16 November 2012

Our ref: ICAEW Rep 170/12

Jo Swinson
Business Environment
Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET

By email: narrativereporting@bis.gsi.gov.uk

Dear Jo

The Future of Narrative Reporting: A new structure for narrative reporting in the UK

ICAEW is pleased to respond to your request for comments on the draft regulations for *the Future of Narrative Reporting: A new structure for narrative reporting in the UK*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REP 170/12

ICAEW REPRESENTATION

THE FUTURE OF NARRATIVE REPORTING: A NEW STRUCTURE FOR NARRATIVE REPORTING IN THE UK

Memorandum of comment submitted in November 2012 by ICAEW, in response to BIS draft regulations *The Future of Narrative Reporting: A new structure for narrative reporting in the UK* published in October 2012.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft regulations *The Future of Narrative Reporting: A new structure for narrative reporting in the UK* published by BIS on 18 October 2012.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

ICAEW OBSERVATIONS

We support BIS' initiative to enhance company narrative reporting

5. We support BIS' work to enhance the quality of narrative reporting. We believe that the quality of UK narrative reporting has increased considerably in recent years, an achievement largely due to a narrative disclosure regime that facilitates bespoke, relevant disclosure and the positive effects of peer pressure in inducing companies to enhance their disclosure standards. Overall we welcome the regulation, and other initiatives such as the FRC's *Effective Company Stewardship* initiative, as a positive step forward. Its main success lies in suggesting that the major issues about which shareholders require information should be pulled-out into a 'strategic report', separated from less important, more anodyne information (where in particular, due to operation of the liability regime under s 463 CA 2006, there was a tendency to place all disclosures in the Directors' Report). However, there are some specific areas where refinements could be made, and these are explored further below.

The strategic report does not appear to be an effective 'one stop shop'

6. The regulations do not include a requirement to include any directors' remuneration information in the Strategic Report. The Government had originally suggested they would require this, including the 'single number' for each director's pay. This change of position means that those receiving the Strategic Report alone, instead of the Summary Financial Statements, would see nothing directly on directors' remuneration. This might not satisfy their information needs. These members would presumably need to access the Directors' Remuneration Report online in order to vote on directors' pay. Although this information is available through this channel, and indeed many members are automatically enrolled to receive electronic communications anyway, its omission does reduce the value of the Strategic Report as a stand-alone document. We wonder whether some companies might voluntarily opt to include summary directors' remuneration information in the Strategic Report anyway, although such an approach cannot be expected to be adopted consistently.

7. We also note that the proposal to include standardised financial information from the primary statements within the Strategic Report has also been dropped. In the 2011 consultation, BIS indicated that the content of Summary Financial Statements would largely go into the Strategic Report, and thus shareholders who currently elect to receive only Summary Financial Statements would not suffer any significant loss of information. We supported that earlier proposal; prescribing the duplication of extensive amounts of financial statement information within the new report could have made it cluttered. However, we note that without any of this information, the report does seem to be deficient as a replacement to Summary Financial Statements. It is possible that this issue was discussed in focus groups as a follow-up to the 2011 consultation, but we cannot see a reference to this in the paper accompanying the draft regulations. In cases where the Strategic Report is intended to function as a stand-alone document, it appears to us that BIS need to give further thought as to whether users will be receiving the financial information they need. As the regulation is currently drafted, shareholders receiving only the Strategic Report will not even be told whether the audit report has been modified or not.

8. There is a similar issue with regards to going concern disclosures. The FRC guidance on going concern notes that relevant disclosures are covered by several sources of requirements. In particular, accounting standards (both FRS 18 and IAS 1) require disclosure within the audited financial statements of material uncertainties casting significant doubt over an entity’s ability to continue as a going concern. The current business review requirement (and we understand this will be replicated in the Strategic Report) is to disclose principal risks and uncertainties within that report. This will probably include risks relating to going concern where there are material uncertainties. However, this does not mean that current practice is commonly for such disclosures to be written on a stand-alone basis. FRC guidance on going concern suggests that, rather than having disclosures scattered around, it is better to group them together in one place in a note to the financial statements, and then provide appropriate cross references. As a final point, information about dividends will remain in the Directors’ Report, but this may be of great interest to those receiving the Strategic Report alone.

9. These points create a problem if the Strategic Report is to be capable of being a stand-alone document, but also be in identical form within the Annual Report. Presumably the Strategic Report, if sent alone, cannot include cross references to information it does not contain itself. Therefore the disclosures relevant to, say, going concern will either end up being scattered around the annual report and accounts, with just enough in each location to satisfy its requirements, or they will be duplicated across the Strategic Report, Directors' Report and Audited Financial Statements, thus adding to clutter.

What is classified as 'strategic'

10. We are concerned that the Government has chosen to mandate certain issues as requiring inclusion in the Strategic Report of all quoted companies when they may not be strategic to all in every reporting period. While gender diversity is high on the policy agenda at present, other things have been in the past, and others will be in future that will supplant this as a public policy concern. It would in our view have been better to encourage disclosure on a comply or explain basis, rather than mandating disclosure. Even in situations where companies believe that diversity of their directors and workforce is a strategic issue, it may be that other forms of diversity are considered much more important, for example ethnic diversity. Moreover, this tendency to include such items as mandatory often leads to boilerplate, as well acting as a precedent to other arms of government who believe their current 'important' issue must be strategic to all companies too, leading them to seek to require mandatory disclosure in the Strategic Report (where the Directors' Report may be seen as 'second best'). We do question whether this disclosure might not sit better within the Directors’ Report (where the general listing of the names and photographs of all of the parent company directors will of course make their gender obvious).

Transition from Summary Financial Statements

11. We understand that the Summary Financial Statements regulations will be redrafted shortly. We understand it is the Government's intention that on transition any shareholder that has opted to receive Summary Financial Statements will automatically receive the Strategic Report instead. If this is to be achieved, it would appear sensible to incorporate a specific transitional provision to this effect, so it is much clearer.

12. We note that safe harbour under s463 of CA 2006 would apply to the Strategic Report. This is necessary for a stand-alone document, as otherwise companies could be induced to move this information back into the Directors' Report in order to benefit from safe harbour protection.

The need for clarity around gender diversity and human rights disclosures

13. For the gender diversity disclosures, the drafting is not currently clear as to which directors and managers are referred to. It could be interpreted, from s414 (c) and s414A(3), as all directors of any group company, but we suspect that what is intended is directors of the holding company, and then conversely managers and employees of the group as a whole. 'Managers' is a rather subjective term and it is not immediately clear who should be included within this group. Given that 'key management personnel' is already defined in IAS 24 *Related Party Disclosures*, and information is already collated for this group, it would be appear sensible also to draw on that definition in the regulation (although for many entities 'key management personnel' may be a synonym for the group directors). Clarity is certainly required on this point as the s417 CA 2006 requirement for groups does not work here where consistent numbers are required. The regulation does not specify whether an average or a year-end figure should be given for the gender diversity disclosure, and this should also be clarified: many entities will find a year-end figure more straight-forward to compute.

14. As the regulation introduces for the first time a requirement to report on human rights policies, many companies may struggle on initial implementation to offer meaningful information in this respect. Indeed it is not immediately clear where they can turn for guidance. We would suggest that the UN Ruggie Report (2008) and the Equator Principles (redraft 2012) could be helpful, but more specific guidance may be welcomed by preparers. We look forward to seeing this from the FRC in due course. However, even once there is greater awareness of the types of information that might be included within this disclosure, it may be in many instances that there is nothing of significance to report. In these cases, boiler plate text is likely to become the norm, rather than companies having to state that they have nothing to disclose.

Auditor information disclosures duplicated

15. The requirement for directors to state they have given all relevant audit information to auditors has been included with the Strategic Review requirements, but has also been left in the Directors' Report. It is not needed twice and should just stay within the Directors' Report, which will at least accompany the audited financial statements.

Removal of superfluous disclosures

16. The deletions of superfluous disclosures from the Companies Act are helpful, although in our opinion these could have gone further. In particular we note that some overlaps with the Listing Rules will remain until addressed by the FSA. We do not believe this is an optimal approach. Were the FSA (or its successor) to have clearly committed to remove this duplication, and had set out firm proposals on how it would do this, then the approach taken in the regulation could have been appropriate. But in the absence of this commitment the continuation of duplication in company law may represent a wasted opportunity. This issue has been passed between the FSA and BIS for far too long.

Reinstate the 'principal activity' disclosure

17. We note that the requirement to disclose a company's principal activity has been removed. We appreciate that the requirement to disclose the business model in the Strategic Review will render this disclosure superfluous for quoted companies. We suggest that this disclosure be maintained for non-quoted companies, including small companies.

Effective date

18. The effective date currently stated on the draft regulation is accounting periods *ending* on or after 1 October 2013. We agree with this choice of effective date. Few of the requirements will require extensive historical data collection – particularly if a year-end figure is used for the gender diversity disclosure. The ease of application however does depend on when the final version of the regulations is published, so that companies can plan for what will be definite requirements.

19. The new directors' remuneration disclosures should become effective on the same date, such that only a single transition exercise is necessary. For greenhouse gas reporting, the case for a consistent effective date is less strong, but definitely not for any earlier application – a delay may be preferable here given that some companies are not currently collecting any data on a voluntary basis and the draft regulations thereon are currently so unclear as to be unworkable. A further point in relation to greenhouse gas reporting is how the disclosures, required to be given in the Directors' Report, can be linked to the environmental disclosures in the Strategic Report when that is supposed to be a stand-alone document.

Secondary legislation

20. On publication of the regulation, some current secondary regulations will need to be removed, while others will need to remain. For example, the Summary Financial Statements regulations with regards consultation should be retained.

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