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Response to Consultation on "Effective Company Stewardship"

Dear Mr Haddrill,

On behalf of our Society, I would like to make the following comments on the document entitled "Effective Company Stewardship" recently published by the FRC. Note that we represent the interests of individual shareholders who invest directly in the stock market (more background on our organisation is at the end of this letter).

1. Narrative Reporting.

A - I am sure most people would agree that the Annual Report should "communicate high quality and relevant narrative and financial information to the market". However this places a high burden on companies and also leaves them open to the disclosure of information that is of benefit to their competitors. Indeed from the analysis on page 2, it is not surprising that such information as "contractual and other arrangements", "strategy" and "principal risks" are often not adequately covered. The level of analysis required may well be acceptable to large FTSE-100 companies, but it would place a heavy burden on small companies to comply fully with what you seem to be requiring. We support the general principle of improving reporting, but we think boards should have discretion about what is reported and how much effort is spent in producing such reporting.

B - You suggest that companies should decide "how and where they provide particular information". This gives us some concerns. At least at present shareholders know that all relevant information is contained in the Annual Report, and we would be opposed to any fragmentation of the location of such information. It would only be acceptable if the location of other information was consistently held in a specific place that all shareholders would know about (e.g. on a company's web site on a specific named page).

C - You also propose that the Annual Report "be posted on a company's website, rather than produced in print". WE ARE STRONGLY OPPOSED TO THIS MEASURE. Our reasons for opposition are as follows:

Although most of our members are active internet users, and we would certainly want to see all Annual Reports available on a company's web site in a standardised format (preferably as a complete pdf document which is not always the case at present), our members often prefer to receive a printed copy.

There are two reasons for this:

- (i) It is not easy to browse an Annual Report on-screen, and printed copies are by their nature more portable. So our members often print out reports when they are researching companies. But for existing holdings, this simply transfers the cost of printing to the shareholder from the company.
- (ii) Annual reports are often formatted with subtle colours, fine text and light colour shades for text. These do not print well on the typical home or small office printer. There is a basic problem with designing a report that is readable "on-screen" with one is printable on both low volume and high volume printers (even such basic matters as multi-column layouts versus single are better in one format than another).

Although we accept that the cost of producing and distributing printed reports is high, and will become more expensive as postage costs rise, only those shareholders who actually want a printed copy get one as the default is already "web-based" communication. For those people who do want printed copies, the economies of scale of centralised printing and distribution still makes sense over the local printing by the individual shareholder (which is environmentally nowhere near as efficient as centralised printing).

Obviously there are some companies (banks and insurance companies are good examples), whose Annual Reports are now hundreds of pages long. But there is already the option of producing "Summary" reports available to companies. In addition we would suggest that the length of Annual Reports has become wildly excessive of late. More data and larger Annual Reports have not assisted in the communication of more information. One example is that of banks who have done a wonderful job of obfuscation. The size of the RBS Annual Report, for example, did not enable shareholders to see the underlying weakness of the banks cash flow before they got into difficulty. We want more information, not more data. It would certainly make more sense to transfer some of the detail to a web hosted format for those who want the detail, leaving the Annual Report primarily as a narrative document with only summary financial data included.

In essence, removing the obligation to provide a printed report (when requested), is a further step along the path of removing a traditional communication channel between companies and their investors. We suggest that this will further impede proper shareholder democracy and the control of companies (and their boards) by their shareholders which has been severely eroded in the last few years.

D – You also propose that companies "provide access to Annual Reports and accounts through the web in a form that enables them to be searched quickly and easily". That is already available of course if they are provided as a pdf document where a manual search is involved, as most companies do (but not all). The use of XBRL is a more complex question, and there would be substantial costs involved I suggest. It would need to be clear there was sufficient demand, and benefit, from that for the extra cost to be justified. It would certainly assist with "automated" searches and enable the provision of new facilities for investors in due course.

2. Assuring Integrity.

A – In general the proposals here seem to involve more bureaucracy with lengthier reporting (and we have already expressed opposition to increasing the size of Annual Reports). It would certainly increase the costs of audit, which is in essence an unproductive cost which comes straight off the bottom line of the earnings of companies.

We do not support such trends in essence, and see no great benefit in the expansion of the audit report or reporting by the audit committee.

B – You specifically recommend “there should be greater investor involvement in the process by which auditors are appointed”. Obviously at present, the directors decide on the auditors and the shareholders approve the appointment, but in practice they never dispute the board’s recommendation. Your proposals for more explanation on how the audit committee reached its recommendations might be useful. However to suggest that the committee “discuss with a number of principal investors the approach to be taken...” is nonsensical. All shareholders are equal in principle so it would be wrong to discuss such matters with some shareholders and not others. In addition, in many public companies, there are few shareholders with more than a small percentage of the equity so how such “principal investors” are to be determined is unclear.

One issue not even tackled in the report is the question of the failure of auditors to respond to questions from shareholders. They see themselves solely as accountable to the company and its board of directors (following the Caparo judgement). Unless this principle is overturned, we are unlikely to see much improvement in the quality of auditing or audit reports.

C – As regards the proposals for a “Safe Harbour” on forward looking statements, there may be some merit in this idea.

3. Fostering Quality Improvements.

We do not have many comments on this section, although we certainly would support the development of better financial reporting for financial services businesses. The accounts of such companies are a long way from being transparent to the shareholders, and there is great difficulty in comparing the performance of such companies.

4. Legislative and Cost Implications.

We are not in favour of removing statutory requirements that dictate how and where certain information is set out in a company’s Annual Report. It ensures consistency and ease of use by shareholders if information is presented in a consistent format.

As we have already said above, we are generally not in favour of increasing the complexity of reporting, expanding the role of auditors, or increasing the burdens of reporting on companies. These are all unproductive costs. More concentration on simplification of Annual Reports, with a focus on less but more meaningful information is what is required. This might assist in shortening the more bloated Annual Reports.

Yours sincerely

Roger W. Lawson
Chairman

About the UK Individual Shareholders Society (ShareSoc)

ShareSoc represents and supports individual investors who invest in the UK stock markets. We are a mutual association controlled by the members with "not-for-profit" articles and incorporated as a company limited by guarantee. The organisation is financed by member subscriptions, donations from supporters and by its commercial activities. More information on ShareSoc can be obtained from our web site at www.sharesoc.org (our objects are fully defined on this page: www.sharesoc.org/objects.html).