

The Association of Corporate Treasurers

Comments in response to
The Future of Narrative Reporting
Department for Business Innovation & Skills,
September 2011

November 2011

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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The stated objective of the Narrative Reporting consultation is to simplify the framework for narrative reporting, reduce the burden on companies and to provide clear, useful reports to shareholders.

Scope and Structure

One of the key proposals is to replace the current Business Review and Director's Report with a Strategic Report and an Annual Directors' Statement.

- Strategic Report: board sets out the strategy, direction and challenges facing the company (including principal risks and uncertainties, KPIs and key financial information)
- Annual Directors' Statement: provides the framework for detailed narrative disclosures, to be published online

Summary comment

Overall the ACT very much supports the principle of good narrative reporting to add context, colour and explanations to information included elsewhere in the accounts. Strategy risks and challenges form a key part of this. However we do see some danger in loading the report and accounts with excessive detail and copious information.

The ACT responded to a consultation on narrative reporting back in March 2006. Our key messages in that response were:

- We remain strong supporters of effective narrative reporting
- We encouraged forward-looking narrative disclosure
- On commercial confidentiality, we considered it essential that directors are allowed considerable discretion in what they discuss in forward looking statements and should state what kind of matters they feel unable to comment for reasons of commercial confidentiality.
- Encouraging openness: we argued in favour of a "safe harbour" to protect directors when making forward looking statements

We have chosen only to answer selected questions and we believe that others are in a better position to answer other questions.

Specific Questions

Question 1:

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

Whilst we agree in principle and support the concept of a Strategic Report we remain to be convinced that the proposed framework will either benefit shareholders or preparers of the accounts. Some of the proposals appear a little inconsistent, for example, the requirement that the Strategic Report should be concise yet comprehensive.

The Strategic Report

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, and*
- *Key information on executive remuneration and its link to performance?*

Yes, other than the final two items. Whilst these are current political and social issues they are not necessarily *strategically* significant to all companies and should be dealt with in the Annual Directors' Statement. Where major environmental issues are indeed particularly significant they should, of course, be covered under principal risks and uncertainties in the Strategic Report as any other such risk.

As regards the principal risks and uncertainties, we would like to endorse the FRRP's position as stated in FRRP PN 130, "The Financial Reporting Review Panel highlights challenges in the reporting of principal risks and uncertainties"¹. This is designed to avoid boilerplate disclosure as much as possible. If it were thought that to give effect to this position would require a degree of definition of "principal risks and uncertainties", we would in principle support this.

Question 3:

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

Yes

Question 4:

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

We do not believe it is necessary, and it is often logistically very difficult, for each director individually to sign off the Strategic Report. We also believe it is inappropriate for the company secretary to sign as under company law they do not have the same responsibilities as directors unless they are themselves a director.

The Annual Directors' Statement

Questions 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)? and

¹ 01 February 2011, <http://www.frc.org.uk/frfp/press/pub2503.html>

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?

We agree that inclusion by cross-reference to other published material should be permitted only if (i) it is on a specified website (with link provided and any necessary access instructions) and (ii), as is suggested, the Annual Directors' Statement either contains a confirmation that the cross-referenced material is up to date or notes any significant changes at the date of the Statement.

Whilst we do not believe that the accounts should be loaded down with detail, cross referencing material to a document stored online only makes sense if the document is stored and dated as at the date of the annual report. For example, a treasury policy is a living thing, adapted to changes in the market place and in the contingencies affecting the company. The document might be expected to be updated during the course of a year and so cross reference from the Statement cannot be to the 'live' document. Over time this can result in numerous versions of the same policy document being online so it should be very clear to the reader what version they are reviewing and a be link provided to the latest, operational, version.

A further issue that needs to be addressed is making it very clear to the reader of the accounts what information has been drawn from the audited accounts and what hasn't.

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

Forward looking disclosure and directors' liability

The government believes directors are reluctant to make meaningful forward looking statements in their reports and is keen to receive views on what could be done to encourage fuller and more meaningful disclosures and on how best to promote understanding of the protection provided by UK's liability regime.

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 misunderstanding about the UK liability regimes,*
- *Other concerns?*

We agree that the current UK liability regime ought not to discourage forward-looking statements, but we cannot rule out unfamiliarity with the law.

Probably a greater contributor to this reluctance is the natural human instinct of not wanting to be shown to have been wrong (however much qualification might have

accompanied the statement when made). The fear is of the risk that at the time the statement is shown to have been wrong (especially if over-optimistic) there will be adverse media coverage, ruined reputations, etc.

With reference to whether the issues in the current regime relate to the following:

- *Companies listing in the US as well as in the UK*
Yes, this is likely to be a strong disincentive.
- *Companies contemplating a prospectus*
Yes.
- *Common misunderstanding about the UK liability regimes*
Possibly.
- *Other concerns*
See comment above.

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?

There is a need for absolute clarity on safe harbour provisions for statements made in the Strategic Report and The Directors' Statement.

We consider that directors should be required to state what kind of matters they feel unable to comment for reasons of commercial confidentiality or because of the unavailability of safe harbours in other relevant jurisdictions.

Reporting of remuneration

Companies are already required to provide details of how directors' remuneration is linked to performance however this information is complex, lengthy and difficult to disentangle. The Government wants greater clarity and wants this information in the Strategic Report.

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?

We do not believe that executive remuneration is normally strategically important enough to be reported in the Strategic Report and that it should usually be reported in the Directors' 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?

We agree with the principle of linking executive remuneration to performance and of not rewarding failure. There may be cases where the trigger for the awards is commercially sensitive and in these instances a very generic description of the trigger should be disclosed.

However, in our experience in many cases remuneration linked to the relevant year is only a part, sometimes a small part, of non-salary remuneration, more being related to long-term incentive plans. The disclosures need to be able to take this into account.

We think it is important to observe that good performance may itself not reflect in improved company performance as usually measured. As businesses evolve and sometimes decline, top management may be doing a terrific job for investors and other stakeholders by managing decline well. In a multi-divisional firm, where a business to be exited is material, the overall group performance may look terrible even though top managers are performing well and earning annual and long-term incentive scheme payments.

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?

No. Comparing performance with CEO remuneration does not of itself provide an instantaneous and correct analysis of cause and effect. In addition a change of CEO, company restructuring, or acquisition during the five year period will cause distortions which would require very extensive (and expensive) restating. Juxtaposing the two would be misleading. (See last paragraph of comment on question above.)

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, but in the Annual Directors' Statement.

The role of enforcement and narrative reporting

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. We think that the FRRP has been doing a very good job but gets little media attention in most cases.

The Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury providing the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,200 members work widely in companies of all sizes through industry, commerce and professional service firms.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at <http://www.treasurers.org/technical/manifesto>.

<p>Contacts: Michelle Price, Associate Policy & Technical Director (020 7847 2578; mprice@treasurers.org) John Grout, Policy & Technical Director (020 7847 2575; jgrout@treasurers.org) Martin O'Donovan, Deputy Policy & Technical Director (020 7847 2577; modonovan@treasurers.org) Colin Tyler, Chief Executive (020 7847 2542 ctyler@treasurers.org)</p>	<p>The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK</p> <p>Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org</p>
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The Association of Corporate Treasurers is a company limited by guarantee in England under No. 1445322 at the above address