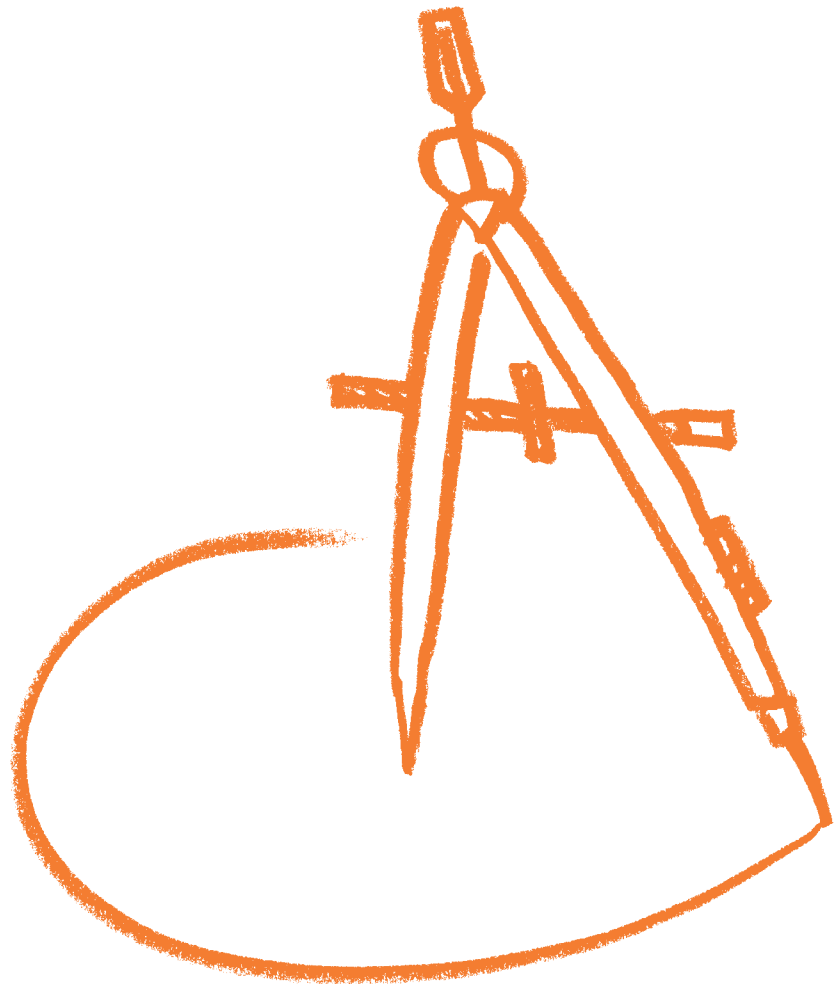


Enhanced business review

Turning full circle



October 2007

This paper summarises some of the main changes to the Business Review that have come about as a result of the Companies Act 2006.

Quick guide

1. The Companies Act 2006 received Royal Assent on 8 November, 2006.
2. It is coming into effect in stages by October 2008. Some of the Act already applies – for example, the provisions on electronic shareholder communications came into effect on 20 January, 2007.
3. The Act expands the content requirements for the Business Review.
4. These new reporting requirements will apply to companies whose financial year begins on or after 1 October, 2007.
5. The new requirements effectively bring UK narrative reporting for quoted companies much closer to the disclosure requirements envisaged under the earlier Operating and Financial Review (OFR) legislation. The OFR was abolished by the Government in November 2005 but is now thought of as best practice.

Enhanced business review Q&A

What's changed?

The Companies Act 2006 introduces a new statutory purpose for the Business Review and adds in some new content requirements for quoted companies.

What's the statutory purpose?

Business Reviews will be required to inform members (i.e. shareholders) of the company and help them assess how the directors have performed their duty to promote the success of the company. This covers a range of additional requirements including the need to take into account the company's employees, suppliers, other stakeholders and the long-term interests of the company.

What's the new content?

The Act makes little change to the existing Business Review content – this is still required – but it also adds in some new requirements for quoted companies.

These are:

- the main trends and factors likely to affect **the future** development of the business;
- information about the **environment**, the company's **employees**, and **social** and **community** issues;
- information about persons with whom the company has contractual or other arrangements essential to the business (this is the '**supply chain**' provision that you might have heard about).

Why have these new requirements been introduced?

The Government came under pressure from various interest groups after Gordon Brown abolished the OFR. These new requirements are a result of lobbying during the final stages of the Companies Act.

Why did the 'supply chain' provision cause such a storm?

Because it was added in at the last minute by the Government against the wishes of business organisations, such as the CBI. They claimed that the requirement to detail 'contractual or other arrangements' essential to the business was unnecessarily burdensome and could lead to problems with, for example, animal rights activists.

Wasn't there a similar provision in the original OFR?

Yes, there was and, ironically, it didn't cause much of a problem the first time around. This was all about lobbying in the final stages of the Bill's passage through Parliament.

Didn't we have to include environmental and employee related information already?

Yes – the existing Business Review requires 'analysis using other KPIs, including information relating to environmental and employee matters'. That still remains. The new requirements expand this to a general requirement for information on these issues – and adds in social and community issues. It is similar to the original OFR requirements.

Didn't the original Business Review also require forward-looking information?

Directors' reports had to contain 'an indication of likely future developments in the business of the company'. This new provision requiring the 'main trends and factors likely to affect the future development' is more specific and detailed.

Isn't there a 'get-out' clause in the enhanced Business Review?

There is – of sorts. The Government introduced a couple of concessions to businesses that exempt companies from disclosing information that might be 'seriously prejudicial' to the company's interests. The 'supply chain' provision can also be avoided in cases that might be 'seriously prejudicial' to that person and contrary to the public interest.

Out with the old, in with the new

Business Review regimes compared

Existing/previous legislation	New legislation
<p>All companies (except those exempted under the small companies regime*) are required to include a Business Review in their directors' report.</p> <p>To cover:</p> <ul style="list-style-type: none"> – a fair review of the business; – principal risks and uncertainties facing the business. <p>It should be a balanced and comprehensive analysis of:</p> <ul style="list-style-type: none"> – the development and performance of the business during the financial year; and – the position of the company at the end of that year. <p>It must also contain:</p> <ul style="list-style-type: none"> – an indication of likely future developments in the business of the company. <p>To the extent necessary for an understanding of the development, performance or position of the company it should include:</p> <ul style="list-style-type: none"> – analysis using KPIs; – analysis using other KPIs, including information relating to environmental and employee matters. <p>KPIs mean factors by reference to which the development, performance or position of the business or company can be measured.</p>	<p>Basic content requirements broadly similar to the original legislation as detailed on the left.</p> <p>Additional requirements for quoted companies:</p> <p>To the extent necessary for an understanding of the development, performance or position of the company's business, content must include:</p> <ul style="list-style-type: none"> – the main trends and factors likely to affect the future development, performance and position of the business; and – information about: <ul style="list-style-type: none"> i. environmental matters (including the impact of the company's business on the environment); ii. employees; and iii. social and community issues; <p>including information about policies and effectiveness of those policies;</p> <ul style="list-style-type: none"> – information about persons with whom the company has contractual or other arrangements essential to the business of the company.
No disclosure exemption.	Companies not required to disclose information that might be 'seriously prejudicial' either to the company or, in the case of supply chain information, to that person and contrary to the public interest.
Applicable to financial years beginning on or after 1 April, 2005 until new legislation comes into effect.	Business Review content applicable to financial years beginning on or after 1 October, 2007.

*Small companies regime applies if a company meets at least two of these conditions in a financial year.

1. Turnover – not more than £5.6m
2. Balance sheet total not more than £2.8m
3. Number of employees – not more than 50

Additional issues:

Cross-referencing

The DTI (now the Department for Business, Enterprise and Regulatory Reform – DBERR) made it clear in early 2006 that companies could cross-reference from their directors' report into a voluntary OFR. The introduction of a new directors' liability clause potentially called this into question as the legal protection only applied to the directors' report and directors' remuneration reports.

Recent statements from the Department would seem to clarify that the cross-reference is still applicable – and offers protection – as long as it is clearly labelled and follows the guidance originally laid out by the DTI. The cross-referencing should also take into account how the report is going to be presented in an online environment. We would, as ever, advise readers to consult their own legal counsel on these issues.

Logical structure of reports

The need to include the Business Review within a directors' report has led some companies to suggest calling the whole of the front of their annual report a directors' report. We would caution against that approach – *unless you are confident that you can communicate within the confines of a directors' report.*

Traditional directors' reports tend to be legalistic and compliance based. They do not lend themselves to good communication. A Business Review cross-referenced from the directors' report may therefore have a better chance of becoming a communicative document. Good reporting should, after all, be about communication.

Best practice

Our own analysis of narrative reporting in the UK suggests that many larger, quoted companies continue to use the Accounting Standards Board's Reporting Statement on the Operating and Financial Review as a guide. This has, in effect, become the guide to best practice in the absence of any guidelines on the Business Review. Following the reporting statement will, in general, ensure that your company more than meets the legal requirements of the Business Review.

Compliance, communication...or both?

Unfortunately, the increasing levels of regulation surrounding narrative reporting have led some companies to simply tick the regulatory boxes and not think about the 'story' that they are telling. Or how it fits together.

This is a pity. Knowing how to tell your story in a succinct fashion is a good way to ensure your own board communicates how it is driving the company's growth. Good narrative reporting is about communication – both internally and externally – not just compliance.

Narrative structure of reports

A good Business Review will follow a good narrative structure. It will tell readers:

- What you do;
- Where you do it;
- Why you do it;
- What you are planning to do;
- How you have performed and how you measure performance;
- The opportunities in your industry;
- The threats to your business as a result.

This information should also cover the specific content areas required by the legislation, for example, the need to talk about environmental, employee and social and community issues.

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