Title: Narrative Reporting	Impact Assessment (IA)
Lead department or agency: BIS Department for Business, Innovation and Skills **Other departments or agencies:** N/A	**IA No:** BIS0284 **Date:** 12/05/2010 **Stage:** Consultation **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Andrew Busby (x0112) andrew.busby@bis.gsi.gov.uk

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The problem being considered is how to increase the value of company non-financial ("Narrative") reporting by the largest companies. Recent developments in company reporting have favoured increasingly lengthy and complex annual reports, reducing their utility both to investors and other interested parties. There is also general support from stakeholders for measures to simplify the framework, to reduce the incentives to make "boilerplate" disclosures and to increase the comparability of data provided by companies as part of the reporting process. Finally, there is a coalition commitment to "reinstate an Operating and Financial Review (OFR) to ensure that directors' social and environmental duties have to be covered in company reporting, and investigate further ways of improving corporate accountability and transparency".

What are the policy objectives and the intended effects?

To improve corporate transparency and disclosure by allowing key strategic information to be provided to investors in a focused, concise report, supported by detailed online disclosure of non-financial information to enable comparability of this information between companies. The intended effect of this is that corporate reporting becomes more focused, and that specific information is more easily obtained to facilitate comparisons between companies. The benefits of the proposed approach accrue to investors through more focused disclosure, to companies by streamlining of the framework and to enable NGOs, analysts and interested members of the public to access and compare the data they need to effectively hold companies to account. The volume of data will be reduced by streamlining disclosure requirements.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Three high level policy options have been considered:
1) Reintroduce the 2005 mandatory reporting and audit regime for the Operating and Financial Review
2) Require companies to produce a high level strategic report supplemented (where appropriate) by detailed disclosure online (available in hard copy on request).
3) Do nothing
Options (1) and (2) involve modifying the existing reporting regime, as set out in the Companies Act 2006. Option (2) is preferred, as it best meets the goals of improving transparency and comparibility of data, while minimising the regulatory burden. Option 1 imposes a large regulatory burden, which in turn would likely lead to an increase in tick-box compliance with the regulation. There was a consensus from the 2010 narrative reporting consultation that something needs to be done and therefore option (3) has no support .

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 10/2017
What is the basis for this review? PIR. **If applicable, set sunset clause date:** Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

SELECT SIGNATORY Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: .... Date: ....

Summary: Analysis and Evidence

Policy Option 1

Description:

Reintroduction of the 2005 Operating and Financial Review (OFR)

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -387	**High:** -723	**Best Estimate: -560**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0		£45	**£387**
High	0		£84	£723
Best Estimate	0		£65	£560

Description and scale of key monetised costs by 'main affected groups'

Annual costs are estimated to be £65 m for 1100 quoted companies only. In line with the earlier OFR Regulatory Impact Assessment this comprises an increase in audit fees of £57 m (assuming an average 6% increase in 2009 audit fees) and £8 m increased costs for preparation due to the introduction of a statutory reporting standard (detailed costs are set out on page 18 and 19). Sensitivity analysis around the increase in audit costs (4% low and 8% high) and preparation costs (+/- 10%) gives an upper and lower range of £45 m to £84 m

Other key non-monetised costs by 'main affected groups'

There will be transitional costs involved but as the policy option is unviable due to the large ongoing annual costs it entails, it is disproportionate to calculate these.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Mandation of a standard report for all quoted companies would enhance comparability. A combination of a mandatory standard and increased audit requirements would meet NGO requests for greater legal requirements for companies to provide standardised information on Corporate Social Responsibility (CSR) and increased user ability to rely on narrative information.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5

The method of cost calculation followed the method used in the 2005 Regulatory Impact Assessment for the introduction of the OFR.
A sensitivity analysis has been carried out on the calculation above using a 4, 6 and 8% increase in 2009 audit fees to illustrate a low, best estimate and high bound respectively. Increased costs of preparation are based on OFR RIA with 10% upper and lower bound sensitivity.
The average costs of audit were taken from "Audit Pricing in Private Firms" and the "Financial Audit Fees Survey" 2009 as discussed on page 19.

Direct impact on business (Equivalent Annual) £m):			**In scope of OIOO?**	**Measure qualifies as**
Costs: 65	**Benefits:** 0	**Net: -65**	Yes	IN

Enforcement, Implementation and Wider Impacts

<table>
<tr><td colspan="3">What is the geographic coverage of the policy/option?</td><td colspan="3">United Kingdom</td></tr>
<tr><td colspan="3">From what date will the policy be implemented?</td><td colspan="3">01/11/2013</td></tr>
<tr><td colspan="3">Which organisation(s) will enforce the policy?</td><td colspan="3">FRRP</td></tr>
<tr><td colspan="3">What is the annual change in enforcement cost (£m)?</td><td colspan="3">0</td></tr>
<tr><td colspan="3">Does enforcement comply with Hampton principles?</td><td colspan="3">Yes</td></tr>
<tr><td colspan="3">Does implementation go beyond minimum EU requirements?</td><td colspan="3">Yes</td></tr>
<tr><td colspan="3">What is the CO_2 equivalent change in greenhouse gas emissions?
(Million tonnes CO_2 equivalent)</td><td colspan="2">Traded:
NIL</td><td>Non-traded:
NIL</td></tr>
<tr><td colspan="3">Does the proposal have an impact on competition?</td><td colspan="3">No</td></tr>
<tr><td colspan="3">What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?</td><td colspan="2">Costs:
100</td><td>Benefits:
100</td></tr>
<tr><td>Distribution of annual cost (%) by organisation size
(excl. Transition) (Constant Price)</td><td>Micro</td><td>< 20</td><td>Small</td><td>Medium</td><td>Large
100</td></tr>
<tr><td>Are any of these organisations exempt?</td><td>Yes</td><td>Yes</td><td>Yes</td><td>No</td><td>No</td></tr>
</table>

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	25
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	25
Small firms Small Firms Impact Test guidance	No	25
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	25
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	25
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	25
Human rights Human Rights Impact Test guidance	No	25
Justice system Justice Impact Test guidance	No	25
Rural proofing Rural Proofing Impact Test guidance	No	25
Sustainable development Sustainable Development Impact Test guidance	No	25

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 2

Description: Introduce a new Strategic Report (PREFERED OPTION)

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£0.47	**High: -£0.93**	**Best Estimate: -£0.68**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£0.47		0	**£0.47**
High	£0.93		0	**£0.93**
Best Estimate	£0.68		0	**£0.68**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs to business are estimated to be £483,000. They will occur in the first year only and will be borne by companies and the accounting regulator, the ASB. They estimate that it will take every quoted company, of which there are 1,100, 15 hours to familiarise themselves with completing the new strategic form. There will be no costs to non-quoted companies. Providing improved voluntary guidance is estimated to cost the ASB in the region of £200,000. There will be no ongoing annual costs.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

It is not possible to monetise any of the benefits at this stage.

Other key non-monetised benefits by 'main affected groups'

Improving the quality of information will improve investors' ability to hold management to account and will encourage effective engagement between the company and its owners. In turn this should lead to better run companies and a better balance of returns between shareholders and company executives. It will also lead to improved confidence in the UK reporting and corporate governance regime as a result of more meaningful disclosure and greater comparability between companies.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The upper and lower benefits estimates are based upon a 10% sensitivity analysis around the cost per hour and costs to ASB and the time required for familiarisation was calculated a sensitivity analysis of 10, 15 and 20 hours.
It has been assumed that the costs to ASB are taken from their current budget and are not passed onto companies.
Assume that benefits although non-monetised will outweigh costs.
All other assumptions are discussed on page 20 onwards.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: 0..06	**Benefits:** 0	**Net:** -0.06	Yes	IN

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/11/2012				
Which organisation(s) will enforce the policy?	FRRP				
What is the annual change in enforcement cost (£m)?	N/A				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	Yes				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:** NIL		**Non-traded:** NIL		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:** NIL		**Benefits:** NIL		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large** 100
Are any of these organisations exempt?	Yes	Yes	Yes	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

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Wider environmental issues Wider Environmental Issues Impact Test guidance	No	25
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	25
Human rights Human Rights Impact Test guidance	No	25
Justice system Justice Impact Test guidance	No	25
Rural proofing Rural Proofing Impact Test guidance	No	25
Sustainable development Sustainable Development Impact Test guidance	No	25

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 3

Description: Do Nothing

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

There are no costs as there will be no change to current regulations

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

There will be no benefits as there will be no change to current regulations.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

It is assumed that current costs and benefits will continue to accrue in the same manner as they do currently but there are no additional costs and benefits as the regulations do not change.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: NIL	**Benefits:** NIL	**Net:** NIL	No	NA

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	n/a				
Which organisation(s) will enforce the policy?	FRRP				
What is the annual change in enforcement cost (£m)?	N/A				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	Yes				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:** NIL		**Non-traded:** NIL		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:** NIL		**Benefits:** NIL		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

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Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	http://www.bis.gov.uk/files/file21361.pdf
2	
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	0.68	0	0	0	0	0	0	0	0	0
Annual recurring cost	0	0	0	0	0	0	0	0	0	0
Total annual costs	0.68	0	0	0	0	0	0	0	0	0
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	0	0	0	0	0	0	0	0	0	0
Total annual benefits	0	0	0	0	0	0	0	0	0	0

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

Problem under consideration;

The final regulatory impact assessment for the OFR (January 2005) set out many of the arguments for the regulation of narrative reporting. These are principally around overcoming the asymmetric information market failures that characterise the principal-agent relationship at the heart of company law. Shareholders (the principal) as owners of the company have limited information on which to judge the performance of the directors (the agent). Without the regulation of narrative reporting, company management is unlikely to report in a manner and on a sufficiently timely basis that would be useful for shareholders. Appropriate and proportional mandatory company disclosure also reduces the costs to investors of accessing the information they need to hold management to account. This is particularly so in relation to executive pay where disclosure is a key mechanism for helping to minimise agency costs and to align the incentives of managers with the interests of shareholders.

Within the UK's corporate governance regime the role of shareholders is paramount, and providing them with the information they need to challenge management has always been a key element of company law. Until relatively recently the major focus of attention of both regulators and major investors has been on financial reporting by companies but narrative reporting has increased in importance and regulation and best practice has developed to reflect this position. The regulation of narrative reporting is primarily aimed at overcoming information failures that may arise between quoted company management and shareholders. However, the annual report is placed on the public record (via Companies House), which enables other stakeholders to make use of this information and many have come to rely on it to hold companies to account in terms of environmental and social responsibility issues.

High quality narrative reporting provides the context for the financial reports of the company as well as providing additional information on strategy, risks and performance. The business review introduced as a replacement to the OFR and the enhanced business review (for quoted companies introduced through the Companies Act 2006) have provided the platform for increasing quantities of information for shareholders. However there have been growing concerns expressed about the clarity and focus of this information and its usefulness to shareholders. This was clearly expressed by stakeholders in their response to the 2010 BIS narrative reporting consultation[4] and is the driving force for the current proposed changes.

In addition, changes in technology (including increased use of websites and electronic communication following the introduction of e-coms as the default option for companies in the Companies Act 2006) have changed the ways in which companies communicate with investors and other stakeholders and provide them with the opportunity to provide more "real-time" information. A recent FutureValue report[5] which examined how companies use electronic media to disseminate their annual reports found a wide variation in the usage and quality of electronic media by companies, but found that 62% of FTSE100 (30% of FTSE250) companies a full web-based annual report (i.e. using HTML) with most of the remainder using a downloadable PDF version of the annual report or an online viewer. The same report found that there has been some modest increase in the use of HTML over the last 3 years.

However, companies remain unsure about whether this use of new technology and means of communicating are in line with current statutory reporting requirements. The changes proposed here to the reporting framework (a strategic report supported by sets of data such as a new annual directors statement and the audited financial statements) would provide that clarity and serve to streamline information flows to users.

Finally, some minor changes to reporting requirements are needed to enhance consistency of reporting on pay, to remove the burden of unnecessary disclosures, and to provide investors with the information they need to hold companies to account in respect of issues such as board diversity, greenhouse gas reporting and performance drivers of pay which have risen to prominence in recent years.

There are overlapping requirements for quoted company pay disclosures in both the Companies Act and the FSA's Listing Rules. These are requirements which are intended to provide the user with similar information, but the requirements are not identical which therefore raises burdens on the company for no gain to the user. We intend to work with the FSA to make the respective requirements identical.

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[4] Available from www.bis.gov.uk/consultations

[5] Futurevalue 2010 Online Annual Reporting Study, published March 2011

In terms of executive pay there is little evidence that company performance has been the main driver of the level of executive pay.

There is also a concern that there remains a substantial lack of transparency surrounding executive pay that results in asymmetry of information and moral hazard. In particular, despite companies already being required to give very full disclosure of remuneration under the Directors' Remuneration Regulations (DRR), companies do not seem to provide a clear line of sight between levels and structure of remuneration and directors' performance in meeting the company's strategic objectives. Inadequate or obtuse linkage between pay and performance has the potential to provide incentives for directors which are badly aligned with those of shareholders and consequently affect the quality of the directors' relationship with wider stakeholders, including employees.

The additional disclosure requirements arising from the Women on Boards project will be included as part of this consultation. Disclosure is one of the ten recommendations from the February 2011 Davies Review into women on boards which aims to "generate momentum behind, and increase focus on, this business priority". The Review also said "Transparent reporting will help Chairmen and CEOs to better understand the composition of their workforces and monitor attrition rates".

Rationale for intervention

BIS launched the 2010 consultation "The Future of Narrative Reporting"[6] to solicit views on the current narrative reporting framework. A number of key themes emerged from the responses to the consultation:

- In general UK quoted companies produce high quality reports. Nonetheless, there remains room for improvement particularly those companies with most room for improvement where compliance only with the minimum legislative requirements is limiting the value of disclosures. Particular areas of concern were the complexity and overlapping requirements of the current regime, pointing strongly to the need for a thorough review across the whole of the narrative reporting landscape to streamline the framework and facilitate a significant step change in the quality of disclosure
- Some investors noted that disclosure of company strategies, risks and opportunities was essential in enabling them to make informed decisions on the likely long term performance of their investments. While this confirmed the value of good quality narrative reporting, it also emphasised that many investors rely on other more timely sources of company information for their investment monitoring. Equality of access to critical business information was noted – big investors appear to have greater direct access to management and therefore insight and information than either retail shareholders or other stakeholders.
- Companies are struggling to meet the varying information needs of a range of users. The price of trying to satisfy diverse interests might be overlong and inaccessible reports which make it hard for the user to identify relevant, consistent or comparable information from a mass of uncoordinated data. However, views on what constituted relevant data varied. Standalone reporting of social and environmental matters in particular was viewed by some as evidence that such issues were poorly integrated into the reporting of strategy and risks of the business and as a result did not provide relevant and consistent information. Equally there were concerns from users that annual reports are too often perceived as a marketing tool (with information presented in an overly positive manner) rather a balanced and fair view about the business and its prospects.
- The tension of comparability versus the need to reflect the unique nature of individual companies was a strong theme resulting in very different views on many questions. Audit and assurance on narrative information was also raised as an area needing further thought.
- Many also noted the various existing non-regulatory initiatives to encourage good reporting such as regular surveys of good practice and awards as well as the role of the Financial Reporting Council (FRC) and its operating bodies in providing best practice guidance and in assessing compliance with accounting and legal requirements. Various respondents asked whether there was need or scope for strengthening any of these elements.

Any differences in opinion tended to be consistent with respondent type and reflected divergent views on the quality of existing reporting as well as the best approach to improving the quality of corporate reporting.

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[6] Available at www.bis.gov.uk/consultations

Current Quality of UK Narrative Reporting

The UK corporate governance regime for quoted companies is already rated highly[7] . There have been various private sector[8] and regulator reviews[9] of the quality of UK companies' narrative reporting/business reviews (covering mainly quoted companies) over the last ten years. In general these reports have found that the quality of narrative reporting is improving but that there is still much variation and room for improvement between the best and worst performers. There are also concerns with the increasing length and complexity of the reports.

The reports show that there has been a significant increase in the number of companies disclosing information on the principal risks and uncertainties facing the business, rising to 95% in 2010 (2003: 25%) although a number are still only reporting on very generic risks. There has also been an improvement in companies clearly identifying their key performance indicators, with 90% of companies presenting KPIs in 2010 (2003: 45%). However the majority of companies (87%) are still not clearly identifying targets for their KPIs making it difficult for users to assess performance.

The average length of the annual report has substantially increased over the last decade. In its 2010 survey Deloitte reported that the average length of the annual report had more than doubled since 1996 with the average length of the report in 2010 being 101 pages (1996: 44). Over the same period the percentage split between narrative and financial reporting in the annual report remained broadly constant.

While companies have faced additional disclosure requirements over this period the report questions whether increased volume means that companies are communicating more effectively.

The corporate reporting consultancy, Black Sun reports[10] that over the last 5 years

"…*the quality of narrative reporting has been promising, although while we have seen a number of companies raise the bar over the last few years in terms of the quality of content and the accessibility of key information, there are still a significant number of less promising reports which merely adopt a box-ticking approach*"

and

"*Companies need to rethink their reporting to evidence the quality of decision making and the quality and sustainability of a company's strategy. Companies need to stop hiding behind the complexity, which undoubtedly is there, and concentrate on simply "telling a story" that people can believe in*".

A 2007 ASB report[11] looking at the quality of narrative reporting found that the greatest area of difficulty for companies when producing their narrative reports is the disclosure of forward-looking information. The ASB found that only 13% of companies were producing reports of a "good" standard and there were no companies falling into the "best practice" category.

On 1 February 2011 the Financial Reporting Review Panel (FRRP) released a press notice which highlighted the challenges in the reporting of principal risks and uncertainties, and encouraged boards of directors to consider six questions in making disclosures in their business review. In its August 2010 Annual Report the FRRP had reported findings from targeted reviews of narrative reports including that improvement was needed in reporting of a company's business model.

The excessive volume and lack of structure to corporate information currently inhibits useful engagement between the company's management and the company's shareholders (especially institutional investors in quoted companies but also for retail investors and those investing in smaller quoted companies). Links between company performance and executive pay in particular have been noted as unclear. It is widely held that a lack of transparency between narrative and financial reporting reduces effectiveness. Shareholders are therefore impeded in their efforts to hold management to account.

As outlined above user concerns include the increasing length and complexity of reports and the lack of identifiable key company specific information such as the strategy of the company. Many commentators have also noted the tendency for a "kitchen sink" approach by many companies which means that there is a tendency to report any and all information regardless of its significance. This makes it difficult for investors to easily identify key information within the annual report.

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7 http://www.gmiratings.com/(kpn22eiphusrrhm3rfis1zuz)/Images/GMI_Country_Rankings_as_of_10_27_2010.pdf

8 For example, "Swimming in Words" Deloitte survey of narrative reporting in annual reports (October 2010) and "A Snapshot of FTSE 350 reporting" PWC (2009).

9 Financial Reporting Council (FRC) reports "Louder then Words" (2009) "Cutting Clutter" (April 2011).

10 Black Sun "Rethinking Reporting, Annual Analysis of FTSE 100 Corporate Reporting Trends 2009"

11 Accounting Standards Board "A review of Narrative Reporting by UK Listed Companies in 2006" January 2007

Commentators[12] suggest that this cluttered reporting by companies arises for a number of reasons including a lack of agreement between stakeholders on what is "material"; risk aversion amongst companies and report preparers who fear that non-disclosure will be challenged by regulators; time pressures which mean it is easier to simply repeat prior disclosures; and simply copying the behaviour of other companies. Directors are also sensitive to the risk to their individual and the company's reputation and liability. Directors and management also fear being held to account by reference to a third party's priorities rather than the company's priorities and the risk of public criticism with the benefit of hindsight.

Annual reports of quoted companies, including their narrative elements, are addressed primarily to the company's shareholders. That said, over time company law disclosure requirements for the annual report have emerged to meet the needs of various other stakeholders in the company. This is because the annual report was seen as a suitable vehicle for public statements by the company, especially for requirements which arose before widespread use of electronic communication. In addition stakeholders other than the shareholders will have an interest in the annual report and its narrative elements.

In practice for the largest UK companies (especially those quoted on the main market of the London Stock Exchange) interaction between shareholders and management takes place regularly during the year to discuss strategy and discuss concerns and shareholders have other key sources of information (such as analysts' reports). Many companies make this information available concurrently on the company's website, including through live webcasts. However, a high quality annual report is seen as an indicator of good management. The annual report is still valued as a critical block of company information by all investors and is key information for others such as retail investors and those researching newer companies.

Policy objective

The policy objectives are to:

- enable investors to better understand the business model, strategy and risks faced by the company by facilitating more meaningful disclosure supported by more detailed sets of data online;
- enable investors to better understand the link between directors' remuneration and company strategy and performance;
- facilitate more effective reporting of corporate social responsibility and environmental information, and;
- remove conflicting and/or overlapping regulatory requirements that inhibit clear reporting.

Description of options considered (including do nothing);

Three high level policy options have been considered:

1. Reintroduction of the 2005 regime for the Operating and Financial Review
2. Require companies to produce a high level strategic report supplemented (where appropriate) by detailed disclosure online (available in hard copy on request)..
3. Do nothing

Option 1: Reintroduce the original OFR along with enhanced statutory assurance from the company's auditor and a mandatory reporting standard for all non small companies.

The Business Review is an essential element in company narrative reporting. It has its origins in the EU Accounts Modernisation Directive, which required all companies other than small to prepare a Business Review. The Operating and Financial Review (OFR) originated when this directive was implemented in the UK in 2005[13] which introduced the mandatory OFR for quoted companies. These Regulations were effective for financial years beginning on or after 1 April 2005.

[12] Including FRC (2009) "Louder than Words"

[13] by the Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005

The Regulations provided for a reporting standard published by the Accounting Standards Board. They also provided an enhanced audit requirement whereby the auditor reported whether any matters coming to their attention in the course of the audit were inconsistent with the information in the OFR.

The statutory OFR was repealed in December 2005 and, following further consultation, the Business Review provisions (which were in place for non-small companies) were enhanced for quoted companies and restated in the Companies Act 2006; these provisions came into effect for reporting years beginning on or after 1 October 2007.

The Business Review requires companies to provide broadly the same information on non-financial matters as the earlier OFR. Briefly, all companies, other than small, are required to prepare a business review as part of the directors' annual report. The purpose is to help shareholders assess how the directors have performed their duty to promote the success of the company. Quoted companies must also, to the extent necessary for an understanding of the company's business, include information on environmental, employee, social and community matters, as well as on contractual and other arrangements essential to the business. The Business Review does not include the enhanced audit requirement for the OFR or statutory recognition of a reporting standard.

Annex 2 compares the content of the current Enhanced Business Review (for quoted companies) to that required by the OFR in the 2005 Regulations. In terms of content, there is little difference between the two – specifically, both require quoted companies to report (among other things) on:

- a review of the business, including principal risks, performance and development;
- environmental matters (including the impact of the company's business on the environment);
- the company's employees;,
- social and community issues, and;
- auditor to say whether the review is consistent with the financial statements.

The principal differences between the 2005 OFR regime and the enhanced business review are:

- The 2005 OFR regulations required companies to state whether the report was "prepared in accordance with relevant reporting standards and (b) contain particulars of, and reasons for, any departure from such standards."
- The 2005 OFR regulations required the preparer's auditors to state "whether any matters have come to their attention, in the performance of their functions as auditors of the company, which in their opinion are inconsistent with the information given in the operating and financial review."

The OFR also contained more detailed disclosure requirements than the enhanced business review. Reinstatement of the OFR would therefore involve amending the Companies Act 2006 to include the provisions above. The principal source of costs to business in this option are a result of the enhanced audit requirement.

Option 2: Introduce a new short strategic report underpinned by detailed data and minor amendments to content.

This proposal has four principal components, aimed at addressing the issues with the current reporting framework that were identified in the recent BIS consultation "The Future of Narrative Reporting":

- To reshape the **form** of primarily quoted company narrative reports to introduce a new strategic report supported by readily accessible detail to enable comparison
- To consult on the **right supporting regime** through new guidance (preferred option – revise current voluntary reporting statement); revised audit/assurance arrangements (preferred option – no change to current requirements); and the role of the Financial Reporting Review Panel (FRRP) in overseeing compliance by quoted companies (preferred option – no change to FRRP's role)
- To address how primarily quoted companies **present and disseminate** their reports by facilitating greater use of electronic media to enhance accessibility and consistency but without removing access to hard copy information
- To streamline the **content** of company narrative reports which will be simplified where possible to reduce burdens on business while also implementing new provisions for quoted companies on pay and women on boards – see the Annex 3 for detail

The detailed data could be provided on the company's website. The strategic report would replace the Summary Financial Statements. Annex 3 sets out in more detail changes in content including the removal of overlapping reporting requirements and some minor new requirements in relation to pay and diversity on boards for inclusion in an Annual Directors Statement.

The current provisions on narrative reporting reflect European requirements and the extensive debate and consultation on UK company law which led to the Companies Act 2006. The term 'narrative reporting' is used to describe the non-financial information that is included in company reports in order to provide a broad and meaningful picture of a company's business, its market position, strategy, performance and future prospects. Narrative reporting - sometimes referred to as the "front half" of the annual report - includes a number of elements, some of which are required by statute or Financial Services Authority (FSA) rules. These include:

- the Directors' report, including the business review;
- the Chairman's statement and the Chief Executive's review;
- the Directors' Remuneration Report; and
- corporate governance disclosures.

Some companies also choose to provide separate social and environmental reports. In addition, the FSA's Disclosure & Transparency Rules require some companies to make periodic financial statements, which contain forward looking statements about the company's strategy and objectives. These various elements of narrative reporting should be consistent and clearly presented so that readers can understand the principal factors likely to affect a company's long-term performance, for example:

- relating long-term performance criteria for directors' remuneration to the company's strategic objectives;
- where appropriate, by linking reporting on social and environmental factors to the principal risks set out in the business review.

In terms of the form of the report, the current company law requirements for the narrative elements of non small company annual reports would be replaced by:

- a Strategic Report providing core information about the business together with high level financial data;
- online material which would constitute the Annual Directors Statement

This proposal addresses the problem of user access to the information that they need, which for quoted companies is currently difficult principally due to the volume of data. This in turn makes it difficult to compare one company with another on discrete issues. The new Strategic Report (greater prominence given to key messages) and the Annual Directors Statement (in standard format) would address both issues of accessibility and comparability.

The Strategic Report would cover the essential information about the business: its forward looking strategy, its business model, performance/key financial data, significant changes to governance, and its principal risks. Elements of financial performance, pay, governance and risks would be elevated from more detailed information. The disclosures need only be disclosed in the Strategic Report, but may be supported by more detail online.

The Strategic Report would be supplemented in part by the information provided in standard format in an Annual Directors' Statement, which might be on a website only. In reality, some of this material only changes periodically. Statutory requirements should be kept to the minimum necessary in the strategic report (largely a reworked business review) to allow the company flexibility in presenting the information. However, we envisage a greater degree of prescribed structure - for example, new standard headings to underpin the annual directors' statement.

The annual directors' statement will be the repository for detailed disclosure on pay, greenhouse gas emissions, women on boards (as part of the corporate governance statement), and any voluntary disclosures about gender pay equality.

Companies are currently able to ask shareholders if they would accept Summary Financial Statements (SFS) in the place of the annual report. The Companies Act 2006 (CA06) sets out minimum requirements for content of SFS, with emphasis on historical financial performance. We propose changing the CA06 to replace the SFS with the strategic report, which would change the emphasis of high-level company communication from historical financial performance to strategy and governance.

Scope

We propose that the new framework should be used by all non small companies. There will be negligible net cost to non-quoted companies in doing so (they would have to change two headings only), but using new headings for all companies will have significant benefits. It will:

- future proof the structure of UK company law, for example by facilitating future use of iXBRL on company websites and in corporate filings;
- maintain the consistency of UK law across different groups of companies as defined in CA06 (the size criteria) thereby helping companies that move across thresholds and users of company reports who look at reports of private and quoted companies;
- enable private companies to take advantage of the above benefits, which otherwise will accrue primarily to quoted companies, and;
- not prevent any future changes to the CA06 company size criteria.

The right supporting regime for the proposed new framework

An effective supporting regime for the proposed new structure is vital if the benefits are to be realised following implementation. There are three main elements to this:

- the audit and assurance regime underpinning the reporting framework;
- guidance for those preparing annual reports
- enforcement of the requirements and the role of the regulator

Currently, the auditor asserts that narrative information provided in a company's annual report is consistent with the financial statements. Specifically in relation to:

- Annual accounts – the auditor provides an opinion as to whether the financial statements present a "true and fair" view
- Directors Report – the auditor states whether the information in the report is consistent with the financial statements
- Corporate Governance Statement (where separate) – the auditor states whether the information is consistent with the financial statements
- Directors Remuneration Report – specified elements are audited and the auditor also provides an opinion as to whether it has been prepared properly

Voluntary guidance for preparers is issued by Accounting Standards Board (ASB) and the FRRP is responsible for ensuring compliance by large and quoted companies with the legal reporting requirements.

Audit/assurance

Some investors and NGOs would be concerned if directors were allowed to provide narrative information without any form of independent challenge or scrutiny. This assurance is outside the scope of an audit of the financial statements. The consultation will outline the following options and invite views on our recommended options (a) and (e) highlighted below:

a) **Retain the current consistency check by the auditor who reports to shareholders whether certain narrative information is consistent with the financial statements (similar to the earlier OFR requirement, but providing a lower level of assurance)**

b) introduce a new requirement for the board, in approving the strategic report, to ensure that it is "fair and balanced" (analogous to CA06 requirements that financial statements should be "true and fair" – a concept with meaning specific to financial statements that has been described over time through case law)

c) require directors to describe the process of report preparation, and auditors to opine on whether that process has been followed

d) to require assurance by the auditor of specific elements of the report, for example, the strategic report or sustainability information contained in the strategic report and the annual directors statement

e) **encourage requests from shareholders to the company for greater assurance on discrete data.**

The existence of and degree of assurance provided by the current consistency check is currently not widely understood, so it appears that the benefits from the current regime have not yet been fully explored or exploited. That said there may be cases where users of discrete information would benefit from assurance to a greater degree than is currently mandated.

Respondents to the 2010 BIS consultation were split on whether greater assurance should be required so BIS could feasibly encourage a culture of "ask the company". Companies are currently able to buy additional assurance voluntarily, and presumably do so when their particular circumstances identify that it would be beneficial. Some quoted companies choose to have assurance on certain data in their reports – for example, some mining companies chose to publish an independent assurance report on selected sustainability data. However use of such assurance is limited and its credibility is variable depending on the basis on which it has been prepared and the provider. There is no established standard or market in assurance of sustainability information which is currently costly and generally only undertaken by the biggest companies.

Guidance for preparers

Some companies and investors favour statutory standard on the basis this would provide greater certainty. A statutory standard would also be favoured by wider stakeholder groups such as the NGOs and Trade Unions. However, a statutory reporting standard would introduce a significant administrative burden on companies and users in a period where the benefits from the current voluntary regime have yet to be fully explored or exploited.

We would propose a review of the current voluntary ASB statement which should be changed to provide greater flexibility to those companies opting to use it. This would also be in line with the FRC's proposals in its recent paper "Effective Company Stewardship[14]" and would better allow companies to "tell their story".

The consultation would cover the following with (g) as our recommended option:

f) companies to develop sector specific guidance with investors

g) the ASB reporting statement should be replaced by a revised ASB Narrative Reporting Statement on a best practice basis

h) the ASB reporting statement should be replaced by a new Narrative Reporting Standard on a statutory basis

i) Additional subject specific guidance/standards should be developed and recommended

Options (f) and (i) are not recommended as there is nothing to stop companies and/or investors producing these types of guidance and standards voluntarily; however, there may be a role for Government and regulators in promoting this. Option (h) is not recommended, as it would impose significant costs on companies and would reduce flexibility, leading to more "boiler-plate" disclosures aimed at compliance rather than communication.

The current ASB voluntary reporting statement is widely held to be high quality and useful to preparers and users alike. There was broad consultation at the time that the statement was drawn up, with broad

[14] "Available at http://www.frc.org.uk/images/uploaded/documents/Effective%20Company%20Stewardship%20Final2.pdf"

support for the final product. We understand from our consultations that the statement is often referred to by companies even if they do not state voluntary compliance with the statement. BIS wishes to retain the best elements of the existing voluntary guidance framework, while revising the existing guidance to reflect the proposed new reporting framework.

These options are not exclusive – for example revised ASB guidance could cross refer to subject specific guidance which is seen as representing good practice. Sector guidance could supplement ASB guidance.

The regulatory cost of statutory guidance would include ASB preparation and consultation costs.

Enforcement – the role of the regulator

The Financial Reporting Review Panel seeks to ensure that the annual accounts of public companies and large private companies comply with the requirements of the Companies Act 2006 and applicable accounting standards.

The FRRP carries out its responsibilities on behalf of the Secretary of State in relation to annual accounts and other documents falling within its remit. The FRRP reviews company accounts and reports for compliance with the law and applicable accounting standards.

It is the role of the Panel to enquire into cases where it appears that the rules have not been followed - in the words of the Companies Act 'where it appears to the Panel that there is, or may be, a question whether accounts comply with the requirements of this Act'. Where there may be a case to answer the Chairman appoints a group to conduct the enquiry.

Ultimately the FRRP is empowered to apply to the court under section 456 Companies Act 2006 for a declaration or declarator that the annual accounts of a company do not comply with the requirements of that Act and for an order requiring the directors of the company to prepare revised accounts. Thus far, the FRRP has been able to achieve appropriate action by companies without having to resort to the courts.

Options for consultation are as follows with j) as our recommended option:

- **j) Enhancing the public profile of the FRRP to ensure that stakeholders are clear that their remit extends beyond financial reporting.**
- k) Better using the FRRP's experience to note or to cite examples of good practice
- l) Extending the FRRP's remit to cover all narrative content in reports
- m) No change to current arrangements

A greater enforcement role for the FRRP under option (l) would introduce significant administrative burdens for both the regulator and companies that are subject to review. The benefits from the current voluntary regime with regard to FRRP profile and remit have yet to be fully explored or exploited. It is also held by many respondents that more formal enforcement could impair innovative reporting and encourage more widespread bland narrative statements. Good practice in company narrative reporting is currently promoted through a number of awards ceremonies, and is also the topic of a number of market-driven reports and studies. We therefore view option (k) as unnecessary. Option (m) is not preferred as feedback from companies and others indicates that they would benefit from greater clarity of the remit of the FRRP.

Option 3: No regulatory change

This option represents no change from the current regime.

Costs and benefits of each option (including administrative burden)

Option 1: Reintroduce the Operating and Financial Review

Costs

The **total costs** for the reintroduction of the **2005 OFR regime** are composed of **preparation costs** and **audit costs**. The RIA for the introduction of the OFR in 2005[15] suggested a total additional cost of £28 million per annum for assurance costs and statutory reporting standard over and above those for the Modernisation Directive requirements and £11 million for preparation. These figures were extensively tested with stakeholders at the time, and we have no cause to dispute the basis on which they were calculated. Updating the £28 million figure to incorporate increases in average audit fees since 2005 and the £11 million for costs of preparation suggests a total cost now of **£64.6 million** per annum for all quoted companies (£56.7 million for increase in audit fees and £7.8 million for preparation against the new statutory reporting standard). This assumes a likely increase of 6% in annual audit fees on the basis of stakeholder discussions at the time of the OFR.

Preparation Costs

The IA in 2005 looking at the OFR estimated that a significant component of the cost for the introduction of an OFR is employees' and executive directors' time, with additional time impacts in subsidiaries, central finance and secretarial functions. Based on responses to the consultation it was estimated that the mean average costs to prepare the OFR for quoted companies was:

Large Quoted (FTSE 100) – Average cost per company is £15,000

Mid Cap Quoted (FTSE 250) – Average cost per company is £10,000

Smaller Quoted – Average cost per company is £5,000

Using these figures we have estimated the costs of reintroducing the OFR to all quoted companies .

Size/ Class of Company	Average Cost per Company	Total Number of Companies	Total Costs (£m) Best estimate	High (£m) (+10%)	Low (£m) (-10%)
Larger Quoted	£15,000	100	1.5	1.7	1.4
Mid Cap Quoted	£10,000	250	2.5	2.8	2.3
Smaller Quoted	£5,000	750	3.8	4.1	3.4
		1100	**7.8**	**8.5**	**7.0**

A 10% sensitivity analysis was carried out around the average cost per company giving upper and lower bound estimates of £8.5 m and £7.0 m respectively. The best estimate figure of £7.8 m is lower than the £11 m figure quoted in the 2005 OFR impact assessment due to a reduction in the number of quoted companies since 2005. Note also that this figure has not been increased to reflect production cost increases since 2005 as no data is available to quantify that increase – the sensitivity analysis reflects the degree of uncertainty in this figure.

Audit Costs

The IA in 2005 estimated that the introduction of the OFR would result in between a 4% and 8% increase in audit fees. These figures were obtained following discussions with audit firms that indicated that the requirement to opine on the process directors follow in preparing the OFR would require new and significant work to that undertaken in the normal course of an audit.. As a sensitivity analysis we calculated an increase of 4, 6, and 8 percent in audit fees. Using the Financial Director "Audit Fees Survey 2009" for FTSE 100 and FTSE 250 firms and the January 2002 paper "Audit Pricing in Private firms" for smaller quoted firms we obtained the 2009 average audit costs for FTSE companies shown in the table below.

[15] Available at http://www.bis.gov.uk/files/file21361.pdf

	Average Audit Fee	Number of Companies	Total Audit Cost (£m)	Increase in 2009 Audit Fees (£m)		
				High 8% increase	Low 4% increase	Best estimate 6% increase
FTSE 100	£5,499,000	100	550	44.0	22.0	33.0
FTSE 250	£766,000	250	192	15.3	7.7	11.5
Smaller Quoted	£272,480	750	204	16.3	8.2	12.3
All Quoted		1,100	946	75.7	37.8	**56.7**

Total Cost

Best estimates therefore give a total potential cost of Option 1 of £65m (comprising increased audit costs of £57 m and increased preparation costs of £8 m).

Upper and lower bound estimates based on the sensitivity analysis above are £84 m (comprising increased audit costs of £76 m and increased preparation costs of £8.5 m) and £45 m (comprising increased audit costs of £38 m and increased preparation costs of £7.0 m).

Transitional Costs

One off transitional costs for companies of implementing a mandatory OFR were not calculated in 2005, possibly because the annual cost of mandatory assurance was so high. We now need to consider transitional costs for companies of moving from the current business review to a mandatory standard for companies publishing an OFR.

We estimate that familiarisation costs of a mandatory OFR would be at least the size of the annual cost of preparation, £18,000 for a FTSE 100 company, but as this policy option is no longer viable due to the large on-going annual costs it is disproportionate to attempt to calculate the transitional costs more accurately.

Benefits

Mandation of a standard report for all quoted companies would enhance comparability. A combination of a mandatory standard and increased audit requirements would meet NGO requests for greater legal requirements for companies to provide standardised CSR information, and would increase users' ability to rely on narrative information.

Option 2: Replace Directors Report with Strategic Report and Annual Directors Statement

Changing the form of the report – costs:

The main costs of introducing the **new strategic report** underpinned by on line data will be one-off familiarisation costs for those preparing annual reports; these include additional management time to ensure that report meets statutory requirements. We have assumed that it will take all quoted companies 15 hours to familiarise themselves and using Annual Survey of Household Earnings[16] data following BIS methodology we have assumed that the cost per hour for senior/middle management/clerical is £29.30 gross per hours for corporate managers including 24% uplift for non-wage costs.

Cost calculation: x companies * y hours * cost/hour (senior/middle management/clerical grades).

= 1100 * 15 * £29.30 = £483,000

The above calculation uses a population of 1100 quoted companies. Non-quoted companies are not included in the calculation, as the proposed changes for companies not subject to the quoted companies provisions in the Companies Act 2006 amount to changing two headings in their narrative reports. The cost for changing two headings is assumed to be zero.

A sensitivity analysis has been performed on these costs using a low and high bound of 10 and 20 hours respectively and a 10% sensitivity analysis on the cost per hour. This gives a lower estimate of £290,000

[16] http://www.statistics.gov.uk/downloads/theme_labour/ashe-2010/2010-occ4.pdf

and an upper bound of £709,000. We have discussed these cost estimates with a range of quoted companies. It has been difficult to obtain specific estimates of costs from them (we suspect partly due to most companies not collecting the required data), however we have not received any feedback that our estimates are not realistic. The consultation document will include questions seeking further verification of these estimates.

Our intention is that the new framework will be drawn up in a manner which will be principles based and relatively simple to understand, so that annual compliance costs will be no higher than they are under the existing regime (we hope for a net benefit because better communication should lead to efficiencies for both companies and shareholders). We will consult on these assumptions.

We understand from informal consultations with companies that they anticipate that additional costs of the new framework will be minimal on the grounds that companies already have the website frameworks in place (website design is the main cost; companies told us that the cost of making a wider range of information available on their website is minimal by comparison to cost of website design – which they already have in place as a listing rule requirement). Members of the Quoted Companies Alliance who are mainly smaller quoted companies, confirmed in a meeting with us in early May that the implementation costs of greater online disclosure would not be onerous..

In terms of the revised content of the reporting framework the final impact will depend on the success of removing overlapping requirements such as those between company law and the FSA listing rules on pay (see Annex 3 for further detail). Whilst we do not consider it possible to quantify the impacts given the relatively minor changes in content we anticipate that the final net impact will be deregulatory and provide overall benefits to business. The removal of inconsistencies with the listing rules on pay in particular will provide meaningful cost reduction to quoted companies – we will seek to quantify this through the consultation process.

The proposed additional reporting requirements, including those in relation to executive pay and women on boards, apply only to quoted companies and do not impose any significant additional costs on companies. On pay this is self evident because BIS will be requiring publication of information that the company already collects to meet existing aggregate disclosure requirements. On both pay and women on boards we have confirmation from our meetings with company secretaries of FTSE100 companies that our proposals will not significantly increase their administrative burden as the requirements are relatively minor and the data readily available within companies.

Changing the form of the report – Benefits

The new strategic report will provide better quality information for shareholders to hold management to account, contributing to the Government's aim of encouraging greater stewardship of companies by their owners. There will be improved confidence in the UK corporate governance regime as a result of more meaningful disclosure and greater comparability between companies in terms of pay and board diversity. Ultimately, a more effective reporting regime which encourages engagement and the holding of management to account should lead to better run companies and a better balance of returns between shareholders and company executives.

In addition to the benefits to shareholders and the wider economy there will be some reduction in costs for companies in preparing annual reports as a result of the removal of duplicate and overlapping requirements.

Whilst none of these benefits are directly quantifiable because of the wide range of shareholders likely to be affected and the difficulty of assigning monetary value to greater clarity and accessibility of narrative information it is clear from stakeholder consultations that such an approach is considered beneficial.

Content – Costs and Benefits

Pay (applies to quoted companies only)

The costs of new disclosure requirements on auditable pay would be minimal because the information is gathered to make existing disclosures. There would be significant savings for companies if the CA06 requirements and the listing rule requirements were made consistent (for example at present companies have to make two sets of disclosures on defined retirement benefits, including obtaining two different reports from actuaries). Other changes to disclosure of board and senior executive pay to improve disclosure to shareholders are summarised in Annex 3. Some of these measures may require additional disclosure, however this will be balanced against the streamlining measures outlined above. The overall impact of changes to pay disclosure is therefore expected to be minimal.

Women on Boards (applies to quoted companies only)

We propose to implement the disclosure proposals of Recommendation 2 of the Davies Review[17]. We understand from feedback from GC100 that disclosure requirements restricted to executive level would have minimal costs attached, largely because the information is readily to hand and/or already in the public domain.

Removals – streamlining, and removing overlapping requirements

The average length of a quoted company narrative report is 51 pages according to a recent Deloitte survey[18]. The proposed removals are conservatively estimated to be two pages on average (4%). A further 1% aggregate saving in management time is estimated for removing duplication (which represents time saved in having to refer to two separate places to check that disclosure meets both requirements). Therefore all other things being equal we estimate an aggregate saving across quoted companies of 5% of narrative report costs. We currently do not have sufficient evidence to be able to estimate the current costs of narrative reporting in order for us to be able to calculate these benefits but during consultation this is something we would hope to gain further information on.

Audit and assurance - Costs:

a) Option a – There will be a zero cost impact because it does not change existing requirements.

b) Option b – Would impose zero costs, because it is something that the board should be doing (privately) already, but companies could incur legal costs if directors felt the need to voluntarily take advice on the meaning of "fair and balanced" in their particular circumstances

c) Option c would likely be less onerous than the OFR audit and assurance process, but still significant on the grounds that directors would have to describe the process and auditors would need to report on the evidence available.

d) Option d would be more onerous than the OFR requirement, because it would require additional specific work programmes and reports

e) Option e - nil £ for the purposes of the IA because the assurance would be obtained by the company on a voluntary basis.

Audit and assurance – Benefits

Assurance supports confidence in company reports – to various degrees, depending on the nature of the opinion being given. Generally, the greater the level of assurance, the greater the cost, but the relationship between the two is not necessarily proportional or linear. Specific benefits of the options are:

a) no new benefits to shareholders

b) more balanced reports, and greater engagement by the board in the annual report process

c) some assurance to shareholders, however feedback from preparers and others indicates that this option will lead to an increase in boilerplate disclosures

d) degree of increased reliability for users of the sections of the report that are subject to auditor assurance, no benefit to other users.

e) greater reliability of data for users

The preferred options are a), b) and e) which would deliver a greater level of assurance to investors about the objectivity of the annual report without adding greatly to the burden on business.

Guidance for preparers - Costs

f) Costs would fall directly on companies and institutional shareholders, which will vary by sector depending on the detailed guidance required.

g) Costs to ASB in revising the reporting statement (previously one-off cost of a completely new standard was estimated to cost £200,000 as part of the OFR RIA). We expect the ASB costs of revising an existing voluntary statement to be significantly less than writing a new mandatory standard. We understand that costs of this order would currently be absorbed within the existing

[17] Available at http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf

[18] "Swimming in Words" available from www.deloitte.com

ASB budget rather than being passed on to companies. The use of the standard by companies would remain voluntary and therefore impose no costs to companies.

h) There would be costs for the ASB in revising the voluntary reporting statement (similar to option 2b), and additionally for companies in first familiarising themselves with a revised mandatory standard and then annual management time in complying with the standard. We would anticipate these familiarisation costs to be of similar magnitude to those for above for changing the form of the report.

i) costs of developing sector specific voluntary guidance would fall on individual regulators or sponsoring agencies.

Guidance for preparers - Benefits

Improved guidance should lower costs of companies complying with the proposed framework requirements and help to improve company reporting. Options f) and i) risk being more expensive than option g) and risk a system of reporting which is disjointed/uncoordinated and therefore risks incomparability between companies.

The preferred option is g) which would ensure continued support for a regime built on promoting best practice rather than a more costly statutory regime.

Enforcement - Costs

Options j), k), and m) have nil or minimal cost as they make use of existing communication channels and resources and no further resources or communication channels would be required. There would be some additional costs for the Financial Reporting Review Panel (FRRP) if they are allotted an enhanced enforcement role under option l), which would probably be passed on to market participants via the FRC levy (see footnote 11) – estimate annual costs of five extra staff at £120k each.

Enforcement - Benefits

Arguably an enhanced enforcement role for the FRRP would make it more likely that new requirements are adhered to by companies and that the benefits of our preferred option would be achieved. The FRRP has called for more detailed rules to make its job easier. However, its current work has produced one summary report in 2010 and it has therefore had little time to have a demonstrable impact on the quality of reporting. We have had feedback that the FRRP’s work is not currently widely understood or advertised and would therefore recommend option (a), while keeping this area under review.

The preferred option is j) which builds on the work which the FRRP has been doing in ensuring greater compliance by companies rather than imposing greater costs for uncertain benefits.

Option 3: Do nothing

Costs:

If we do nothing, we will not meet changing investor needs and there will be little incentive for companies to improve reporting. It will not address existing information inefficiencies, or simplify reporting for companies.

Benefits

If we do nothing then there will be no need for companies to adjust reporting requirements.

Risks and assumptions;

Risks:

- proposals which are largely voluntary may have limited impact on quality of reports

Assumptions:

- the FSA will agree to consult on changes to the Listing Rules (particularly on pay disclosures)
- there are limited transition costs for companies
- there will be benefits (detailed above) in the form of better corporate governance, information efficiencies for users and consequent marginal reductions in cost of capital for companies which are generally accepted in principle but difficult to monetise.

Direct costs and benefits to business calculations (following OIOO methodology);

Under the 'One In, One Out' rule whereby a measure that has a net cost to business must have a measure or measure of equivalent cost removed in order to be implemented, Currently we are not able to quantify benefits of this policy, however, we are optimistic that the consultation process will provide evidence to enable this. In the absence of currently quantifiable benefits of this policy the equivalent annual net cost benefit of the proposed changes is £0.06m over the ten year period.
It would be possible for BIS to identify a corresponding, relevant "out" of £0.05m, should this be necessary following recalculation of the OIOO cost post-consultation, however we would not expect this to be necessary following quantification of the benefits..

Wider impacts;

The proposed changes to the reporting framework will encourage a change in emphasis from communication which is primarily designed for paper publication to communication which is primarily web-based. Therefore proposed changes to the framework will favour those users of corporate information who use electronic access.

UK developments will influence the ongoing narrative reporting debate in the EU.

Summary and preferred option with description of implementation plan.

Option (2) is preferred, as it best meets the goals of improving transparency and comparibility of data, while avoiding imposing a large regulatory burden on companies (option 1), which in turn would likely lead to an increase in tick-box compliance with the regulation. There is little or no support from stakeholders for option (3).

Option (3) would not effect the desired improvement in the quality of narrative reporting. Option (1) would impose administrative burden on quoted companies for uncertain additional benefits or benefits that accrue primarily to users who are not shareholders. Option (1) also does not address the core problem for users of information published by quoted companies, which is complexity.

Preferred option (2) best meets the objective of facilitating an improved reporting framework while minimising the administrative burden on affected companies. The new framework will be constructed in a principled manner so that it is obvious to preparers and users alike where users need to go in the company's data sets to obtain certain types of information. It will streamline reporting so that key messages are elevated from the detail, but that detail supports those key messages and is available to those that need it. The new framework will therefore facilitate better reporting on issues such as pay, women on boards, and CSR information such as GHG reporting. Option (2) should result in a net reduction of the volume of annual information reported to shareholders that is not used by them, and therefore result in a net reduction in administrative cost to the company and a net increase in efficiency for users.

Option (2) will be implemented through changes to the Companies Act 2006 (and relevant subordinate legislation). The date of implementation will be influenced by this process, however we currently forecast a date of October 2012 should we require only secondary legislation to make the changes.

Therefore, whilst we are currently forecasting a net cost of the preferred option as a result of one-off familiarisation costs we anticipate that the benefits of the proposed changes to both companies and investors will significantly outweigh these over a ten-year period.

Specific Impact Tests

Small Firms Impact Test

The proposed changes will not have any impact and as there is no impact on micro companies from these proposals it is unaffected by the budget moratoria.

Statutory Equalities Duties

The proposed changes will not have any impact.

Economic impacts

There will be no competition effects associated with this policy. Small firms are not expected to be disproportionately affected.

Environmental Impacts

The proposed changes are not expected to have any significant impact. There may be a negligible effect due to an increased amount of paper.

Social Impacts

The proposed changes will not have any impact.

Sustainable Development

The proposed changes will not have any impact.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review , or there could be a political commitment to review (PIR)];

Political commitment to review

Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]

Proportionate check that the changes to the narrative reporting framework are having the desired effect

Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]

Evaluation using data on the length and content of company narrative reports examining quality of disclosure. To include a scan of stakeholder (principally company, shareholder and NGO) views on the effectiveness of the new framework.

Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]

Baseline position as measured by the recent BIS consultation "The Future of Narrative Reporting".

Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]

Significant improvement in stakeholder perceptions of the narrative reporting framework. Survey of content of narrative reporting shows better disclosure of company risks, strategy and business model. Companies making use of the provisions to provide supporting data online in comparable format.

Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]

BIS, the FRC and others routinely collect and analyse data on company annual reports

Reasons for not planning a review: [If there is no plan to do a PIR please provide reasons here]

N/A

Annex 2 - comparison of OFR and business review provisions

The statutory OFR was introduced in 2005 by SI 2005/1011 alongside provisions for all companies other than small to produce a business review in line with the requirements of the EU Accounts Modernisation Directive. The statutory OFR was repealed in December 2005. Following consultation, the business review provisions were enhanced for quoted companies and restated in the Companies Act 2006 coming into effect for reporting years on or after 1 October 2007. Under the Companies Act 2006 quoted companies must address additional requirements in their business review over and above the requirements of non quoted companies.

Operating and Financial Review **(Schedule 7ZA of the Companies Act 1985)** **– applies only to quoted companies**	**Directors' Report: Business Review** **(Section 417 the Companies Act 2006)** **– applies to all companies other than small but see (5) and footnote 6**
(1) An operating and financial review must be a balanced and comprehensive analysis, consistent with size and complexity of the business, of - (a) the development and performance of the business of the company during the financial year, (b) the position of the company at the end of the year, (c) the main trends and factors underlying the development, performance and position of the business of the company during the financial year, and (d) the main trends and factors which are likely to affect the company's future development, performance and position, prepared so as to assist the members of the company to assess the strategies adopted by the company and the potential for those strategies to succeed.	(2) The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company). (3) The business review must contain: (a) a fair review of the company's business, and (b) a description of the principal risks and uncertainties facing the company (4) The review required is a balanced and comprehensive analysis of : (a) the development and performance of the business of the company during the financial year; and (b) the position of the company's business at the end of that year, consistent with the size and complexity of the business.
2. The review must include – (a) a statement of the business, objectives and strategies of the company; (b) a description of the resources available to the company; (c) a description of the principal risks and uncertainties facing the company; and (d) a description of the capital structure, treasury policies and objectives and the liquidity of the company.	

3 (2) If the review does not contain information and analysis of each kind mentioned in paragraphs 4 and 5, it must state which of those kinds of information and analysis it does not contain. 4 (1) [To the extent necessary to comply with the general requirements of paragraphs 1 and 2,] the review must include - (a) information about environmental matters (including the impact of the business of the company on the environment), (b) information about the company's employees, and (c) information about social and community issues. (2) The review must, in particular, include - (a) information about the policies of the company in each area mentioned in sub-paragraph (1), and (b) information about the extent to which those policies have been successfully implemented. 5. [To the extent necessary to comply with the general requirements of paragraphs 1 and 2,] the review must also include - (a) information about persons with whom the company has contractual or other arrangements which are essential to the business of the company; and (b) information about receipts from, and returns to, members of the company in respect of shares held by them.	(5). In the case of a quoted company, the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include: (a) the main trends and factors likely to affect the future development, performance and position of the company's business; and (b) information about- (i) environmental matters (including the impact of the company's business on the environment); (ii) the company's employees, and (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and (c) subject to subsection (11), information about persons with whom the company has contractual or other arrangements essential to the business of the company. If the review does not contain information of the kind mentioned in b & c, it must state which of those kinds of information it does not contain. …. (10) Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company. (11) Nothing in subsection (5)(c) requires the disclosure of information about a person if the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.
6. (1) [To the extent necessary to comply with the general requirements of paragraphs 1 and 2, the review must] include analysis using financial and, where appropriate, other key performance indicators, including information relating to environmental matters and employee matters. (2) In sub-paragraph (1), "key performance indicators" means factors by reference to which the development, performance or position of the business of the company can be measured effectively	(6). The review must, to the extent necessary for an understanding of the development, performance or position of the business of the company, include – (a) analysis using financial key performance indicators, and (b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters "key performance indicators" means factors by reference to which the development, performance or position of the business of the company can be measured effectively (7) Where a company qualifies as medium-sized in relation to a financial year (see sections 465 to 467), the directors' report for the year need not comply with the requirements of subsection (6) so far as they relate to non-financial information. (8) The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.
8. The review must - (a) state whether it has been prepared in accordance with relevant reporting standards and (b) contain particulars of, and reasons for, any departure from such standards.	

Section 235 (3A). If the company is a quoted company, the auditors must state in their report – (a) whether in their opinion the information given in the operating and financial review for the financial year for which the accounts are prepared is consistent with those accounts; and (b) whether any matters have come to their attention, in the performance of their functions as auditors of the company, which in their opinion are inconsistent with the information given in the operating and financial review.	Section 496 The auditors must state in his report on the company's annual accounts whether in his opinion the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts

Annex 3 - Narrative reporting – proposal details

Pay

The narrative and graphic disclosure requirements will be enhanced and more focused so that the revised report will deliver fuller remuneration data together with a stronger analysis of the link between pay, company strategy and performance in a short high level statement. The high level statement will be included as part of the Strategic Report and will be supported by other more detailed information made available on the company's website as part of the Annual Directors Statement (see table below).

The split between the two sets of information remains under discussion, but the current proposal for remuneration content of the strategic report is:

- A table of the total compensation paid (including remuneration from share option schemes and long-term investment plans) for each director;
- Further disclosure on employees' pay – either disclosure of senior employees' pay, or the relationship between directors' pay and employees' pay (as suggested by Will Hutton);
- A fuller and more robust explanation of how the remuneration policy and total compensation relate to the company's strategy and performance;
- Enhanced graphic representation of the company's performance and the link with total compensation.

We will discuss with the FSA where it may be possible to remove the duplication and/or inconsistency between provisions in the FSA's Listing Rules and company law (inconsistent disclosure requirements for similar information).

We will also consult on the potential for IFRS to describe the requirements of the historic (auditable) data. However, IFRS requires disclosure in aggregate, so CA requirements would need to require in addition that the company disclose the IFRS level of detail for each director and senior executive.

Simplification of disclosure requirements:

The tables below summarise current disclosure requirements that the Government believe offer scope for simplification. Under the proposed new framework, detailed disclosures of this type will form part of the Annual Directors' Statement. The Government is taking the opportunity presented by this review to seek views on the continued relevance of some of these disclosures to investors and others. The Government believes that there is scope for significant simplification of the current requirements and wishes to receive the views from investors, companies and other stakeholders on where the greatest potential benefits may be.

For the disclosure requirements identified in the following tables arise from:

- **UK company law**, the Government is proposing that they should be amended as part of the current narrative reporting review. Any changes would therefore have effect for reporting years commencing on or after the 1 October 2012.
- **Listing Rules, Disclosure and Transparency Rules and the Prospectus Rules**, The Department for Business will also be working closely with the FSA over the coming months to examine whether the disclosure requirements in company law and the Listing Rules (including the DTRs) are consistent. We would welcome views from preparers and users of reports on areas where there may be benefits, where it is possible, from greater alignment. More detail on some areas that could be considered can be found at Annex B. It should be noted that any proposed changes to the FSA's rules would be subject to the FSA's own consultation requirements.

- The Government is also committed to working closely with European partners to ensure that the legal framework in this area is as consistent, effective and user-friendly as possible.

It is important to note that the disclosure requirements will not be removed if sufficient evidence is provided that they are of value to users of company reports.

Requirements arising from UK company law

Requirement in current Directors' Report	Recommendation	Reason for recommendation
Asset values – disclose market value of land if substantially different from that shown in the balance sheet	Remove Companies Act disclosure requirement for all companies	Replicates IFRS and UK GAAP; some companies currently state only that "we are unable to disclose on grounds that it is impractical"
Own shares acquired, disposed or cancelled by the company – disclose number, nominal value, consideration paid, reasons for purchase, charges	Remove Companies Act disclosure requirement for private companies	To align UK law with the EU 2nd Directive (Article 1.1), which would represent a saving for private companies that acquire their own shares, for example from former directors.
Charitable donations – where in aggregate donations exceed £2,000, disclose amount given and the charitable purpose	Remove Companies Act disclosure requirement for all companies	There is no evidence either that this requirement has increased levels of charitable giving from companies or of continuing conflicts of interest in respect of corporate charitable donations.
Employee involvement – statement of actions to introduce, maintain or develop arrangements aimed at providing employees with information on matters of concern to them; consulting employees or their representatives on a regular basis; encouraging involvement of employees in company performance	Remove Companies Act disclosure requirement for all companies	This requirement has been transposed through successive Companies' Acts since its introduction in the Employment Act 1982, which amended the Companies Act 1964. The existing requirement generates disclosures which we believe are of little value to investors, employees or other stakeholders. The rights of employees to information are protected by the Information and Consultation of Employees Regulations 2004 (SI 2004/3426). The requirement also applies only to companies who, in each week of the financial year, had an average of more than 250 employees.
Policy and practice on payment of creditors	Remove Companies Act disclosure requirement for all companies	Information is otherwise apparent from financial statements

Requirements arising from the Listing Rules

Requirement in current Directors' Report	Scope for alignment?
Disclosure of material related party transactions	Listing Rules (LR) requires disclosure where one of the following *percentage ratios* exceeds 0.25%: gross assets, profits, consideration (based on market cap), or gross capital. IFRS requires disclosure where the transaction is material, in isolation or in aggregate, to the company or the individual and so disclosure is necessary for a users understanding; IAS 24 may be a broader scope as it may include senior executives who are not directors.
Long term incentive schemes	LR - issuers are required to provide information about arrangements where director is only participant and is specifically designed for recruitment/retention of that director. The information is only required in the first annual report published after they become eligible. Also details of any Long-Term Incentive schemes under which directors receive entitlements including: monetary value, number of shares, interests at end of period, etc. LR 9.8.8(3) to (6). IFRS Schedule 8, Part 11 & 12 Long Term incentive schemes including: details of scheme interest at beginning, end and during the year; plus number of shares and market price of awards. CA - Sch 7A requires details of payments made under LTIP's
Contracts of significance – where director or controlling shareholder have an interest in a contract which has value more than 1% of balance sheet total or P&L heading as applicable	LR – no objective size required but information relating to any contracts to which the issuer or subsidiary is a party and a director is materially interested; or between the issuer, or a subsidiary, and a controlling shareholder. CA 2006 s992 – significant agreements that take effect, alter or terminate on a change of control
Information disclosed to the company by major shareholders	LR – require a statement of the positions of major shareholders, as stated to the company during the year, as at the end of the financial period. Gives a 'snapshot' at the end of the year in question. DTRs – require information regarding adjustments in holdings to be notified to the issuer, and then the market, by investors. CA 2006 s992 (2)(c) & (d) – details of significant holdings in company: identity, size and nature.
Corporate governance disclosures	We would welcome views on whether there are specific overlaps or duplication of corporate governance disclosures required by company law, the listing rules and the corporate governance code.