

23 March 2006

Rt. Hon. Alan Johnson MP  
Secretary of State for Trade and Industry  
1 Victoria Street  
London  
SW1E 6RB

Dear Mr Johnson

### **Company Law Reform – Enhanced Business Report**

We originally wrote to you on 20<sup>th</sup> January, and a representative group met your officials on 8<sup>th</sup> February. We would like to thank you for the steps that the DTI has now taken in terms of giving greater clarity to companies over what is expected of them in the short-term. This letter represents the outcome of a further round of discussions with interested parties including corporations, investors, trade bodies and financial sector players. It should be considered as our joint response to the Government's decision to consult more widely to determine amendments to the Company Law Reform Bill, which is a decision that we also warmly welcome.

There are four key messages at the heart of our response:

- 1. We advocate strong incentives for an active voluntary approach for company reporting based on the framework set out in the Accounting Standards Board's Reporting Statement, with a focus on those companies that have a significant shareholder register (ie listed companies)**

We urge the Government to make clear that companies should be striving to report using the framework set out in the Accounting Standards Board's Reporting Statement as a way of demonstrating that they are operating at best practice and also to be in compliance with the Business Review. This non-prescriptive approach which has also been proposed by ACCA, is non-mandatory in nature since companies will be able to make an individual choice about the content and depth of their reporting on strategic forward looking information including extra-financial factors. It will be for investors in particular, as well as users and observers of reporting, to evaluate whether this level of disclosure is adequate for their purposes, and to offer feedback to the company as appropriate. The onus will then be on companies to explain why performance on aspects which may reasonably be considered to be material for a sector are not being reported.

Given the indications that this feedback mechanism could be the subject of market failure and thus be ineffective, we propose that the Government makes an assessment of whether this process of feedback and improvement is working as the Government intends after two reporting cycles.

- 2. The fears that directors have about personal liability related to honest attempts at forward looking reporting must be addressed**

We fully recognise that one important factor in the current debate about a revised scheme of enhanced business reporting is the need for a policy response to address the apparent increased threat of 'derivative actions' against directors. We acknowledge strong support in some quarters for a 'safe harbour' provision to address this issue, but are also fully aware of concerns with this approach and that there may be other legal approaches to provide directors with sufficient reassurances when providing forward looking information. We

therefore call on the DTI to clarify directors' legal positions and liabilities as part of the Company Law Reform Bill.

**3. The discussion paper issued by the International Accounting Standards Board on 'Management Commentary' offers a long-term focus and addresses concerns about an unequal playing field**

There is an opportunity to equip the UK with a regime of corporate accountability that is both forward-looking and pragmatic, and one that goes with the grain of developments in international practice. There is little doubt that debate about OFR has become polarised and backward looking with entrenched positions on all sides. Aligning corporate reporting in the UK with this international process will offer the opportunity for a fresh start for all and address concerns about an unequal playing field. We therefore consider it vital that any decisions the Government takes going forward about enhanced or comprehensive business reporting – terms we prefer to the vagueness of 'narrative reporting' – be done with full awareness of future developments in reporting which will be shaped by IASB. Of course, such international efforts will be strengthened by experience of successful national projects. If such a framework is formulated, implemented and supported by the Government, it will indeed enable the ASB to continue the progress it has made in influencing the global reporting agenda.

**4. We urge the Government to assume a leadership role by formulating policies that will harness support among those who value the well-being of a long-term and responsible "UK plc" and would be in favour of better corporate reporting as a way of improving the way the financial system in the UK functions**

As the first step in creating such a coalition, we propose a set of Principles for Reporting & Accountability which, if taken together and interpreted in a balanced manner, could be the basis for an effective constituency in favour of evolutionary reform of the system in the UK. The Principles are detailed in Appendix 1 and we urge the Government to accept its leadership responsibilities and use this framework to create such a coalition as a key part of its strategy for moving to an 'enlightened shareholder value' approach which is focused on the long term.

## **Conclusion**

Given the considerable uncertainty created by the abolition of the OFR, we consider it essential that the Government re-affirms its commitment to a longer-term and more enlightened definition of shareholder value and uses the Company Law Reform Bill to ensure that reform of reporting is fully aligned with this definition.

The type of information that companies produce, and in what form they produce it, has a profound impact on the way in which shareholders use that information – and a knock-on effect on the way in which capital markets play their role in i) the efficient allocation of capital and ii) discouraging the externalisation of costs on to other companies, society, the environment and future generations. Whilst the above proposals are clearly focused on the needs of long-term responsible investors, the changes that would result would go a long way towards meeting the legitimate expectations of wider stakeholders. These proposals, therefore, represent a workable solution in the short term, and address the Government's medium and long-term objectives. We would be very happy to work with your officials on aspects of the new regime.

We are copying this letter to the Chancellor of the Exchequer, Rt. Hon. Gordon Brown MP.

Yours sincerely,

Anne Richards  
Chief Investment Officer  
**Aberdeen Asset Management**

Susan Enefer  
Manager, Corporate Governance  
**British Columbia Investment Management Corporation (bcIMC)**

Steve Falci  
Chief Investment Officer-Equities  
**Calvert Group**

Francis Ingham  
Head of Public Affairs  
**Chartered Institute of Public Relations (CIPR)**

Tim Purcell  
Chief Executive Officer  
**CO3**

Peter Webster  
Executive Director  
**EIRIS**

Matt Christensen  
Executive Director  
**European Social Investment Forum (Eurosif)**

David Blood  
Managing Partner  
**Generation Investment Management**

Roger Yates  
Chief Executive  
**Henderson Global Investors**

Rosemary Radcliffe CBE  
Chairman  
**Independent Working Group on the OFR**

Douglas Ferrans  
Chief Executive Officer  
**Insight Investment**

Hendrik du Toit  
CEO  
**Investec Asset Management**

Edward Bonham-Carter  
Joint Chief Executive  
**Jupiter International Group PLC**

Peter Kinder  
President  
**KLD Research & Analytics, Inc.**

Councillor John Saunders  
Chair  
**Local Authority Pension Fund Forum (representing 39 separate pension funds)**

Peter Scales  
Chief Executive  
**London Pensions Fund Authority**

Keith Jones  
Chief Executive Officer  
**Morley Fund Management**

Frank Curtiss  
Special Projects Officer  
**RAILPEN Investments**

Neil Dwane  
European CIO  
**RCM**

John Gummer  
Chairman  
**Sancroft**

John Elkington  
Founder & Chief Entrepreneur  
**SustainAbility**

Mark Goyder  
Director  
**Tomorrow's Company**

Penny Shepherd  
Chief Executive  
**UK Social Investment Forum (UKSIF)**

Ann Byrne  
Chief Executive Officer  
**UniSuper Limited, Australia**

Peter Moon  
Chief Investment Officer  
**Universities Superannuation Scheme**

Nick Stace  
Director of Campaigns and Communications  
**Which?**

Will Hutton  
Chief Executive Officer  
**Work Foundation**

## Appendix 1: Principles for Better Reporting and Improved Accountability

Underpinning our support for enhanced (or comprehensive) business reporting is our belief that it is important to:

1. Improve company decision-making and risk management: experience shows that the process of reporting on the drivers of long-term value and risk which are most relevant to their particular company focuses the minds of senior management, and thus helps them actively manage these factors and so improves their decision-making.
2. Improve investor decision making and so foster long term value creation: by enabling investors to compare the prospects and performance of companies more accurately, this improves the financial system's focus on long-term value creation and the allocation of capital with benefits for the entire economy and those who have a diversified exposure to it.
3. Improve stakeholder communication and trust: without compromising the accountability of companies to shareholders, enhanced business reporting is fully aligned with the "enlightened shareholder value" approach and goes a long way to enabling employees, the community, regulators and all stakeholders to assess better the performance of companies on critical environmental, social and governance issues and to understand their "values in action".
4. Encourage a shift from compliance to judgement: recognising that every company is different, there is a clear need for an overall framework which offers companies the flexibility to exercise their judgement and think less in terms of an external standard for reporting but rather to be aware of and focus in a practical way on the real health of their business.
5. Improve the quality and range of information reported on: encouraging corporate managers to consider the totality of variables that influence corporate performance (including extra-financial factors<sup>1</sup>) encourages greater use of judgement by capital markets in evaluating and comparing the prospects and performance of companies beyond traditional financial analyses.
6. Encourage simplicity, brevity and reduce duplication of effort: by freeing companies to convey information with the minimum of repetition – allowing them to cross-refer readers to other available information outside of the core narrative – companies can create a core narrative which captures, in one place, all the key information and context that is needed for interested parties to form an overall assessment of the company.
7. Encourage smarter regulation and greater market freedom: by maintaining a regime that achieves the optimum balance between minimal burden on companies and maximum market transparency and which takes into account of company size and ownership structure.
8. Protect companies, and in particular individual directors, against inappropriate legal risks: the risk that evolution in the reporting framework may be used in opportunistic derivative suits and other unwarranted litigation is real and needs joint action.
9. Accept the right of executives to decline to disclose information where it is in their competitive interest to do so: investors should respect this rationale and companies should not use it as an easy excuse.
10. Prepare for international convergence: by shaping UK reporting regimes so that they are ready for the emerging model of international standards and to play a leadership role in encouraging such convergence, so that any short-term threat of competitive disadvantage to "UK plc" is quickly removed and indeed converted into a first-mover advantage.

---

<sup>1</sup> Extra financial factors are fundamentals that have the potential to impact companies' financial performance or reputation in a material way, yet are generally not part of traditional fundamental analysis. Some examples are future political or regulatory risks, the alignment of management and board with long-term company value, R&D/innovation, the quality of human resources management, risks associated with governance structure, the environment, branding, corporate ethics and stakeholder relations.