

## The future of narrative reporting

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To begin on an academic note: in the absence of an authoritative definition of the minimum content of an OFR, it is difficult to give a precise meaning to the question, should companies publish an OFR? The ASB's Reporting Statement on the OFR (essentially the standard prepared during the brief life of the statutory OFR, but stripped of its mandatory status) provides a benchmark for minimum content and argues that it is 'best practice' to indicate whether an OFR complies with this, but there is no compulsion to do so. Hence a company can call any narrative report an OFR. Indeed, it would appear to be perfectly legal to comply with the minimum requirements of the Business Review and call the resulting section of the Directors' Report an OFR. What's more, on the basis of behaviour under the previous non-mandatory ASB statement, it seems likely that companies will claim the title OFR for disclosures that do not meet the ASB benchmark. For example, the Deloitte survey of OFRs for 2005 reported that only 38 per cent of companies publishing a formal OFR or 'showing clear recognition' of the OFR requirements gave a sufficiently forward-looking orientation to the narrative, although forward-looking information has been specified in all the ASB's statements on the OFR from the publication of their initial pronouncement in 1993.

A better way of looking at the issue is: how much (and what) management commentary should a company publish?

I suggest that a useful starting point for quoted companies considering this question is the increasing pressure on them to manage the market's expectations of their performance so that there are 'no surprises', or at any rate, no big surprises. A formal, comprehensive OFR reporting framework provides the opportunity to manage the communication process in a systematic way geared to achieving this outcome. Many companies will already have set up procedures to construct OFRs that start from careful, regular, internal reviews of corporate strategy and the story about that strategy the company wants to communicate to its investors; it seems a pity to throw all that preparatory work away when the system will probably have to be rebuilt in a few years' time anyway, as the market demand for more and more information - and more timely information - continues to grow. Disclosing new types of information - strategic, forward-looking, narrative, risk-based - requires a change of culture, especially around the corporate annual report, traditionally prepared within a well-defined, quantitative reporting framework, with discretionary narratives added on ad hoc. The relaxation in the rules means that companies can take things a little bit slower, and, perhaps, feel under slightly less pressure, but it would be foolish to walk away from the opportunity for a major improvement in investor communications.

In deciding what to include in the OFR, companies should do two things: reach out to their investors, to find out what they want. The initial reaction of organisations representing institutional investors to the abolition of the statutory OFR suggests that there is a genuine demand from sophisticated investors for OFR-type disclosures.

reach back within the organisation to analyse what operational managers see as the critical factors that determine success and risk. This can produce an inventory of information that the Board can use to manage the disclosure process.

Of course, one thing companies will have to do is ensure they comply with the minimum requirements for the Business Review. Working out what this minimum really is - that is, how the wording of the statutory requirements will be interpreted by investors and, ultimately, enforcement agencies, has been made much more difficult by the volte face over the OFR. When quoted companies were going to be subject to a statutory OFR and the Business Review was for non-quoted companies, the Business Review proposal did not cause much fuss, probably because it was expected that the wording of the rules would be interpreted flexibly. Now that the government is defending its decision to abolish the OFR by emphasising how really very similar the requirements of the Business Review and the OFR were, this has focused attention on how extensive the Business Review requirements can be interpreted to be. For example, the statutory OFR explicitly required an analysis of trends and factors underlying past development, performance and position and of trends and factors likely to affect future development, performance and position; the Business Review doesn't. But the government's comparison of the OFR and Business Review requirements, issued as part of its campaign to defend the abolition of the OFR, emphasises that both past and future trends and factors would need to be included in a Business Review where necessary to achieve the level of disclosure that is required - which is a balanced and comprehensive analysis of the company's past development and performance and current position. So, for example, a company can only omit discussion of trends and factors underlying its performance in the past year if it can somehow provide a balanced and comprehensive analysis of its past performance without mentioning the trends and factors underlying that performance. This seems to open up the whole question of what is meant by an 'analysis of performance' but neither investors nor the Financial Reporting Review Panel are likely to be satisfied by an exercise in medieval sophistry. So, another reason for quoted companies to stick with their plans to produce an OFR would be to err on the side of caution in deciding what counts as complying with the Business Review requirements - and, more importantly, in deciding what sophisticated investors will regard as a fully informative annual report.

**Sources:**

Deloitte, Hold the Front Pages: Surveying OFRs and Narrative Reporting in Annual Reports, 2005.

The government's analysis of the difference between the OFR and the Business Review was published in the invitation to comment on any changes to the Business Review requirements needed following its adoption for quoted companies, DTI, 15 December 2005.