The Hundred Group
of Finance Directors

Investor Relations and Markets Committee

Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

19 October 2010

Dear Madam

The Future of Narrative Reporting – A Consultation

We are pleased to submit our comments on the above consultation.

Who we are

The Hundred Group is a non-political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly, but not entirely, from the constituents of the FTSE100 Index. Our aim is to contribute positively to the development of UK and International policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the view of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers.

Our views

We welcome the consultation by the Department for Business Innovation & Skills and the opportunity to respond on these issues.

Due to the nature of the consultation we have not sought to answer all the questions raised. We have focused on our responses on our experiences as preparers of financial statements, including our interactions with investors and other stakeholders.

Narrative reporting has received much attention in recent years by a wide range of bodies. Following the 2005 repeal of the Statutory Operating and Financial Review (OFR), this was substantial reinstated by 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 OFR remains in place as voluntary guidance. We have also seen recent IASB proposals for Management Commentary as well as the establishment of the International Integrated Reporting Committee (IIRC) to review narrative reporting on a global platform.

As a community of preparers we understand the importance of Narrative Reporting, and indeed of all our stakeholder communications. We are of the opinion that the use of financial statements is of primary importance, and should continue to be a key communication tool in our ongoing dialogue under the requirements of the Business Report. Through the past two reporting seasons we note improved narrative reporting and believe that, through the passage of time and development of best practice, this trend will continue.

The level of resource dedicated to Investor Relations, and in particular the preparation of the financial statements, demonstrates the ongoing commitment of preparers to clear communications. Clear, relevant and timely communication of information has been consistently shown to improve investment decisions and boost investor confidence. It is a strong arm of Corporate Governance and the willingness to improve consistently has been demonstrated by the market, leading to the improved narrative reporting we see today compared to, say, five years ago.

In addition we believe that the role of other communication tools cannot and should not be ignored when considering the appropriate requirements for narrative reporting within the financial statements. In particular we consider the information included in our investor presentations and within our websites as live, relevant and adaptable communication tools vital to our ongoing stakeholder relationships. We also ensure that all communications are available to all stakeholders ensuring that information reaches a wide audience.

In this way Annual Reports, and the narrative reporting within them, are not, and should not be, designed to be all things to all stakeholders.

With this in mind we urge the Department to consider carefully the need for any further regulation on narrative reporting. In our opinion there is a real risk that increased regulation would be a direct driver of increased 'boilerplate' disclosure, increased volume and limited additional value to the end users, ultimately depleting transparency and boosting complexity. In a time of fluctuation, stability and consistency of regulation can be the most helpful tool, particularly when coupled with a government keen to promote examples of best practice and effective investor communication.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours sincerely

Peter Will

Peter Williams
The Hundred Group – Investor Relations and Markets Committee

APPENDIX

Value of narrative reporting

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

We would direct the Department towards the responses received by investors and users of the financial statements when considering this question.

We are of the opinion that we provide sufficient, relevant and appropriate information to our stakeholders.

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

As preparers of financial statements there are some significant and important constraints over the communication of company strategy and principal risks and uncertainties.

Commercial constraints exist over the disclosure of detailed forward-looking strategy. Whilst an understanding of the direction and intentions of a company are required for investors and stakeholders to make appropriate investment decisions, this must be offset by the need to keep some commercially sensitive developments inside the company. We would urge the Department to be cautious if considering requirements which could put UK companies at a competitive disadvantage.

Disclosure of risks and uncertainties required by the Business Review, and in compliance with EU Directive requirements, such as the EU Accounts Modernisation Directive and the EU Transparency Directive, provide relevant and pertinent information for stakeholders and investors. However, we highlight the inherent difficulty in providing a comprehensive list of risks and uncertainties. In making disclosures management make decisions as to which risks are material to the business. As with all disclosure matters there is a tension between full disclosure and the confusion that disclosure of non-material matters can provide.

At the time of the former statutory OFR, our members were concerned at the lack of a safe harbour, i.e. some protection from legal liability, particularly with respect to disclosure of forward-looking information. The subsequent introduction of Section 463 Companies Act 2006 has acted successfully to mitigate these concerns. In addition, following the Davies Report, the HM Treasury instigated adoption by Parliament of additional safe harbour measures in other relevant UK Regulations concerned with the financial markets, has helped strengthen this position.

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.

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

Yes.

The information provided within the financial statements reflects the issues discussed by the directors to the appropriate extent.

However, the role of the directors is complex and broad reaching. At times the directors will need to consider, for example, potential acquisitions or disposals which are confidential and would be inappropriate to disclose to stakeholders at the initial stage of consideration. In addition the directors consider factors such as the performance of the Board and Audit Committees individually and as a whole. In compliance with good corporate governance findings will be communicated appropriately, however the threat of full disclosure should not become prohibitive to the effective operation of the board.

One point of interest is the current debate around the extent to which the Audit Committee discussions with the internal and external auditors are reflected in external communications. We are of the opinion that these discussions and debates are of high value to the boards, and that this value is supported by an open, honest and constructively frank environment. Any disclosures being considered should take into account the potential for behavioural change that may be an unintended consequence of inappropriately extensive disclosure.

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

We would invite the Department primarily to review the returns provided by shareholders in relation to this question.

In our experience we find that our shareholders are generally well informed as to the key issues within strategies and in performing risk analysis.

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?

We would invite the Department primarily to review the returns provided by shareholders in relation to this question.

In our experience we find that our shareholders and analysts are proactive in asking for additional information as and when required. In some instances we are unable to provide additional information either as being price sensitive, or confidential. If this is the case we will endeavour to provide either substitute information or further explanations. On occasion we will review investor modelling and provide feedback to the investor community, and/or provide our own models to assist with providing decision relevant information.

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)?

We would invite the Department primarily to review the returns provided by shareholders in relation to this question.

In our experience we find that our shareholders and analysts increasingly utilise information provided on our websites and at analyst briefings. Indeed, we increasingly find that discussion of performance is concentrated on information other than statutory information. Adjusted profit and earnings per share information is either equally or more valuable to our investor community than statutory figures.

In our opinion this discrepancy comes about from the restrictions placed over preparers within International Financial Reporting Standards, particularly on the face of the income statement. Whilst we understand that this consultation does not seek to make changes on a global platform, we would bring to the attention of the Department the magnitude of this discrepancy.

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

Yes.

We feel that, in the UK, there is a need from investors to receive relevant information in a clear and concise manner. Likewise as preparers, we look to communicate effectively.

Currently we believe that the level of requirement of information to be included within financial reports can in fact be prohibitive to clear communication. See also our response to question 8 below.

As a matter of practicality there is scope for all regulatory requirements for UK entities to be assembled collectively to aid compliance.

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

We believe that there is an opportunity for the Department to review how information is communicated to investors.

In particular we urge the Department to consider the need to align the method of delivery of information and the nature of the stakeholder. For example, we are of the opinion that for some companies e.g. the Oil and Gas industry, information about the environmental impact and the company's responsibilities and approach to dealing with these is critical to the business strategy of the group. Likewise, some energy groups provide customers with options to have 'green' energy contracts, so disclosure of these policies is critical to an understanding of the business. In both these examples such information is investment decision relevant. For other entities, e.g. service providers, the information on how the group deals with its environmental impact may be of more relevance to stakeholders such as employees, customers and/or suppliers. An ability to be flexible and provide this information on a group's website may, in this example, be more appropriate.

In addition, we note that information in the narrative section of financial reporting is not subject to full audit procedures. By separately disclosing such information outside the financial statements there is more opportunity to provide separate report assurance which would give further reliability to this wider stakeholder base.

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?

We do not see any value in reinstating elements of the OFR.

We are of the opinion that current guidance is already appropriate and additional requirements would only serve to increase regulatory burden rather than improve clarity. We are of the opinion that investor requirements ensure that information provided is to a high standard, and do not perceive that the OFR requirements would lead to any further information disclosure in practice.

As an example of disclosure evolution, we would point to the investor preference for preparers to provide a reconciliation of Net Debt. This reconciliation is not a requirement under IFRS however a large proportion of our members provide this information voluntarily to assist investors. This demonstrates that a willingness to communicate with our investors and stakeholders is a responsive and appropriate tool to shape financial reporting.

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.

10. The business review provisions require quoted companies to report, to the extent necessary, on:

- **in 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?

We would direct the Department towards the responses received by investors and users of the financial statements when considering this question.

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

We welcome the opportunity for best practice examples or sample information to be provided to the preparer community. In practice, the majority of preparers do review disclosures made by competitors across their markets to identify best practice.

In such economically difficult times we would point the Department towards highlighting best practice in current publication, rather than creating sample information.

12. Should there be a shareholders' advisory vote on the Business Review?

We do not believe that a shareholders' advisory vote on the Business Review would be appropriate nor achieve the presumed objective of the Department to improve dialogue between investors and preparers on this area of the financial statements. There is already a shareholder vote on the Annual Report and Accounts and we do not see a role for additional votes.

In our experience the majority of votes are passed with a high majority. In the cases of dispute, investors are open with us with regards to disagreements, including if further information was required in our Business Reviews.

Engagement is not something which can, or should, be legislated on. It is up to the discretion of the investor on the level of their involvement.

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

We believe that a continued support for publicising excellence in business reports would be conducive to an improvement in narrative reporting. In particular we welcome opinions and view points from the investor and analyst community.

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

We would direct the Department towards the responses received by investors and users of the financial statements when considering this question.

We are of the opinion that we provide sufficient, relevant and appropriate information to our stakeholders.

Potential Costs

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.

We would remind the Department of the not insignificant cost and burden to business of the preparation of financial statements.

We consider communication with our stakeholders to be critical to our business model and accordingly dedicate considerable time and effort to this effect. We welcome improvements which will genuinely improve communication and transparency.

However, we urge the Department to consider that all proposed changes they consider will be associated with additional cost. This will include costs taken to prepare and gather information if additional to current disclosure requirements or accepted practice. We would also highlight the additional costs that will be incurred due to the need for all our external communications to be reviewed by in house legal teams and other external advisors.