Mr Stephen Haddrill
Chief Executive
Financial Reporting Council
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Friday, 1 April 2011

Dear Mr Haddrill,

Effective Company Stewardship: Enhancing Corporate Reporting and Audit

The National Association of Pension Funds (NAPF) is the UK's leading voice for workplace pensions. We represent all types of workplace pension schemes, including defined benefit, defined contribution, group personal pensions and statutory schemes such as those in local government. Between them, our members have combined assets of nearly £800 billion, and operate some 1,200 pension schemes. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

The NAPF is grateful for the opportunity to respond to the FRC's consultation, *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*, and we are generally supportive of the seven key recommendations made in the paper.

Our response considers each recommendation individually and offers some further issues to which we believe the FRC should give further consideration.

1. Directors should take full responsibility for ensuring that an Annual Report, viewed as a whole, provides a fair and balanced report on their stewardship of the business.

Ideally, narrative reporting should provide a clear statement as to the company's objectives and how it plans to achieve them, as well as the key risks associated with the strategy. This should be in addition to disclosure of performance against its objectives over the reported year and the longer term. The current reporting regime has not been developed particularly coherently, and has lead to a situation where many reports contain too much irrelevant and immaterial detail, or clutter. There is certainly scope to 'cut the clutter', and this has been recognised by the FRC.

We agree with the FRC's assertions that: regulation, guidance and monitoring should promote reports that are relevant to investors and other users to avoid boilerplate disclosures; information should be provided in a user-friendly and accessible manner; and the Annual Report should be provided on the company's website. Whilst we also agree that companies should decide how and where information is provided, we do believe that the Annual Report should be recognised as a solid foundation of key information about the company and its existence remains relevant and important to investors.

Narrative reporting in an Annual Report should present a balanced view of the company in its own words, and we agree that it is the responsibility of company directors to ensure that the Annual Report provides this fair and balanced view. A report should contain objectives, performance and risks which are relevant and material to their individual circumstances. However, companies need to do this whilst also recognising that shareholders require consistent and comparable information to assist them to make investment decisions. Reports should be structured in a way that makes them clear and concise so that shareholders are able to easily extract the information they require.

Further, directors should ensure accounting policies are applied consistently over time, and this should be monitored by the auditor. This will ensure that year on year comparisons are more easily made and also highlight areas where information may be presented differently and in a way that masks areas of poorer performance.

A Code or framework may be useful, and the NAPF is supportive of initiatives such as that of the International Integrated Reporting Committee, which aims to "create a globally accepted framework for accounting for sustainability: a framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format".

We would argue however that this is not an area to be regulated. The danger with setting prescriptive requirements is that in order to become relevant for all companies, the requirements may need to be very high level, and therefore not useful for making investment decisions. There is also a boilerplate issue whereby companies may omit certain relevant and material information, instead focusing on compliance.

2. Directors should describe in more detail the steps that they take to ensure:

- **The reliability of the information on which the management of a company, and therefore directors' stewardship of the company, is based; and**
- **Transparency about the activities of the business and any associated risks.**

We certainly agree with the FRC's suggestion that companies should provide information about the steps they take to ensure the reliability of the information on which the company's management, and therefore directors' stewardship, is based. We also agree that directors should be transparent about the activities of the business and any associated risks, and that both should be explained in the Annual Report. Further, we believe there is scope to improve transparency around the entire audit process through the Audit Committee report.

We would, however, be grateful for greater clarification from the FRC as to whether this recommendation refers specifically to internal control systems, methods of reporting (internally and externally), risk management, or a combination of all three.

3. The growing strength of Audit Committees in holding management and auditors to account should be reinforced by greater transparency through:

- **Fuller reports by Audit Committees explaining, in particular, how they discharged their responsibilities for the integrity of the Annual Report and other aspects of their remit (such as the oversight of the external audit process and appointment of external auditors); and**
- **An expanded audit report that:**
  i. **Includes a separate new section on the completeness and reasonableness of the Audit Committee report; and**
  ii. **Identifies any matters in the Annual Report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit.**

Audit Committee reporting

We agree that there is scope to improve transparency through the Audit Committee report. In addition to the recommendations in the Consultation, we draw the FRC's attention to the Global Auditor Investor Dialogue (www.enhanceddisclosure.org). This initiative aims to assist boards and Audit Committees in fulfilling their disclosure responsibilities, in turn assisting investors in their evaluation processes.

An expanded audit report

We agree with the FRC's proposals that it would is sensible that the audit report should cover the reasonableness and completeness of the Audit Committee's report. We also believe it should set out any areas for improvement or areas where further information is required. Further, we agree that the audit report should cover other matters in the Annual Report that are believed to be inconsistent with the financial statements or incorrect. Both these measures are likely to give greater comfort to report users that the report is comprehensive, covering the full range of matters that the auditors considered in reaching their audit opinion.

Auditor scepticism

Objectivity, integrity and independence are certainly important to the audit process and ensuring the effectiveness and efficiency of audits. We share the concern of others that in some cases audit firms seek to obtain evidence that supports the judgements of their clients. Auditors should seek to challenge management, rather than gathering prescribed data for the purposes of supporting management's assertions. Firms should employ processes which ensure consistency of their key judgements and findings across clients, rather than implementing specific processes to satisfy the requirements of specific clients.

Non-audit services

With respect to the provision of non-audit services by audit firms, we agree that this is a matter which should be carefully monitored. Investors are concerned about the tendency of companies to use their auditors for non-audit work. While this can on occasion be justified on grounds of relevant expertise and associated costs, ideally more use should be made of third parties.

Where the auditors do supply a substantial volume of non-audit services to the company, the Audit Committee should keep the nature and extent of such services under regular review, seeking to balance the maintenance of objectivity and value for money. In addition, in the annual report there should be full disclosure of the value of any non-audit fees. There should be a clear break-down between the types of services received, with tax compliance services differentiated from tax advisory services and non-statutory acquisition related services separated from statutory services.

Cooperation between regulators and auditors

Consultation and communication between auditors and regulators is of particular importance, and this dialogue could be reinforced. We are therefore supportive of the development of procedures and practices to facilitate a two-way dialogue between supervisors, regulators and audit firms. We would however be wary of mandatory communication procedures which may lead to costly boilerplate disclosures that do not achieve the desired outcome.

4. Companies should take advantage of technological developments to increase the accessibility of the Annual Report and its components.

The use of electronic reporting has developed extensively in recent times, and this has been of great benefit to report users. The ability to search electronic reports for key words and phrases is important, as is the use of hyperlinks directing the user to routine 'boilerplate' reporting, helping to reduce clutter in the report.

Companies should make full use of their website, as it is a fast and effective means of reaching stakeholders. It is easily accessible and enables the company to provide regular updates on its activities. If companies do elect use their website as a means of reaching stakeholders, they need to be certain that the website is easy to navigate. Whilst many companies have useful and informative websites, there remain many who do not use the website effectively, either due to simply not making information available, or by having information which is difficult to find.

We agree that a common reporting language such as XBRL could be useful for facilitating rapid information retrieval. However this should not be seen as a substitute for ensuring that the Annual Report constitutes a whole and coherent document.

5. There should be greater investor involvement in the process by which auditors are appointed.

Currently in the UK, the control over the appointment, removal and fee structure for audit firms lies with the directors and is subject to shareholder ratification at the Annual General Meeting. Whilst the directors' control over this matter may have the potential to cause a conflict, the presence of the shareholder vote, and in many cases an independent audit committee, reduces the cause for concern.

We are supportive of the FRC's proposal that Audit Committees should discuss with a number of key investors the approach to be taken to the appointment or re-appointment of the auditor, including the merits or otherwise of putting the audit out to tender.

6. The FRC's responsibilities should be developed to enable it to support and oversee the effective implementation of its proposals.

The NAPF is supportive of the work of the FRRP and the AIU, in particular the escalation processes used by the FRRP to address issues of non-compliance in reporting. We agree that it would be useful for these oversight bodies to have their remit extended to cover the information covered in the narrative reporting.

With respect to narrative reporting, we draw the FRC's attention to the Department for Business, Innovation and Skills' (BIS) consultation, *The Future of Narrative Reporting*. We believe it is important to both issuers and investors that any guidance arising from both the FRC and BIS consultations is consistent.

The Auditing Practices Board will also require adequate powers, to the extent that it does not already have them, to make the auditor attestations on representations made by the company in the Audit Committee report and elsewhere fully effective.

7. The FRC should establish a market participants group to advise it on market developments and international initiatives in the area of corporate reporting and the role of assurance and on promoting best practice.

We are supportive of the FRC's proposal to create two forums of market practitioners to exchange views on market developments within financial services and non-financial services businesses. It will be important that these groups are balanced and have an appropriate level of investor representation. NAPF members will certainly wish to contribute.

The suggestion of a 'financial reporting lab' to develop, test and trial new concepts in financial reporting models is welcomed by the NAPF and we believe this would certainly lead to greater innovation in the field.

With respect to both these initiatives, we draw the FRC's attention to already existing groups, such as the Corporate Reporting Users Forum (CRUF) and the Company Reporting and Auditing Group (CRAG). The FRC should ensure the work of these groups is not duplicated (the FRC may in fact wish to work with these groups) to ensure the most productive outputs from any related initiatives.

As a final note, it is important that the FRC takes into consideration any other related inquiries, such as the House of Lords Report on Audit, which makes some useful recommendations, and the BIS consultation on narrative reporting. This will ensure consistency of recommendations, as there is a risk of little value being added where investors and issuers are overburdened with inconsistent (and potentially conflicting) recommendations and information.

Yours sincerely,

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