report could lead to box ticking and reporting on factors that are not necessarily material to the company – 'boilerplate' reporting. For example, companies should be required to report on environmental or social factors relevant to them, rather than prescribed factors.

This also raises questions of materiality, and we would therefore expect companies to explain why certain factors are (or are not) considered to be material to their business.

Question 3: Do you agree that the proposed Strategic Report should replace the Summary Financial Statements?

As long as the information contained within the Strategic Report is reflective of the information contained in the Summary Financial Statements, shareholders are not likely to oppose this amendment. Shareholders would be likely to benefit from a summary document which highlights key strategic and financial information about the company, and companies would benefit from a reduced reporting burden.

Question 4: Do you agree that the Strategic Report should be signed off by each director individually?

All directors of a company should be in agreement regarding the content of the Strategic Report. However, ultimately the Chairman is responsible for oversight of the board and board performance and therefore the Chairman's signature alone should be sufficient.

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)?**

We agree that this information should be included in the Annual Directors' statement, but only to the extent it is material to the company. Where such factors are not considered by the directors to be material to the company, they should be encouraged to explain why this is the case.

Any additional information provided voluntarily by the company, and which may be considered less material to the company as a whole, would be best disclosed separately to the Annual Directors' Statement (perhaps on request or via a link to the website). This would help to further reduce the clutter in reporting, and may also reduce the use of unhelpful marketing 'spin' in company reporting.

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)?

We agree this is a sensible development, and would certainly reduce the clutter that is often found in reports. It also enables the company to ensure that report users always have access to the most up to date information on policies, procedures, etc.

However, there is some concern that the Strategic Report risks becoming too simplified, with the reader being required to search through the company website to find links to relevant information. The Government should make certain that reporting does not come over-simplified and that all relevant information is still required in the Annual Report.

It will also be important to ensure that historical information is easily accessible. For example, if report users are directed to a page on the company's website, which is regularly updated with current data, they must still be able to access historical data that was previously reported. This will help to protect the integrity of the audit trail. There is certainly scope to explore how XBRL (the eXtensible Business Reporting Language) may be adopted to address this issue.

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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, it is important that the directors acknowledge their authorisation of any material included by cross-reference and that any changes from the previous year are highlighted.

Question 8: Do you agree that the Annual Directors' Statement should be presented online with a hard copy available to shareholders only on request?

The use of electronic reporting has developed extensively in recent times, and this has been of great benefit to report users. The ability to search electronic reports for key words and phrases is important, as is the use of hyperlinks directing the user to routine reporting (such as less material disclosures or policies that do not change over time), thus reducing clutter in the report. We therefore agree that reporting should be presented online with a hard copy to be made available on request.

We also note that in many cases where reports are presented online, the copying and pasting text or data is not possible. In some cases there is no option to print the document. It becomes difficult for shareholders to collaborate if they are unable to collate relevant data and information on companies. We would therefore urge the Government to ensure that company reporting is easily searchable, with the function available to copy text (with due regard to copyright regulations) and print either the report as a whole or the necessary sections.

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?

We agree with the removal of most of the disclosure requirements arising from Company Law which are identified in Table 1.

We do, however, believe the requirement to disclose charitable donations should remain. However, we believe the threshold for disclosure should be increased – for institutional investors, we believe a disclosure threshold of £10,000 or £20,000 would be more appropriate. In addition, companies should disclose any conflicts of interest in relation to charitable donations.

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?

Given these have come at different times from different bodies, there may be some inconsistencies and we believe there is merit in conducting an exercise to determine which (if any) of these inconsistencies are material.

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, we believe companies should be required to include information about human rights issues, especially where it is likely to impact the reader's understanding of the company's business and it is considered material to the company. We would expect to see this information included in the social disclosures referred to in Question 5 of the consultation.

We also wish to highlight our support for the report by Professor John Ruggie, as identified in the consultation document.

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?

We believe there should be a section of the annual report relating to diversity on the board. This section should include a description of the board's policy on gender diversity, and diversity more generally, in the boardroom, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.

We would expect that a company's diversity policy would extend beyond the boardroom and therefore reporting on progress against that policy will include disclosure on the proportion of women in the company as a whole.

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?

See comments under Question 14.

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?

In relation to Questions 13 and 14, we believe there is a perception that the law discourages forward-looking statements. It would be useful for the Government to encourage forward-looking statements and identify what represents a safe-harbour in relation to such statements. Such clarity should ensure that companies' can provide forward-looking statements with a clear disclaimer that the information

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provided is based on reasonable assumptions. In such cases, directors would not be considered liable in the event the predicted outcome was not achieved.

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, we agree that key remuneration information should be included in the report. We agree that the information listed in section 5.7 of the consultation document should be disclosed, however we do not consider it would be necessary to have this in a prescribed format.

Question 16: Which elements of the current disclosure requirements could be moved to the Annual Director's Statement, or removed entirely?

This is a difficult question to answer, and a difficult balance to achieve, because the need for information will most certainly change over time. Therefore, we would not wish to see a situation where the Government removes reporting requirements from the Annual Directors' Statement, only to require its re-inclusion some time later.

The problem with current requirements is not so much the quantity, but more so the way in which it is ordered/presented to explain remuneration policy.

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?

No, we do not believe this is a necessary inclusion as the calculation of such a figure is complicated and it is very difficult to agree a single figure. It is also important to have the different elements of remuneration clearly explained. A single cumulative figure would not necessarily give a realistic view of the entire picture, nor would it allow an accurate demonstration of the link between pay and performance.

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, we agree that this would be useful information for shareholders and we believe the High Pay Commission's recent recommendation to publish the top ten executive pay packages outside the boardroom seems sensible. We note that there is already something of this nature in place for the banking sector. However, we believe disclosure of this nature should only be disclosure of figures, and companies should avoid disclosing names/positions, as such disclosure may lead to unnecessary ratcheting.

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, we certainly agree that quoted companies should be required to disclose and justify the extent to which remuneration awarded relates to performance and the company's strategic objectives.

The NAPF Corporate Governance Policy and Voting Guidelines (NAPF Guidelines) state that:

"It is incumbent on remuneration committees to demonstrate when both setting and reviewing policy that there is a strong link between pay and performance and that risk is taken into account when establishing performance targets. Committees should acknowledge that from time to time the link may have weakened and should take steps in that event to strengthen it."

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?

We see merit in improved disclosure of historic performance compared to executive remuneration, as there should be a strong correlation between the two (stronger than currently appears to be the case).

However, this is not straightforward. Due to the variation between companies, sectors and the nature of business more generally, performance measures will vary greatly. It is therefore difficult to suggest which (if any) performance measure would be most appropriate for this form of disclosure. The company should be free to choose which performance measure is relevant – and it may indeed be a combination of measures.

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, we would expect the performance criteria to be strongly correlated with the company's overall strategic objectives and the link between the two should be clearly explained in the remuneration policy.

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?

In relation to estimates of the total future remuneration of executive directors, the NAPF Guidelines state that:

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“The Remuneration Report should describe:

- The key parameters and structure of the remuneration policy set by the committee
- How this has been applied to the remuneration and incentive arrangements for the executive directors and other senior executives falling within the committee’s responsibilities
- The cost to the company and (b) the potential end-value to each participant of the company’s remuneration schemes (assuming minimum and maximum vesting levels).”

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 we believe companies should be required to disclose the performance criteria for annual bonuses, recognising that in some cases deferral of disclosure may be appropriate. Whether immediate or deferred, disclosure in general is considered to be an improvement.

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?

Whilst some stakeholders may find this information useful, it is difficult to find a measure that is truly accurate and therefore relevant.

We note with interest that this practice is becoming used more widely – in the United States and among UK public sector organisations for example.

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?

If total directors’ remuneration is reported, then there should be no reason for companies to also calculate the remuneration as a proportion of profit. Investment analysts will be able to undertake the necessary calculations for the purpose of their own investment decision-making.

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, we believe the fees paid by companies to remuneration consultants should be clearly disclosed. We agree with the UK Corporate Governance Code, whereby “there should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors”.

Question 27: Do you agree that company law and the Listing Rule disclosure requirements on remuneration should be made fully consistent?

If the Government has recognised inconsistencies between company law and Listing Rule disclosure requirements, we would ask that they highlight any particular concerns. It is difficult to comment unless we understand whether any inconsistencies exist and the extent to which the Government believes this is of concern.

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?

We urge the Government to address this issue with caution, as there may be implications arising from the impact of accounting standards (for example IAS 19 on pension funds) and other fair value regimes.

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.

Questions 29 and 30 are answered below.

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?

We agree with the Government's proposal that auditors should be required to state whether the information given in the Strategic Report and Annual Directors' Statement is, in their opinion, consistent with the corresponding accounts. We are, however, concerned with the quality of the information provided in the audit report.

The audit report should provide assurance that the information presented by the company is balanced and free from material misstatements. Often the auditor opinion and the result of the audit are not clearly justified and can provide little comfort to shareholders. This can in some way be attributed to the reluctance to apply the "true and fair" approach, instead favouring one which relies too heavily on the application of audit and accounting standards without due regard to judgement.

Ultimately, the responsibility for reporting additional information to stakeholders should be determined by management, as the materiality of information will differ between companies. Therefore, the onus is on the Audit Committee to ensure that relevant and meaningful information is provided in both the annual accounts and the accompanying narrative report.

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We believe the Government could usefully add some clarity as to the scope of “true and fair”, as this may improve the usefulness of the information provided in the audit report and the company’s reporting more broadly.

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, we believe that the Audit Committee report should disclose information on the periodic re-tendering of the auditor. The NAPF Guidelines state that:

“There is a consensus among investors that periodic tendering of the audit service helps to maintain auditor objectivity. Companies are therefore encouraged to consider submitting the audit function to periodic tender and disclose their policy on this matter, including when the audit was last subject to tender. The NAPF encourages improved disclosure on the auditor re-selection decision and the disclosure of any contractual obligations to appoint audit firms, in the interests of making the criteria used for auditor selection and evaluation as explicit as possible.”

The NAPF Guidelines also state that any change of auditors should be explained to shareholders. We would therefore expect that companies would have a dialogue with shareholders prior to and after the re-tendering process.

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.

We do not believe there would be a substantial impact on companies in terms of costs for implementing these proposals. We do note, however, that companies are in a better position to provide a realistic outlook on this question.

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?

Providing best practice case studies on reporting may be beneficial for companies. The NAPF sees merit in publicising excellence in business reports in order to raise awareness as to what is considered to be best practice in reporting. Already in existence is the ICSA/Hermes Transparency in Governance Awards and the IRS Best Practice Awards. There may also be scope for the FRC, via the FRRP, to publish a report on their results, highlighting companies who report to a high standard.

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, we agree with the Government’s proposal to keep the reporting statement and supporting guidance voluntary.

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?

Companies should be given some flexibility to report on factors which are material to them, and we agree that any changes in the enforcement framework could potentially lead to ‘boiler plate’ reporting. However, it is important that narrative reporting is under scrutiny by the FRRP and that action will be taken where reporting is not deemed to be compliant with the Companies Act and relevant accounting standards.

We therefore agree that the profile of the FRRP should be enhanced and that their remit should remain unchanged.