

The OFR – time to become more radical?

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The OFR became something of more than passing interest to me in mid-2003. Robin Fincham and I were finalising our ICAS monograph: *The Management of Intellectual Capital and its Implications for Business Reporting*. The DTI had recently issued its *Accounting for People (AfP)* consultation paper, in which it identified the OFR as a possible vehicle for reporting on human capital management. Given our findings, the AfP initiative was very welcome. In due course, the OFR became the preferred vehicle for reporting such matters, which in turn translated into a requirement that organisations provide “information about the company’s employees”. The surprise abolition of the OFR requirement in November 2005 also signalled the end of a brief period when accounting for people was on the political agenda. Although the requirement to report on employees has recently resurfaced in the context of the Business Review, there is little to indicate that employee issues are a high priority.

For me, the decision to incorporate accounting for people within an expanded OFR document was essentially a marriage of convenience. The two issues were contemporary, so there was an administrative logic in combining them. The relatively limited set of AfP documentation indicates that no alternative reporting frameworks were given detailed consideration. Section 3 of the Final Report makes passing reference to the Skandia Navigator, the Balanced Scorecard and the EFQM Excellence Model, together with the Economic Value Added and Saratoga Institute approaches. The former pair was hard to ignore, as they had been around for a number of years. By contrast, the others were hardly at the forefront of debates about intellectual capital reporting. Conspicuously absent is any reference to the Intellectual Capital Statement (ICS) approach developed during a research project funded by the DTI’s Danish sister department. Nor is a related approach developed in the course of the MERITUM Project acknowledged.

Employee information was envisaged as one category in a long list of desirable additional issues that should be reported in an OFR. There are two aspects to this observation. First, proponents of accounting for people such as myself believe that it deserves much greater credibility than simply being one of many issues to be incorporated within the contemporary financial reporting package. We could continue arguing about the merits of this view till the end of time. To do so, however, risks overlooking a second, equally important point about the OFR concept as it continues to be debated.

The sheer range of potential components of an OFR suggests it to be an unsound development in the first place. As the length of the list of possible contents increases, the attention accorded them necessarily reduces, unless those charged with drafting this element of the financial reporting package are prepared to significantly increase the length of an OFR. The likelihood of this remains slim for various reasons, for example: such exercises will necessarily consume scarce resources; there is always the danger of revealing sensitive information; and do users want more information in the first place?

There is an interesting counterargument, of course. The OFR offers a major challenge to the accountancy profession, that of developing the requisite new set of drafting skills. Many commentators have already at least implicitly concluded that this is unlikely to happen, the likelihood being one of expertly rehearsing the issues, ticking the boxes, going through the motions, etc. Similar sentiments can also be identified in the Chancellor's November CBI statement.

Just to confuse the debate, there seems to be a widespread acceptance that in the future financial reporting will incorporate a much greater extent of narrative reporting, albeit in the guise of supplementary information. For the present at least, this is where accounting for people rightfully belongs, alongside the various other information that was intended for the OFR, the proposed Business Review and indeed the Management Commentary approach recently identified by the IASB to replace the variety of narrative accountings that have emerged in the past two decades.

At this point, a cynic might be forgiven for concluding that the whole OFR episode provides clear proof that the UK accountancy profession remains in a state of serial denial that there is any serious need to change its approach to financial reporting. More worryingly, it seems as though the profession has been successful in convincing an otherwise resolute Chancellor that the OFR was being foisted upon it, unnecessarily. For this reason, there seems every likelihood that similar future advances, inter alia Management Commentary, will be successfully resisted or at least significantly emasculated.

In addition to being frustrated by the disappearance of any real interest in accounting for people from the UK political agenda, I have become increasingly dismayed by the direction in which the whole narrative reporting bandwagon seems to be heading. I have come to recognise that, in principle, narrative reporting is a highly positive development. In practice, however, narrative reporting looks to be a pretty soft option, all too easily embraced and quietly neutered. If the UK accountancy profession is serious about making genuine progress in the financial reporting sphere, more radical steps are now necessary.

Earlier I identified the Danish ICS approach as being at the leading edge of intellectual capital reporting. Such statements were conceived of as being both narrowly focused, on intellectual capital issues, and of a supplementary nature. To a very great extent this is how they have been deployed in Denmark. Nevertheless, there is good reason to believe that this approach could offer a way forward for financial reporting, on a scale that far outstrips proposals such as the OFR. Its origins at the margins of what most would regard as financial accounting and reporting, particularly in the UK, should not be viewed as being indicative of its full potential. In my view, an ICS provides a valuable mechanism for enacting the business reporting concept identified in the Metcalfe Report over a decade ago and intimately associated with the OFR debate.

What are the key features of the ICS approach? An ICS is a relatively lengthy narrative document designed to communicate and reflect upon how a company seeks to do business, i.e. a form of business model. Its founding element is a knowledge narrative, the story about how the business seeks to create value for its customers. From the knowledge narrative are derived a set of management challenges, which in turn inform the appropriate initiatives required to successfully create value. Finally, a range of relevant indicators are developed in order to report the company's performance. As with the former three elements of an ICS, these indicators are unique to a particular business and the very antithesis of traditional financial reporting statements.

So to return to my opening observations, while an ICS offers an excellent means of accounting for people (or human capital management), I believe the principles on which it is based also have much to offer when thinking about moving beyond the OFR.