



The future of narrative reporting – the legal perspective

Richard Slynn
Partner
Allen & Overy LLP

Should companies continue to prepare OFRs?

The Companies Act 1985 (Companies Act) sets out the current minimum mandatory narrative reporting requirements in relation to the contents of a Business Review. In addition, there is the highly publicised expectation of various interested groups, accounting regulatory bodies and the Government itself that quoted companies should prepare narrative reporting with a significant degree of forward looking orientation. In practice, this expectation could be addressed by either preparing an enhanced Business Review (going beyond the statutory minimum requirements) or preparing a compliant Business Review plus a voluntary OFR (or equivalent).

The Business Review requirements focus much more on the financial year in question, and require a lesser degree of foresight than is required for voluntary OFRs prepared in accordance with the Accounting Standards Board's Reporting Statement (Reporting Statement). Some foresight is, however, still required in that the Business Review must deal with the risks and uncertainties facing the company.

Pending the outcome of the Government's consultation on business reporting, and any subsequent changes introduced into the Company Law Reform Bill, there is little guidance as to precisely what companies are required to do to satisfy the Business Review requirements. However, the DTI have recently indicated that companies will satisfy the requirements if they report in line with what were the statutory requirements for the (now abolished) mandatory OFR (and which are now reflected in the Reporting Statement).

Companies that prepare a voluntary OFR and comply with the Reporting Statement in full therefore have some comfort that they will be both satisfying the Companies Act requirements and observing best practice reporting. Other quoted companies will, however, take the view, particularly in the light of the continued uncertainty and lack of legal clarity, that, for the time being (at least until the outcome of the Government's consultation is known), they would prefer not to depart very far from their existing narrative reporting (perhaps including an OFR based on what they have been producing over the last few years) and will focus their efforts on making the adjustments necessary to satisfy themselves that their Business Review is compliant with the minimum legal requirements.

What aspects of the Reporting Statement's best practice guidelines (if any) should be omitted from business reporting?

One of the key concerns voiced throughout the debates regarding the OFR has been the increased risk of liability for directors in relation to forward looking statements. There has been a perception, especially in the absence of a statutory safe harbour, that fear of liability discourages meaningful and informative disclosure due to the inherent possibility that statements regarding the future may turn out to be incorrect. We addressed these issues in our legal opinion for CIMA of 7 July 2005 with a view to demonstrating the practical steps that can be taken to minimise the risk of liability and to provide information as to what types of liability might arise. Provided these guidelines are followed, the proper procedures are put in place and the directors exercise their judgement using due skill and care, the risks of liability should be small. Nevertheless, there is still a prevailing concern amongst some groups that, unless the Government reconsiders the safe harbour, companies will not embrace fully the guidelines contained in the Reporting Statement calling for companies to report on the main trends and factors which are likely to affect the company's future development, performance and position. For these reasons, it is foreseeable that full compliance with the Reporting Statement will not be met by all quoted companies in this area and there will be a tendency to omit forward looking statements from narrative reporting.

What are the advantages and disadvantages of restricting narrative reporting to the minimum required by the revised Business Review provisions?

Certain quoted companies may perceive it to be an advantage if they stick to the minimum requirements, believing there to be a reduction in exposure for their directors for the reasons given above. Companies will, however, be monitoring the sentiments of interested groups as to the desired levels and qualities of narrative reporting and will take account of the pressures that such groups can exert. There will be a variety of approaches adopted by companies ranging from those which wish to see how this area develops in the near future (given the current lack of clarity) to those companies which wish to grasp what they see as opportunities presented by reporting in accordance with the Reporting Statement. Companies falling into the latter camp will be likely to include those which were significantly along the road to compliance with the mandatory OFR, had put in place internal procedures and practices to deliver that level of reporting, and satisfied themselves that the legal risks were indeed containable. These companies may decide that there are advantages for their businesses in being seen as leaders in terms of best practice reporting with the possibility of the performance dividend that this may yield. For those companies that do not fall into this category, there are a number of measures that the Government could include within the Company Law Reform Bill to address some of the major concerns. These could include:

- creating greater flexibility as to where the Business Review provisions are located within a company's annual report (currently it must be included in the



Directors' Report which is not a pre-requisite of the EU Accounts Modernisation Directive);

- giving greater clarity as to the addressees and the purpose of the Business Review;
- giving greater clarity as to what is required to satisfy the Business Review provisions of the Companies Act;
- providing further clarity on the inter-relationship between mandatory and voluntary reporting; and
- revisiting the safe harbour as a means of increasing directors' confidence in relation to forward looking statements.