Visions of the future

“to the extent necessary”

the debate on the future of narrative reporting
28 June 2006

Visions of the future…

A summary of the views of participants in an interview-format discussion on the future of narrative reporting, hosted by ACCA, in partnership with Tomorrow's Company and h2glenfern. The event was sponsored by Black Sun.

WHAT WE SET OUT TO ACHIEVE

The seminar, held on Wednesday 28 June 2006, was intended to contribute to, and challenge, thinking in this critical area of public policy. The event provided a forum for the views of leading contributors to the unfolding story of the OFR/Business Review from corporate, investor, legal, and other key stakeholder backgrounds. It gave those attending the chance to explore what this means for the future shape, style and substance of company disclosure.

IN ATTENDANCE

In attendance were 100 representatives of organisations ranging from government to NGOs, from companies through to specialist interests. Among those present were some of the most influential people in the development of narrative reporting.

SEMINAR OUTPUT

A summary of the interview discussions, and the list of attendees, has been posted on the websites of the sponsoring and participating organisations (see below). Following the debate, we asked participants to summarise their views on the current situation. The following pages offer their thoughts… their visions of the future of narrative reporting.

LEADING THE DEBATE

Mark Goyder, *Director*, Tomorrow's Company

Ken Lever, *Finance Director*, Tomkins Plc

Peter Montagnon, *Director of Investment Affairs*, ABI

Richard Slynn, *Partner*, Allen & Overy

CONTRIBUTING TO THE DEBATE

Seamus Gillen, *Partner*, h2glenfern

Sallie Cooke Pilot, *Director of Corporate Reporting*, Black Sun Plc

Allen Blewitt, *Chief Executive*, ACCA

CONCLUSION

Professor Andrew Chambers, *Managing Director*, Management Audit

THE PRINCIPLES OF STRONG REPORTING

It was eight years ago when Tomorrow's Company first published "Sooner, Sharper, Simpler". The principles we established in that document laid the foundations for thinking about the Operating and Financial Review. These principles should, we believe, still guide companies, regulators, investors and stakeholders if we are to improve corporate reporting and accountability to the benefit of long-term wealth-creation. They should also guide the efforts of the International Accounting Standards Board as they develop their thinking about narrative reporting.

Improve company decision-making
Report on the drivers of value and risk and thereby focus the priorities of senior management.

Judgment before compliance
Create frameworks which allow companies the flexibility to exercise and then explain their judgment in promoting the success of the company.

Improve investor decision-making
Enable investors to compare the prospects and performance of companies, and thereby focus the financial system on long-term value creation.

Make reports more accessible
Liberate companies to convey a core narrative which captures, in one place, all the key information and context that is needed to form an overall assessment of the company. (Forcing everything into the template of the directors' report is unhelpful).

Improve communication and trust
Without compromising accountability to shareholders, help employees, the community, regulators and all stakeholders to form a picture of the company and what it stands for and better assess all aspects of its performance – financial, social and environmental.

Mark Goyder
Director
Tomorrow's Company

COMPANY VALUATIONS CANNOT SIMPLY RELY ON ANALYSIS OF THE FINANCIALS

In a world where the complexity of the financial reporting model is ever increasing, due to a focus on fair values and a balance sheet approach to income determination, supplementary narrative reporting is essential. Why? To communicate effectively with existing and future investors, so that they understand the potential of a company to generate sustainable growth in value. Only if the equity market is properly informed, is it possible for the market valuation to reflect the intrinsic value of the business.

Being overly-prescriptive as to the content of narrative information, and applying unnecessary regulation, will serve only to stifle the content of the reporting and lead to an unhelpful "boiler plate" presentation. Whilst it is important for the information to present the company in an even-handed way, it is also vital that the communication is relevant and focused on the needs of the investors.

We should remember that continuing to load an increasing compliance burden onto the public company environment has the side effect of making it a less attractive place for talented managers. As the debate about the need for greater communication and narrative reporting continues, let's be sure that the debate does not increasingly become applied to a dying breed!

Ken Lever
Finance Director
Tomkins Plc

THE NEEDS OF INVESTORS

The ABI's members are investors with long-term investment horizons and a strong commitment to forms of disclosure which offer greater levels of reassurance on the sustainability of their investment choices.

We were surprised by the Chancellor's decision to abolish the mandatory OFR and, as part of our contribution towards restoring stability to the narrative reporting framework, took a leading role in arguing for some form of safe harbour provision to be included in the Company Law Reform Bill. We were successful, and now feel strongly that it is companies' responsibility to reciprocate by reporting in a more meaningful and business-focused way.

What are investors looking for? Principally my members want to be able to value a business better by understanding it through the eyes of the directors responsible for the performance and results. They wish to see evidence of high-quality decision-making, an emphasis on the business-critical issues which will generate value into the future, and how management are controlling the risks which are capable of 'killing the business'. Corporate responsibility issues which fail to focus on these areas do not belong in the Business Review or OFR.

For the future, we wish to see a raising in standards of corporate reporting, an ever-stronger emphasis on materiality, and a move away from box-ticking. If we can achieve this, the quality of engagement will improve and, as a consequence, the confidence of investors and company performance. The UK economy will be the ultimate beneficiary.

Peter Montagnon
Director of Investment Affairs
ABI

CHANGING LEGAL REQUIREMENTS IN NARRATIVE REPORTING

Fear of liability, particularly in relation to forward-looking statements, has been a barrier to certain aspects of narrative reporting. The Government's insertion of a safe harbour provision into the Company Law Reform Bill should give directors more confidence.

Further provisions in the Bill (currently being debated in the House of Commons) include the proposal to require directors to demonstrate, in the Business Review, how they have fulfilled the proposed new statutory duty to promote the success of the company having regard to a non-exhaustive list of factors (including the interests of various stakeholder groups). This is a new development which will affect the content of narrative reporting if it survives parliamentary debate.

Furthermore, certain concepts, which were previously incorporated into the (now repealed) mandatory OFR provisions, will be reinstated as a requirement for quoted companies in the Business Review; including, reporting on trends and factors likely to impact the future and requiring more information on environmental, employee and social and community issues.

It will take some time for companies to adjust to these changing legal requirements but it is likely that, once the legal position is clarified, the level and quality of narrative reporting will evolve to accommodate market forces, the requirements of investor and other interested groups and the new civil enforcement powers of the Financial Reporting Review Panel.

Richard Slynn
Partner
Allen & Overy LLP

THE BENEFITS OF PREPARING A GOOD BUSINESS REVIEW

Despite the continuing policy uncertainty surrounding narrative reporting, and the differing requirements associated with past, present and future reporting regimes, the challenges posed are not simply ones of process. The seminar has highlighted the deeper issues at stake – the Business Review is about the performance of the company, and the philosophy embraced in reporting that performance. Reporting increases accountability, and disclosure changes corporate behaviour. Many companies, large and small, are aware of the opportunities being created by this change in levels of transparency.

The opportunities can only be fully exploited, however, if the issues of director liability are understood and managed. Directors need to feel comfortable about their new responsibilities, and the right balance has to be found between accountability and exposure.

As long as the conditions for reporting are right, real operational benefits can be gleaned from the work associated with preparing the Business Review. In the area where the greatest source of corporate value coincides with the least analysis – non-financials – there are a wealth of insights to be secured and converted into operational learning and change.

Both companies and investors have a common interest in this agenda – the developing value story will allow more meaningful engagement, and an opportunity to 'meet in the middle'. The main challenge for companies, as ever, lies in execution.

Seamus Gillen
Partner
h2glenfern

THE IMPORTANCE OF REPORTING AND DISCLOSURE

New statutory reporting obligations, coupled with developments arising out of the Company Law Reform Bill, will alter the corporate reporting landscape. Issues such as the default to electronic communications, will fundamentally alter the means by which a company communicates with its shareholders and other stakeholders.

Future developments will be towards more, not less, comprehensive narrative reporting. Structure, content and formats of reports, as well as ways of disclosing information, will change for good.

The new era of narrative reporting will both provide the backdrop to, as well as drive, these changes in approach. Narrative reporting helps to explain what the numbers mean, and provides the context for the business. Narrative should deliver a clear picture of both the progress that a company has made, as well its strategy and outlook for the future. It should help to explain the dynamics of the business – what value was created, how that value was created and why value will continue to be created.

Companies with vision have already begun to explore the potential offered by this new reporting environment, defining and demonstrating what best practice reporting means for their marketplace. The greater convergence of financial and non-financial information, in particular, requires stronger communication skills, and the accompanying reporting framework and structures to accommodate this new reporting dynamic.

The challenge for companies will be to develop new ways of reporting that both improve engagement with stakeholders as well as deliver business benefit.

Sallie Cooke Pilot
Director of Corporate Reporting
Black Sun Plc

ACCA POLICY ON NARRATIVE REPORTING

ACCA is a strong supporter of narrative reporting. We were disappointed with the decision to abolish the statutory Operating and Financial Review (OFR) which had been through thorough consideration and consultation. We considered that a workable set of provisions had been developed.

ACCA will continue to encourage listed companies to publish their own OFRs under the ASB's Reporting Statement (RS). We consider that the OFR will remain a more comprehensive and a more stakeholder-focused analysis of the company's position than the Business Review.

OFRs which follow the principles in the RS should result in companies reporting a comprehensive picture of their objectives, achievements, prospects and risks, all in the context of a company's operating environment and stakeholder relationships. Compliance with the Business Review rules, as they are currently presented, will potentially result in less information being disclosed, in a more piecemeal fashion, and a loss of the 'big picture' dimension which is characteristic of the OFR model.

The important thing going forward is to ensure that boards are not discouraged from reporting in accordance with the RS because of uncertainty about whether or not the safe harbour provisions will apply to OFR reports. Our preferred solution is to retain the Business Review rules as the basis for less extensive disclosure, but to see listed companies pursue the option of preparing an OFR in accordance with the ASB's RS. Companies taking advantage of this option should be entitled to benefit from the safe harbour protection, even if the OFR is situated outside the Business Review section of the Director's Report.

Allen Blewitt
Chief Executive
ACCA

Conclusion

ACCA was very pleased to be so closely involved in this stimulating and fascinating debate. The fact that the event was oversubscribed, the high calibre and diversity of the audience, as well as the level of questions – all pointed to the importance of narrative reporting to a great many people. It was also clear that, although there is much consensus on where we want to go, there is not quite the same degree of unanimity as to how we should get there.

We have come a long way since November, when the Chancellor announced he would abolish the statutory OFR. His decision generated an intensity of response which must have surprised him, and the resulting debate has been healthy. It is encouraging that some of what might have been lost without the mandatory OFR, such as the greater emphasis on forward-looking information, is now likely to return under the proposals set out in the Company Law Reform Bill. It is also a positive step that the government has finally ceded to the request for a safe harbour, although not perhaps exactly in the way we would have wished. We hope that the current uncertainty over the precise application of the safe harbour can be resolved quickly, and that companies wishing to prepare full OFRs in accordance with ASB best practice can do so with the benefit of the relevant legal protection.

It remains for me to thank the speakers and all those who have been involved in organising this event, and to the audience for its participation.

Prof. Andrew Chambers
Chairman
ACCA Corporate Governance and
Risk Management Committee

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