CFA UK is a member society of

Mark Jackson
Business Environment
Department for Business Innovation and Skills
1 Victoria Street
London
SW1H 0ET

25th November 2011

Dear Mr. Jackson,

I chair the Financial Reporting and Analysis Committee (FRAC) of The CFA Society of the UK (CFA UK)*. This committee of volunteers represents fund managers, analysts and other users of accounts who make investment decisions or other recommendations that determine the way capital is allocated to quoted companies. It responds to consultation exercises conducted by the UK government and regulators, the IASB and the European Commission.

Your department's two-month consultation on "The Future of Narrative Reporting" has coincided with the IASB's first triennial consultation on its agenda, the continuing agenda of regulatory change prompted by the financial crisis, the Kay Review of UK equity markets, the launch of the FRC's financial reporting laboratory and the publication of Proposals to Reform the Financial Reporting Council. The last has particular relevance to the DBIS project on narrative reporting because the FRC (via the ASB) already has a reporting statement on this subject, the Operating and Financial Review, which provides excellent guidance.

We tend to spend our limited time on proposed changes to financial reporting that tackle serious problems, affect important principles or will have a big impact on the future of financial reporting. This puts us in a difficult position when it comes to commenting on narrative reporting by UK quoted companies since we do not believe that the current system is broken. This is not to say that it cannot be improved, but we believe that initiatives already under way at the FRC, of which "cutting clutter" and the financial reporting lab are the latest, are already addressing issues of duplication, questionable relevance, boilerplate responses and unnecessary constraints on forward looking analysis.

In this context, we welcome the chance to respond to the joint FRC/DBIS consultation on reform of the FRC's organisation. We would prefer this to be settled first and then for the reformed FRC to consider how to update the operating and financial review and, importantly, how to ensure that more companies follow its best-practice guidelines.

This puts us in a difficult position with regard to this consultation. Changing narrative reporting is not one of our immediate priorities, so – and I apologise for this – we have not had time to go through our normal process of reviewing the consultation document at one of our meetings, drafting a response and exchanging views on the draft before settling on a full final response. So, I am responding as committee chairman, taking in views expressed by committee members in the past and, informally, on this specific exercise.

The alternative was not to respond at all. But such an omission would remove a counterweight to those groups that are campaigning for change, often on the basis of a different agenda for narrative reporting to that of capital providers. We are concerned about any changes that dilute the purpose of providing investors/analysts with the information they need to make decisions, or recommendations, on where to put their (ie savers', policy holders', pensioners' etc) funds to achieve the best risk-adjusted returns. We also believe that the broadening of the agenda tends to add to the disclosure requirements imposed on companies, which is difficult to reconcile with the objective of simplifying the reporting framework.

A better way to approach the task of simplification would be:
a) to rationalise areas of overlap between UK Company Law (including implementation of EU directives), accounting standards and listing requirements – we welcome the start on this suggested in the document;
b) to follow through on existing FRC guidance, including the OFR, cutting clutter and the financial reporting lab – using the enhanced powers of the post-reform body; and
c) to continue to ensure that financial reporting is focused on relevance to investment decisions, which includes a better understanding of what is **material** to these decisions.

We would be happy to meet you or colleagues from DBIS to discuss the issues.

Yours sincerely,

Jane Fuller
Chair, Financial Reporting and Analysis Committee
CFA Society of the UK

*About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession most of whom work as front office investment professionals (managing portfolios, researching securities and advising on asset management). The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the chartered financial analyst (CFA) designation, or are candidates registered in CFA Institute's CFA Programme. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programmes worldwide; publishes research; conducts professional development programmes; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has 111,000 members in 135 countries, of whom more than 101,000 hold the Chartered Financial Analyst® (CFA®) designation.

Responses 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?
No. The word "strategic" is vague and does not imply a review of a company's operation or performance. The current term "Business Review" covers strategy, business model, financial performance and trends and risks that affect the business. Why change it? Since the whole narrative report is produced by the board, why apply the words "Directors' Statement" to only part of it?
There is a case for separating out some of the detail and making it available via drill-down options from web versions of the Business Review and other corporate reports, or through cross-references to the website in hard copies. Such details might include calculations behind share-based payments, repeated information such as unchanged accounting policies, and additional information on corporate governance compliance and environmental and social matters. A summary "Environmental, Social and Governance Report" could be included as a sub-section of the Business Review, or as a separate section, again with the opportunity to drill down into further information. There are plenty of examples of companies that try to set out their narrative report in a clear and intuitive way that covers all the above bases eg Pearson plc, which has the headings: strategy, performance, responsibility, governance.
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?**

Leaving aside what this main report is called, broadly yes. But the key financial information should not be limited to what is currently carried in the summary; and environmental and social information, and details of executive pay packages, should only be included to the extent that they are material to the explanations of performance and key risks, or of trends that might affect future performance.
There is a perfectly good description of what should go in a Business Review in the OFR Reporting Statement under Objective, the definition of OFR, the Principles and the Disclosure Framework especially pars 27-30, plus several other paragraphs in bold type thereafter eg on generation of value over the longer term, resources, principal risks and relationships, KPIs.

Question 3
Do you agree that the proposed Strategic Report should replace the Summary Financial Statements?
This is not a big issue for us. There may be a misunderstanding here of the way investors/analysts use corporate reports. Because they are familiar with the formats,

they are able to find the sections they regard as important relatively easily and, in these instances, they want to see significant detail eg explanations of the change in net debt or the impact of new climate change measures. You may find some investors who complain about the length of annual reports, but many others appreciate the information that is available. We are also aware that views differ on what is important, and so are wary of cuts that assume a stereotypical approach. CFA UK has not complained about the length or complexity of reports.

Question 4
Do you agree that the Strategic Report should be signed off by each director individually?
Do not feel strongly about this. The board has collective responsibility.

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)?**

No for information that is material to the company's performance or prospects eg post balance sheet events; or governance. Yes where it is immaterial or voluntary, additional information on environmental and social matters.

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, although the cross reference should be from wherever is relevant eg to accounting policies from the start of the financial statements.

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 always helpful if the user's attention is drawn to changes.

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, immaterial details, repetitions of standard policies and procedures, additional voluntary information on environmental and social matters need only be available on the web. Information on the website should always be available in pdf form so as to be readily printable. For some shareholders, the right to request a hard copy may be important, so that should persist for as long as there is a significant demand.

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.
This looks like a sensible start to rationalising overlapping laws or regulation, which we welcome.

Are there any other disclosure requirements arising from company law that in your view could be simplified or removed?
Have not had time to review this.

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?
Have not had time to review these. Nothing has been raised at FRAC meetings.

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?
They should only include information material to the business, which includes significant political and reputational risks.

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, I support the recommendations of the Davies report. The FRAC has not discussed this.

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. Companies are too conservative on this. A safe harbour provision might help.

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. It is always worth being clear about a liability regime – and ensuring that that regime does not discourage disclosure and debate of issues relevant to investors.

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 I would welcome a table giving total remuneration, and the main components, for each director. The list in par 5.7 looks about right as part of the remuneration committee report. But details such as on service contracts and shareholdings need not be in the main report. The FRAC has not discussed directors' pay.

Question 16
Which elements of the current disclosure requirements could be moved to the Annual Director's Statement, or removed entirely?
Details of share options, LTIPs and pensions.

Question 17
Do you agree that quoted companies should be required to disclose the total remuneration of each director in a single cumulative figure?
Yes.
If so, how should be calculated so that it accounts appropriately for the various elements of remuneration packages, including share options, LTIPs and pensions?
Various consultancies, eg MM&K and IDS, do this already.

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. The Walker Review had proposals for disclosures for those paid more than £1m, this could provide a basis for such disclosures.

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 there should be a link between pay and performance, and between pay and total shareholder returns.

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 already have very useful 5-year summaries of most companies' financial performance. Total shareholder return is also obviously relevant, and readily available. So, if the CEO's total pay is made clear, it will be easy to do this anyway.

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?
Questions 21-28 go into a lot of detail, which the FRAC has not considered. A few tentative remarks are made.

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?

Question 23
Should quoted companies be required to disclose the performance criteria for annual bonuses?
Yes where bonuses form a significant part of pay.
If so, should companies be permitted to delay the publication of commercially sensitive performance criteria for up to two years?

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?
This information is now being made available eg through the report of the High Pay Commission, which draws on various sources. A pay pyramid showing numbers in different pay bands each pay bands and the difference between pay at the top, the average and the bottom, might provide useful information as shareholders become concerned about the motivation of staff and reputational risk in this area. But such prescription needs to be properly thought through and FRAC has not debated the pay issue.
If so, how should the ratio be calculated?
Total pay packages should be used for the calculation.

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, this would help us work out whether the cost is material. Where it is not, it would help to put the matter in perspective. But working out where to draw the line would be very difficult. The total pay of a relatively small number of people will rarely be material at a big company.

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

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?

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.
The current level of assurance is adequate.

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?

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 to both.
NB The audit committee report should form part of the main report ie Business Review (Strategic Report using the terminology of this document.)

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.
The two proposals in Q 31 do not sound as though they would cost preparers much.

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?
We prefer principles-based regulation and are wary of detailed prescription. Lengthy guidance should not be necessary. The existing OFR Reporting Statement, which includes several illustrative examples, has it about right. It is also helpful that it picks out the main provisions, including clear guiding principles, in bold type.

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.
The comply or explain model is appropriate. Since the aim is to spread the use of best practice, the FRC should monitor what companies do, including aggregating studies of compliance. It should publish progress reports and name companies that neither comply nor provide an adequate explanation.

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.