

THE

INVESTMENT

ASSOCIATION

INVESTMENT MATTERS

The Investment Association Long Term Reporting Guidance

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Registered office: The Investment Association
Camomile Court, 23 Camomile Street London EC3A 7LL
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INTRODUCTION



This guidance sets out the expectations of the Investment Association's members on various aspects of Long Term Reporting. It applies to companies whose shares are admitted to the Premium Segment of the Official List of the UK Listing Authority. Companies whose shares are admitted to the Standard Segment of the Official List, to trading on AIM, or to the High Growth Segment of the London Stock Exchange's Main Market are encouraged to adopt this guidance as best practice.

THE CALL FOR LONG TERM REPORTING

The design and implementation of an asset manager's investment process, including its analytical capabilities and decision-making, are core features of its business model. The success of these contributes to overall investment performance and the delivery of investment objectives for clients. However, this depends largely on being able to assess a company's long term prospects, and identify those able to deliver sustainable value creation to shareholders over the longer term.

A company's Annual Report is an important source of information for investors, and the primary means of communication to the market. Our members look to it to provide the building blocks upon which they make their investment decisions, and for ongoing stewardship activities. In this respect, Annual Reports should strive to provide a true long term understanding of the business and its drivers, its financial strength, and the quality of management and their decisions.

However, during development of our [Productivity Action Plan](#), our members expressed concerns over how companies are reporting on the long term drivers of value creation and productive enterprise. While our members need to be able to assess a company's likely return on invested capital, and want to understand the balance of expenditures required to support productivity improvements, they noted that this is difficult in practice.

As institutional investors, our members have a fiduciary responsibility to their clients - many of whom are individual savers and pensioners - to understand how investee companies are planning for the long term, and maintain a close interest in ensuring that capital is being utilised efficiently. While important advances have been made in recent years and the overall quality of company reporting is improving, additional effort is required so that our members are better able to identify and finance those companies contributing productive growth in the UK economy.

POTENTIAL AREAS FOR IMPROVEMENT

One area for possible improvement is how companies explain the extent to which they are able to provide a return on invested capital, whether by managing their cost-base, increasing sales through business investment, or other capital allocation decisions. Our members believe that how well a company utilises its capital has a significant impact on its long term profitability and success. They want to understand the company's approach in making these decisions, and are keen to support well-articulated and reasoned investments that lead to productivity improvements and increased shareholder returns over the longer term.

However, for efficient allocation of capital that rewards companies for improving productivity to occur, then reporting, accounting standards, and investment research must enable such analysis by asset managers. Reporting of company performance therefore needs to be clear, relevant, timely, related closely to the needs of users, and directed to sustainable, long term value creation. To assist our members in assessing the long term viability of investee companies, company reporting should give information directly relevant to long term prospects of the business, and good risk-adjusted long term returns.

However, this is not just limited to improved disclosures on capital allocation decisions. Our members seek better disclosures regarding how a company is enhancing the productivity of its workforce, and the steps taken by the Board to shape and influence culture. This, in turn, needs to be matched by a continued transition away from issuing quarterly reports and short-term earnings guidance, supported by the provision of greater long term and thematic research.

EXISTING REPORTING REQUIREMENTS

Our members are anxious to avoid unnecessary prescription, or the imposition of costly reporting requirements, and are supportive of the current legislative framework governing company reporting in the UK. These guidelines have been designed to complement the requirements in the [Companies Act \(2006\)](#), and the [Strategic Report and Directors' Report Regulations \(2013\)](#), and are not intended to add to the current reporting burden placed on companies. These guidelines should be read in conjunction with the [FRC's Guidance on the Strategic Report \(2014\)](#)¹.

These guidelines are not meant to limit the amount of information companies could provide on long term strategic matters to their shareholders. Some shareholders with specific investment objectives may seek disclosures that are more detailed. Conversely, some companies may choose to make additional information available, for example through separate corporate responsibility reports, to enhance their investment appeal and to provide greater in-depth analysis of the long term prospects of the company.

IMPLEMENTATION AND MONITORING

Our members recognise that companies can be better served when ideas for value creation are part of a well-argued long term strategy developed and driven by the company itself. Throughout this guidance, we provide practical examples of potential metrics and frameworks that companies could use to meet our members' expectations, whilst retaining sufficient degree of flexibility to take into account a company's own unique operating environment and long term strategy.

We encourage companies to adopt this guidance at the earliest possible opportunity. The Investment Association's [Institutional Voting Information Service \(IVIS\)](#) will be responsible for monitoring implementation of this guidance, through analysis of Annual Reports reporting on year-ends on or after 30 September 2017. IVIS will outline to our members those companies that continue to adopt short-term reporting models, and where companies are not making the desired disclosures as highlighted.

ACKNOWLEDGMENTS

We would like to thank the members of the Long Term Reporting, Capital Management, and Human Capital and Culture Working Groups for their commitment to developing this Long Term Reporting Guidance. Without their intellectual contribution and industry experience, we would not have been able to bring together this important document.

FURTHER INFORMATION

For further information on this Long Term Reporting Guidance, or the Investment Association's [Productivity Action Plan](#) please contact:

David McCarthy, Policy Adviser – Productivity Action Plan

david.mccarthy@theia.org : +44 20 7831 0898

Andrew Ninian, Director, Stewardship and Corporate Governance

andrew.ninian@theia.org : +44 20 7831 0898

¹<https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf>

LONG TERM REPORTING GUIDANCE



BUSINESS MODELS AND LONG TERM REPORTING

This section outlines our members' expectations on clear and concise business model disclosures, and companies adopting a longer term approach in their reporting to shareholders.

Quarterly reporting

1. Our members' prefer that companies adopt longer time horizons in reporting to shareholders. We call on companies to stop issuing quarterly reports and quarterly earnings guidance in favour of greater attention being given to longer term performance and strategic issues.
2. We encourage companies to review how their current reporting cycle is aiding investor understanding of the business over the long term, and to make the necessary amendments to ensure it focuses on the key drivers of productive growth and value creation within the business.
3. For those companies that continue to report quarterly, either due to competitive market pressures or shorter market cycles, our members ask that those companies publicly explain this position, and how it is relevant to the achievement of their long term strategy.
4. Our view on quarterly reporting is set out more fully in our [public position statement on quarterly reporting](#).

Business model disclosures

5. We welcome the FRC Reporting Lab's recent efforts to improve business model disclosures. We encourage companies to review their current approach against the [FRC Reporting Lab's Business Model Reporting recommendations](#)² to ensure better linkage of business model information to other sections of the Strategic Report.
6. In summary, we wish to highlight several key findings as follows:
 - 6.1. Business model disclosures are vital for enhanced analysis of a company and its performance, position, and prospects. They should explain what a company's competitive advantage is, and how its business model connects to its long term strategy.
 - 6.2. As business model information provides context to other information in the Annual Report, it should be positioned towards the front of the Strategic Report. Where a company operates different business models, these should be explained separately.
 - 6.3. Business model disclosures should provide concise insight into the key inputs, processes, and outputs in the value chain, and how the company's key assets are delivering value in a manner consistent with the long term interests of its shareholders.
 - 6.4. Business model disclosures should also make clear the key risks to the successful delivery of the business' long term strategy, and ongoing operation of the business model. They should outline the risks that pose the greatest threat to the viability of the company, and the action being taken by the Board to mitigate against these risks.

²<https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-Business-model-disclosure.pdf>

Focusing on the longer term

7. Our members believe that company reporting that is concentrated on short-term performance is not necessarily conducive to building a sustainable business, and can inadvertently embed an inappropriate short-term focus in management decision-making, potentially at the expense of investments in the long term drivers of productivity and sustainable value creation.
8. Company reporting that focuses on the longer term underpins investor confidence, and facilitates enduring relationships between companies and shareholders which enhance company performance, and ultimately profitability, that is in the interests of all stakeholders.
9. Our members believe that reporting should strive to provide insight into the significant strategic issues, as well as the principal risks, facing the company over the next three to five years – although they would prefer longer time horizons wherever possible.

PRODUCTIVITY

This section outlines members' expectations on how companies should report on the drivers of productivity within their business.

The drivers of productivity

10. Improving productivity can increase wages, improve living standards, and enhance company performance. Stronger and more productive businesses can help to deliver the exceptional long term investment returns that many millions of people, whose savings and investments our members manage, both demand and deserve.
11. In order to be able to support investments in productivity improvements, our members require clarification from companies as to what the main drivers of productivity are within the business, and how planned investments are expected to drive productivity gains over the longer term.
12. Companies are encouraged to regularly assess the level of productivity within their own business, and explain its impact on operations. Companies are encouraged to use the Productivity Council's '[How good is your business really](https://howgoodisyourbusinessreally.co.uk/)'³ online assessment tool as a starting point for conducting their productivity assessments.
13. Specifically, our members request that, in a narrative discussion in the Strategic Report, companies:
 - 13.1. Set out the process by which productivity is regularly assessed within the business, explain the criteria used to conduct this assessment, and outline the outcome of those assessments over the last year;
 - 13.2. Describe the main drivers of productivity within the business, the extent to which these influence operations within the company, and the planned investments to improve productivity over the next year; and
 - 13.3. Outline the significant opportunities and challenges facing the company in terms of improving productivity over the next year, and the strategy adopted by the Board to respond to these issues.

³ <https://howgoodisyourbusinessreally.co.uk/>

14. Our members acknowledge that the drivers to improve productivity will inevitably be different for different companies and the sectors they occupy, and that it takes time before any investment can improve productivity and yield results.

Measures of productivity

15. To support the above narrative discussion and provide context on the drivers of productivity, our members expect that companies provide evidence of the investments it is making, or is planning to make, in improving productivity.
16. As these will likely be different for each company, companies are encouraged to develop their own set of Key Performance Indicators by which improvements in productivity can be reliably measured over time.
17. As a reference point, our members recommend that companies consider utilising the following framework to structure these quantitative disclosures⁴:
 - 17.1. **Infrastructure:** including, for example, capital expenditure on new equipment and machinery, as well as efficiency improvements in resource allocation;
 - 17.2. **Innovation:** including, for example, total spend on research and development, patents, and technological advancements being made to add future growth;
 - 17.3. **Skills:** including, for example, spending on training, personal development, and processes associated with the recruitment and retention of talent; and
 - 17.4. **Culture:** including, for example, employee engagement, satisfaction in the workplace, changes in company structure, and management of human capital.

CAPITAL MANAGEMENT

This section outlines members' expectations on capital management disclosures, and how companies can improve reporting on the connection between capital management and its long term strategy.

Investor's expectations of capital management

18. Capital allocation decisions play a vital role in determining a company's long term success, and are viewed by our members as some of the most important responsibilities of company management.
19. Our members are keen to understand a company's capital position, how it manages its capital, and measure the performance of its capital allocation decisions. Investor interest in this issue is summarised as follows:
 - 19.1. As institutional investors, our members are interested in long term value creation for the benefit of their clients. They have a fiduciary responsibility to their clients, many of whom are individual savers and pensioners.
 - 19.2. As a result, our members maintain a close interest in ensuring that clients' capital is allocated efficiently, and that the approach governing its use - including its policies, processes, and review mechanisms - promotes sustainable, long term value creation.

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<https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/methodologies/productivityhandbook>



- 19.3. Our members are committed to the principle of responsible ownership outlined in the [FRC's Stewardship Code](#), but recognise it is not the role of investors to be involved in specific capital allocation decisions.
- 19.4. As key providers of capital, our members consider they have a duty to provide investee companies with clarity regarding their expectations of how capital should be managed, and the expected returns. They are keen to support well-reasoned and articulated capital expenditures which are consistent with a company's long term strategy.
- 19.5. For shareholders to support long term investment and productivity improvements requires effective dialogue between investors and companies. Thus as part of regular discussions with companies, our members would welcome engagement on capital management issues.

Understanding a company's Capital Management Strategy

20. Disclosures as to what a company regards as capital, how it makes decisions regarding its allocation, and the process by which it reviews the performance of invested capital are necessary for a balanced, comprehensive understanding of the companies our members invest in.
21. We urge companies to adopt balanced capital management strategies, appropriate for their respective industries, which support long term productive growth. We believe that companies have an obligation to be open and transparent about their capital management strategies so that our members can evaluate them and companies' progress in executing on those plans.
22. Specifically, disclosures regarding a company's capital management strategy should explain the approach taken to managing its capital, provide assurance that it is allocating capital efficiently, and demonstrate that it is acting in a manner that is consistent with shareholder's interest in sustainable, long term value creation.
23. Within the Strategic Report, our members expect that companies will provide narrative discussion concerning:
 - 23.1. The objectives and investment priorities of the company's capital management strategy, including an explanation of the key criteria and underlying assumptions used to assess capital allocation opportunities;
 - 23.2. The policies governing what the company regards as capital, including an explanation of the company's approach to distinguishing between maintenance capital, and capital that is used for growth;
 - 23.3. The process by which capital allocation decisions are made by the company, how often policies regarding capital management are reviewed, and how performance of these decisions are assessed over the long term; and
 - 23.4. The role of the Board in setting the Capital Management Strategy, with discussion regarding its responsibility in providing oversight over final capital allocation decisions and reviewing past performance.

Capital allocation decisions in practice

24. It can often be difficult to determine how management are efficiently utilising the capital provided to create sustainable, long term value. This includes understanding how a company is investing in its future, how it makes key decisions to adapt to environmental changes, and how it seeks to mitigate long term risks.



25. Our members believe that capital management is a dynamic process, meaning that ongoing dialogue between shareholders and management is critical in building understanding about capital allocation decisions, as well as how shareholder's long term interests are being advanced by management.
26. Given the importance of capital allocation decisions to its long term success, a company should keep all capital allocation decisions under regular review, and provide shareholders with updates on significant developments.
27. Our members prefer that companies provide an analysis of capital that is integrated into discussions about long term strategy, and the resources needed to deliver on that strategy. To facilitate further investor understanding, companies should provide disclosures on capital management within the Strategic Report which should include:
 - 27.1. A discussion of the significant capital allocation decisions made during the past year;
 - 27.2. An explanation of the nature of the dialogue with key shareholders on capital allocation decisions during the past year, including a commentary on how these discussions have influenced the company's decision-making process;
 - 27.3. The outcomes of those significant capital allocation decisions, with reference to how those expenditures have led to productivity improvements and supported the delivery of the company's long term strategy; and
 - 27.4. Where appropriate, an explanation of any significant cancellations or withdrawals from past capital allocation decisions that have been made in the past period.
28. Given the complex nature of capital expenditures, and noting that it can take time to see changes in company performance, our members recognise that it may not always be possible to link specific capital allocation decisions with company results within an annual cycle.

Supporting quantitative disclosures

29. As part of this effort, companies should work to develop financial metrics, suitable for each sector or market it operates in, that support a framework for long term growth. Components of long term remuneration should link to these metrics.
30. To allow investors to be able to undertake a comparative analysis of previous performance, companies should as a minimum include, either in a single table or via a clear signpost system, the following quantitative disclosures:
 - 30.1. Working capital;
 - 30.2. Investment Capex;
 - 30.3. Research and Development;
 - 30.4. Capital distribution, including debt servicing, dividends and buy backs; and
 - 30.5. Investment in skills and training.
31. For each disclosure, companies should explain how the figure was calculated. Where possible, companies should provide these disclosures on a segmented basis by location, sector and/or market. All disclosures should allow for year-on-year analysis.

Merger and Acquisition transaction data

32. As one of the most significant capital allocation activities, investors have a particular interest in understanding major merger and acquisition decisions. Specifically, investors want enhanced disclosures on the rationale for past merger and acquisition activities, and the performance of those activities over time.
33. Suggested measures that a company should consider including as part of its disclosures on mergers and acquisitions include:
 - 33.1. Information on the full price paid;
 - 33.2. Debt reconciliation;
 - 33.3. Annualised sales;
 - 33.4. Returns/margins;
 - 33.5. Tax planning; and
 - 33.6. ROCE/ROI on the transaction.

Nature of funding

34. Investors need to understand the approach taken by a company to fund its capital management strategy, the company's appetite for risk, and the potential opportunities for further investment.
35. To help achieve this, our members seek information regarding company's funding arrangements and the nature of funding, including but not limited to:
 - 35.1. The company's policy and approach to leverage, including net debt to EBITDA;
 - 35.2. Mix of funding approaches, including bonds, bank loans, private placement and other funding sources;
 - 35.3. A net debt reconciliation shows how a company's indebtedness has changed over a period as a result of cash flows and other non-cash movements;
 - 35.4. Key maturity dates;
 - 35.5. Impact of bonds / the state of bank covenants; and
 - 35.6. Actuarial assumptions.

Cost of Capital

36. Which capital allocation opportunities a company pursues is influenced by the cost of capital, although many companies do not consistently calculate it, or disclose any information on it.
37. Companies should, therefore, provide shareholders, as part of the Annual Report, with disclosures regarding:
 - 37.1. The company's cost of capital, including an explanation as to how this is calculated;
 - 37.2. The process by which the company's cost of capital influences its capital allocation decisions, including an explanation of how a discount rate is applied for risky or volatile activities; and

37.3. The extent to which the expected return on investment will exceed the cost of capital.

Demonstrating return on investment

38. Where possible, companies should demonstrate the returns generated as a direct result of the capital allocation decisions made. In this context, investors acknowledge that it may not always be possible to prove a direct causal link between a specific capital allocation and expected returns.

DISCLOSURE OF MATERIAL ENVIRONMENTAL AND SOCIAL RISKS

39. This section is based on a modification of the Investment Association's [Guidelines on Responsible Investment Disclosure](#) published in January 2007. It outlines the disclosures that our members would expect to see included in the Annual Report. Specifically, they refer to disclosures relating to the Board responsibilities and policies, procedures, and verification systems in place to manage material environmental, social and governance risks.

Importance of ESG issues


40. Our members believe that sound management of significant environmental and social risks by a company's Board can have an important, positive flow-on effect on the businesses long term ability to deliver sustainable value creation for its shareholders.
41. Increased disclosure on environmental and social risks can help lead to a more broad assessment of the environment in which companies operate, and their performance in managing different stakeholders, giving a fuller understanding of the full spectrum of financial and non-financial risks facing a company than traditional fundamental analysis.
42. Recognising the importance of these issues, our members therefore encourage companies to demonstrate how they are creating, sustaining, and protecting value through the management of material environmental and social risks, and how this aligns with the achievement of the businesses long term strategy.

Role of the Board in addressing ESG issues

43. With regard to the Board, the company should state in its Annual Report whether:
- 43.1. As part of its regular risk assessment, the Board takes account of the significance of environmental, social and governance (ESG) matters to the business of the company.
- 43.2. The Board has identified and assessed the significant ESG risks to the company's short and long term value, as well as the opportunities to enhance long term value that may arise from an appropriate response.
- 43.3. The Board has received adequate information to make this assessment and that account is taken of ESG matters in the training of directors.
- 43.4. The Board has ensured that the company has in place effective systems for managing and mitigating significant risks, which, where relevant, incorporate performance management systems and appropriate remuneration incentives.

ESG disclosures in Annual Reports

44. With regard to policies, procedures and verification, the Annual Report should:
- 44.1. Include information on ESG related risks and opportunities that may significantly affect the company's short and long term value, and how they might impact on the future of the business.

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- 44.2. Include in the description of the company's policies and procedures for managing risks, the possible impact on short and long term value arising from ESG matters. If the Annual Report and accounts states that the company has no such policies and procedures, the Board should provide reasons for their absence.
 - 44.3. Include information, where appropriate using Key Performance Indicators (KPIs), about the extent to which the company has complied with its policies and procedures for managing material risks arising from ESG matters and about the role of the Board in providing oversight.
 - 44.4. Where performance falls short of the objectives, describe the measures the Board has taken to put it back on track.
 - 44.5. Describe the procedures for verification of ESG disclosures. The verification procedure should be such as to achieve a reasonable level of credibility.

ESG issues being considered by the remuneration committee

- 45. With regard to the Board, the company should state in its remuneration report:
 - 45.1. Whether the remuneration committee is able to consider corporate performance on ESG issues when setting remuneration of executive directors. If the report states that the committee has no such discretion, then a reason should be provided for its absence.
 - 45.2. Whether the remuneration committee has ensured that the incentive structure for senior management does not raise ESG risks by inadvertently motivating irresponsible behaviour.

HUMAN CAPITAL AND CULTURE


This section outlines our members' expectations as to how companies should report on human capital and culture.

Human capital and productivity

- 46. A key driver of productivity is how a company is managing its workforce and whether it is being deployed efficiently. Our members believe a well-engaged, stable, and trained workforce is more likely to be more productive and, in turn, be more likely to drive long term business success.
- 47. However, there is limited reporting by companies setting out their approach to human capital management, how it is working to develop a positive operating culture, and of the significant investments being made to improve the productivity of their workforces over the longer term.
- 48. We believe that these issues are deserving of more transparency by companies through enhanced annual disclosures on human capital. Human capital considerations are integral to our members' initial decision-making processes and ongoing stewardship activities.

Understanding a company's approach to human capital management

- 49. Company disclosures should foster improved investor understanding of the role played by the company's workforce in generating sustainable, long term value creation. To achieve this, within the Strategic Report companies should provide shareholders with a narrative discussion on:
 - 49.1. The significant investments that the company has made over the past year, and is planning to make in the next, to improve the productivity of its workforce, including the outcomes of those decisions where possible;

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- 49.2. The significant opportunities, and principal risks, relating to the company's approach to human capital management, and of the strategy adopted by the Board to respond these issues; and
 - 49.3. The manner by which the workforce is incentivised to be more productive, and how this approach to motivating the workforce is compatible with the businesses' long term strategy.

Metrics to support human capital disclosures

- 50. Our members consider that boilerplate statements based on a long-list of reporting metrics are unhelpful when it comes to understanding a company's approach to managing its human capital.
- 51. Companies should consider the appropriate mix of quantitative and qualitative disclosures to help explain its approach to human capital management, and how this creates value. Companies should develop a combination of both narrative discussion and metric-based reporting to facilitate investor understanding.
- 52. As each company will likely have a different approach to human capital management, our members acknowledge that is up to companies themselves to determine which metrics best support the narrative discussion to shareholders.
- 53. Having reviewed the requirements of 12 other organisations and bodies and consolidated the potential metrics that could be used to explain a company's approach to human capital. As a minimum, our members have identified the following metrics as being of particular importance:
 - 53.1. Total headcount – broken down by the division between full-time and part-time employees, gender, and diversity;
 - 53.2. Annual turnover – including both planned and regrettable turnover;
 - 53.3. Investment in training, skills, and professional development – including the rate of progression and promotion within the business; and
 - 53.4. Employee engagement score.
- 54. In addition to disclosing the headline company-wide figure, each metric should be segmented by market, geographic location, and/or sector to provide greater awareness of the workforce's overall composition and stability.
- 55. For each metric, companies should provide an explanation for how the figure is calculated. Companies should also provide an explanation of what figures for a particular metric represent in terms of progress towards broader strategic objectives or productivity improvements.

Culture

- 56. We welcome the FRC's report [Corporate Culture and the role of Boards](https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Report-o.pdf)⁵ as being reflective of the importance of culture to the long term success of the companies our members invest in. Our members agree that a healthy corporate culture is a valuable asset, a source of competitive advantage, and vital component in the creation and protection of long term value.

⁵ <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Report-o.pdf>



57. Our members consider that it may not be possible to rely on a single metric or corporate statement to gain a proper understanding of the culture of a company. Instead, our members strive to take a more holistic view, deriving information on a company's culture from a range of sources and indicators relevant to the specific company concerned.
58. This will range from approach to capital management and executive pay, the outcomes of employee and customer surveys, as well as their own experiences of interacting with the company, employees, management, and Board.
59. Our members believe that it is the Board's role to determine the purpose of the company and ensure that the company's values, strategy, and business model align to this purpose. Boards should demonstrate how the strategy to achieve a company's purpose reflects the values and culture of the company, and the extent to which it is actively engaged in the business of shaping, overseeing, and monitoring culture.
60. Boards should therefore give careful thought to how culture is assessed and reported. Companies should choose and monitor those indicators it believes are most appropriate to its own business and the outcomes they seek, providing shareholders with an explanation as to performance against those indicators and why they have been selected.