



The Association of Corporate Treasurers

Comments in response to

Consultations on narrative reporting

Department of Trade and Industry, 15th December 2005 and
1st February 2006

March 2006

The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers is a centre of excellence for professionals in treasury, including risk and corporate finance, operating in the international marketplace. It has over 3,500 members from both the corporate and financial sectors, mainly in the UK, its membership working in companies of all sizes.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education. The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

General

The ACT welcomes the opportunity to comment further on this matter. Contact details are provided at the end of this document.

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Comments

Previous comments

The ACT has commented in the past during the various stages of previous consultations on reporting.

Since the Chancellor's announcement about the future of narrative reporting at the end of 2005, the ACT has commented in its letter of December 19th (attached – attachment 2). It has also joined with a number of other bodies in commenting on directors' liabilities in the letter of March 14th Attachment 2. Our principal concerns were the future of forward-looking narrative reporting and a desire for a safe harbour provision to avoid such discussion being of the bland, boiler-plate type. These remain our key issues.

Narrative reporting

Forward looking statements

We remain strong supporters of effective narrative reporting. We also think that directors should be encouraged to discuss their expectations for the future – not looking merely at the events and trends of the previous year and the position at its end.

We welcome that “The Government is committed to improving strategic, forward-looking narrative reporting by companies...”

We note however, that the Business Review as set out is very lacking in requirements for any “forward-looking narrative” at all, in view of the “during the financial year” and “at the end of that year” language used and believe that this should be rectified (see Table, below). The Business Review is applicable to all Companies (save for small companies) but the additional forward looking information we seek may only be needed at a group consolidated level or for larger companies.

The discussion paper on the Management Commentary issued by the International Accounting Standards Board in October 2005 concludes that two of the principles that a management commentary should possess are that it should have an orientation towards the future and should provide an analysis of the entity through the eyes of the management. Although the IASB is at a very early stage in considering this subject, these two principles are common to many countries that have current requirements or guidance, so it is reasonable to assume that in due course they will be adopted as core principles by the IASB. With this in mind such concepts, particularly the forward-looking aspect, could sensibly now be built into the extended business review requirements for group consolidated level reporting.

We also welcome that “Ministers consider that there will still be an important role for best practice and that the Standard provides useful guidance.” We welcome that Ministers encouraged/ASB the FRC to issue guidance for best practice for OFR style-reporting over and above the minimum requirements of legislation.

In many companies there is great reluctance to consider forward-looking statements. Experience shows that many in-company reviews of draft reports and associated material partly consists of ensuring that there are *no* meaningful forward looking statements. Work going on in companies since the announcement that the OFR as previously conceived will not be mandatory, has partly been to delete the forward looking aspects under the previous requirements – the forward looking aspects of the Management Review (if any) being much reduced.

Commercial confidentiality: avoiding being misleading

The extent to which directors feel able to do that will, in part, be conditioned by their own knowledge of competitive circumstances in their industry. In some industries, directors may feel able to talk more freely about some aspects – product launches, the development of a variety of projects, for example. In others, these may represent important commercial, competitive, information. That an energy company is building a new power station is not a secret. That fast moving consumer goods companies use “innovation” as a competitive tool and will frequently be launching new products or varieties is not a secret. In some industries the comparable information is of high commercial value.

Accordingly, we consider it essential that directors are allowed considerable discretion in what they discuss in forward looking statements.

However, if directors make any forward looking statements and there are significant matters on which they don’t comment that could make conclusions drawn from what they have said misleading. Accordingly, directors should state their policy about what kind of matter on which they feel unable to comment for reasons of commercial confidentiality.

Encouraging openness

Directors are properly concerned that statements made by the company are “correct”. However, especially when considering forward-looking statements, their concern is raised. Forward looking statements inevitably involve assumptions and opinions and projections involving some, perhaps a large proportion of, subjectivity. Directors are thus concerned about potential liabilities arising from such statements.

We have preciously argued in favour of a “safe harbour” for such statements made in good faith and not recklessly. This is to avoid the great risk that such discussion will always be bland and tending to a legally drafted “boiler plate” format unless there is a clear and explicit (not merely implicit in other law) protection against civil suit, for Boards and individual directors, for statements made and opinions expressed in good faith and not recklessly (letter of December 19th, attachment 1).

In a regime of principles rather than rules, a high level principle protecting statements made and opinions expressed in good faith and not recklessly would not undermine the existing standards of reporting – with which directors would be complying in any case. Proving recklessness would probably require proving that existing guidance such as Turnbull guidance or the ICAEW’s guidance on forward looking statements had been capriciously ignored.

We were therefore pleased to support the joint letter of 14th March 2006 (Attachment 2).

Related matters following extension of consultation

In our August 2004 comments in response to Draft Regulations on the Operating Financial Review and Directors' Report (May 2004) we argued in support of the Secretary of State's decision in relation to the previous OFR regarding discussion of CSR and environmental issues. Giving discretion to directors to consider what aspects of CSR and environmental issues are relevant to shareholders, has the great advantage that it inherently provides suitable and dynamic limits for board reporting..

We hope that this decision will not be changed in light of the renewed consultation following the end of the mandatory OFR.

Comments on specific questions raised in 15h December Consultation

Following the publication by the Accounting Standards Board (ASB) of the Reporting Statement 'The Operating and Financial Review' on January 26th 2006, we confine our comments on the specific questions raised in the consultation of 15th December 2006 to sections 1 and 8 from the table of Schedule 7ZA.

Re 1

We note that The directors' report must contain (paragraph 6 of Schedule 7) "an indication of likely future developments in the business of the company".

Importantly missing in the BR is development of the Schedule 7 requirement, by way of discussion previously required in the OFR: "d) the main trends and factors which are likely to affect the company's future development, performance and position" - perhaps the most important item in the then conceived OFR.

We believe that this requirement should be added to the mandatory requirement for the BR at the consolidated group level and perhaps for larger companies.

Re 8

We believe that 8(b) from 235 (3A) ("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. ") should be added to the requirement for the BR, and, further, it should be retained for any voluntary OFR-type content.

Auditors come across a lot of material in course of an audit which is not itself included in the accounts.

Users would find it very difficult to accept that auditors were aware of inconsistencies in the BR or voluntary OFR but were not required to state that.



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19 December 2005

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Dear Permanent Secretaries

The Chancellor has recently announced that the OFR will no longer be a mandatory requirement. The DTI has now published the amending Regulation and at the same time made a corresponding announcement seeking views on certain aspects of the business review that arise out of the EU Accounts Modernisation Directive requirements.

Financial reporting – reporting of numerical out-turns estimated to have arisen from prior operations at a past date – is inherently retrospective. Yet both running a company and making decisions on whether to invest, or maintain an investment in it, are essentially about the future.

The key requirements in the OFR were developed in the UK over many years and included:

- Narrative reporting
- Consideration of trends and risks
- Discussion of matters affecting future performance and the potential for business strategies to succeed

We hope that these main thrusts will be retained and encouraged under a voluntary arrangement.

We note too that the IASB has begun to consult about a requirement for a management discussion.

The Modernisation Directive and the need for a business review in Annual Accounts is about bringing the whole of Europe up to a *minimum* standard for corporate reporting. Current UK practice is materially superior to this, to the benefit of investors and issuers (our core Association membership is made up of individuals working for corporate

issuers). This is not a question of “gold-plating” since the concept of an OFR is already well established amongst quoted companies on a voluntary basis. As professional treasurers we feel that good practice in the UK should go beyond the Modernisation Directive’s business review, since that is not particularly forward-looking. We hope that the FRC will continue to issue guidance on what is good practice for an Operating and Financial Review, as the ASB has done in the past, and that is based on reporting standard RS1.

Whatever the expressed intentions of any business review, however, discussion of the future inevitably involves the expression of opinion and the making of assumptions. There is great risk that such discussion will always be bland and tending to a legally drafted “boiler plate” format unless there is a clear and explicit (not merely implicit in other law) protection against civil suit, for Boards and individual directors, for statements made and opinions expressed in good faith and not recklessly.

Our members have extensive experience of involvement in corporate reporting by the companies they work for. This experience confirms that in the absence of explicit protections forward looking narrative reporting will not be done at all meaningfully. The experience in the US does suggest that safe harbour provisions do encourage more meaningful commentaries.

We know that the view has been expressed by the DTI that such an explicit safe harbour is not necessary in the UK. This may, strictly, be true. However, we are firmly of the view that in order to influence actual behaviour of directors to make the reports meaningful – which is, after all, the objective – rather more is necessary.

Given a supportive legal background, we believe that market pressures on listed companies and their own self-interest will drive practice towards much more useful narrative reporting by companies on those aspects the directors themselves consider to be important. Good practice can then be left to build up and adapt through guidance and best practice dialogue over a number of years.

This will enable the UK’s excellent traditions of corporate governance and (relative) openness voluntarily embraced by leading companies to develop ahead of the less open traditions of much of mainland Europe.

All of the above is consistent with our previous inputs to the UK’s long development of what has become called the Operating and Financial Review.

The ACT will be responding to the request for views on the business review in due course but we thought it might be helpful to flag the important point about the need for a safe harbour at an early stage.

Yours sincerely

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Association of British Insurers



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14 March 2006

Dear Secretary of State

Together with the organisations supporting this letter and which are listed below, we are keen to foster the development of high-quality forward-looking narrative reporting by companies, whatever the outcome of the current debate on the Operating and Financial Review. We believe better reporting would raise the quality of engagement between companies and their shareholders. It would also introduce a more long-term focus into such engagement. Experience shows that the preparation of narrative reports can also deepen the understanding of boards and management about the issues facing their own company.

Such a framework is only possible, however, on the basis of trust. We are all agreed that the threat of litigation, whether perceived or actual, is currently a serious impediment to the delivery of meaningful narrative reporting by company boards. The Current Company Law Reform Bill permits us to address this problem, and we are writing to urge you to take advantage of this opportunity.

We believe consideration should be given to approaches which mesh with the UK's principles-based approach as distinct from the rules-based prescriptive definitions applied in the US. A central element should be clear recognition in UK law that directors should not be penalised for statements made in good faith and which are not reckless. Such a principle might apply only to forward looking statements. Or it could usefully apply to all company statements. For example, it might be a helpful means of encouraging useful interim management statements, which companies will soon have to deliver under the Transparency Directive and which will cover both past and prospective information.

Were the Bill to make this principle unambiguous, we believe that many of the liability concerns confronting boards would start to dissipate. This would be enhanced if there

were simultaneous review of the proposed relaxation of the terms under which the derivative actions can be launched and clarification of the scope of those to whom liability would be owed.

It would still of course be up to companies and shareholders to cooperate in ensuring the delivery of meaningful narrative reporting. However, the prospect of success would have increased significantly if the current liability regime was addressed.

We would regard this as an important step forward. Representatives of all the organisations supporting this letter would be happy to meet with you and your officials to discuss the issue further.

Yours sincerely



Stephen Haddrill
Director General
Association of British Insurers



Miles Templeman
Director General
Institute of Directors

cc Rt Hon Gordon Brown, MP
Chancellor of the Exchequer

Organisations supporting this letter

Association of British Insurers
Association of Corporate Treasurers
Chartered Institute of Management Accountants
Confederation of British Industry
Hundred Group of Finance Directors
Institute of Business Ethics
Institute of Chartered Accountants of Scotland
Institute of Chartered Secretaries and Administrators
Institute of Directors
Investment Management Association
Investor Relations Society
National Association of Pension Funds
Quoted Companies Alliance

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