

## Invitation for comments on the Business Review

The Chancellor announced on 28 November that the Government had decided no longer to require quoted companies to prepare a statutory Operating and Financial Review (OFR), in addition to the Business Review. In the Pre-Budget Report, the Chancellor made clear that the position had been reviewed in response to concerns over the proportionality of the burden imposed by the statutory requirement for an OFR, over and above the minimum requirements of the EU Accounts Modernisation Directive. Alun Michael has now made regulations to implement this announcement. The regulations repeal the requirement on quoted companies to prepare an Operating and Financial Review for financial years starting on or after 1st April 2005. Quoted companies, however, have to include a Business Review as part of the Directors' Report, in compliance with the minimum requirements of the EU Modernisation Directive.

The Company Law Reform Bill currently before Parliament contains provisions relating to the Operating and Financial Review. The Government intends to bring forward appropriate amendments to the Bill. Before doing so, Ministers would like to receive views on various aspects. The purpose of this letter is to invite such views.

The contents of the Business Review cover much of the ground covered in the Operating and Financial Review, but in less prescriptive form. A summary of the main similarities and differences is attached. The depth of analysis required is proportionate to the size and complexity of the business. A small company (namely one which satisfies two of the following: turnover of not more than £5.6m; balance sheet total of not more than £2.8m; not more than 50 employees) need provide no such review.

The Government is committed to improving strategic, forward-looking narrative reporting by companies, and to enhanced dialogue with shareholders based on such reporting. The Government believes it is important for companies to report on non-financial issues relevant to the development and performance of the business, including, for example, environmental matters and human capital management, and, where material, they will need to do so under the Business Review requirements. The Business Review will need to cover principal risks and uncertainties as well as giving a balanced and comprehensive analysis of the business.

Companies that have been preparing to produce an OFR will be able to use all the work they have undertaken with this expectation to produce their Business Review. It will be open to them to provide an OFR voluntarily where they believe this will be beneficial for their shareholders.

As regards enforcement of the Business Review requirements, the Financial Reporting and Review Panel has the legal authority to review a company's Directors' Report, for financial years beginning on or after 1st April 2006 and, if necessary, go to the court to compel a company to revise its report.

In most respects the reporting required under the Business Review is similar to that of the OFR, but it is in less prescriptive form. Ministers do not think that the degree of prescriptiveness in the statutory OFR is necessary, but they would wish to consider whether any particular requirements of the Business Review need to be clarified to achieve more effectively the Government's objectives regarding the Business Review. The Government is committed to forward-looking narrative reporting and wants to ensure that the Business Review achieves its purpose. The Business Review requirements should also be seen against the background of the new statutory statement of directors' duties in the Bill.

The OFR would impose an additional duty on auditors namely that they would not only be required to state that the information is consistent with a company's accounts, but also whether any matters inconsistent with the information in the OFR had come to their attention during the course of the audit. This additional duty over the minimum requirements of the EU Accounts Modernisation Directive is being removed.

The legal role of the Standard on the OFR will be removed as a consequence of the removal of the OFR statutory requirement. However, Ministers consider that there will still be an important role for best practice and that the Standard provides useful guidance. They expect that companies will continue to develop their reporting and that investors will continue to press them to do so. Ministers want to see best practice promoted alongside the statutory requirements.

Views are now invited on:

- whether any particular requirements of the Business Review need to be clarified to achieve more effectively the Government's objectives regarding the Business Review;
- any other considerations which Ministers should consider in deciding how to frame suitable amendments for the Company Law Reform Bill on these matters.

In view of the Parliamentary timetable for the Bill, and in the light of the extensive consultation there has already been on these issues, views are invited by 15 February.

Views should be sent to:

[companylawreform@dti.gsi.gov.uk](mailto:companylawreform@dti.gsi.gov.uk)

Please begin the heading of your e mail with the words "Business Review".

## BUSINESS REVIEW AND OPERATING AND FINANCIAL REVIEW

The table below shows the main requirements of the Business Review and the Operating and Financial Review, principally from the amendments to the Companies Act 1985, inserted by SI 2005, No. 1011.

Operating and Financial Review (Schedule 7ZA of the Companies Act 1985)	Directors' Report: Business Review (Section 234ZZB of the Companies Act 1985)	Comment
<p>1. An operating and financial review must be a balanced and comprehensive analysis, consistent with size and complexity of the business, of -</p> <p>(a) the development and performance of the business of the company during the financial year,</p> <p>(b) the position of the company at the end of the year,</p> <p>(c) the main trends and factors underlying the development, performance and position of the business of the company during the financial year, and</p> <p>(d) the main trends and factors which are likely to affect the company's future development, performance and position,</p> <p>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.</p>	<p>2. The review required is a balanced and comprehensive analysis:</p> <p>(a) the development and performance of the business of the company during the financial year; and</p> <p>(b) the position of the company at the end of that year,</p> <p>consistent with the size and complexity of the business</p>	<p>Trends and factors affecting the development, performance and position of the business would be included in the Business Review where necessary for a balanced and comprehensive analysis of the development, performance and position of the business or to describe the principal risks and uncertainties facing the business.</p> <p>The directors' report must also contain (paragraph 6 of Schedule 7) "an indication of likely future developments in the business of the company".</p>
<p>2. The review must include –</p> <p>(a) a statement of the business, objectives and strategies of the company;</p> <p>(b) a description of the resources available to the company;</p> <p>(c) a description of the principal risks and uncertainties facing the company; and</p> <p>(d) a description of the capital structure, treasury policies and objectives and the liquidity of the company.</p>	<p>1. The directors' report for a financial year must contain</p> <p>(a) a fair review of the business of the company, and</p> <p>(b) a description of the principal risks and uncertainties facing the company.</p>	<p>The Business Review would include information on objectives, strategies and resources where necessary to provide a fair review of the company.</p> <p>The Takeover Directive will require companies with securities carrying voting rights admitted to trading on a regulated market to publish information on capital structure in the directors' report. This requirement is implemented in Clause 649 of the Company Law Reform Bill.</p>

<p>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.</p> <p>4. (1) [To the extent necessary to comply with the general requirements of paragraphs 1 and 2,] the review must include -</p> <p>(a) information about environmental matters (including the impact of the business of the company on the environment),</p> <p>(b) information about the company's employees, and</p> <p>(c) information about social and community issues.</p> <p>(2) The review must, in particular, include -</p> <p>(a) information about the policies of the company in each area mentioned in sub-paragraph (1), and</p> <p>(b) information about the extent to which those policies have been successfully implemented.</p> <p>5. [To the extent necessary to comply with the general requirements of paragraphs 1 and 2,] the review must also include -</p> <p>(a) information about persons with whom the company has contractual or other arrangements which are essential to the business of the company; and</p> <p>(b) information about receipts from, and returns to, members of the company in respect of shares held by them.</p>		<p>Information on environmental, employee, social and community matters, policies and the implementation of policies would be included in the Business Review where necessary to provide:</p> <p>(i) a fair review of the business,</p> <p>(ii) a description of the principal risks and uncertainties, or</p> <p>(iii) a balanced and comprehensive analysis of the development, performance and position of the business.</p> <p>Information on these matters would also be included in the Business Review as analysis using key performance indicators, including information relating to environmental matters and employee matters, where necessary for an understanding of the development, performance or position of the business.</p>
<p>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.</p> <p>(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</p>	<p>3. The review must, to the extent necessary for an understanding of the development, performance or position of the business of the company, include –</p> <p>(a) analysis using financial key performance indicators, and</p> <p>(b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters</p> <p>5. In this section, "key performance indicators" means factors by reference to which the development, performance or position of the business of the company can be measured effectively</p>	

<p>8. The review must-</p> <p>(a) state whether it has been prepared in accordance with relevant reporting standards and</p> <p>(b) contain particulars of, and reasons for, any departure from such standards.</p>		
<p>Section 235 (3A). If the company is a quoted company, the auditors must state in their report –</p> <p>(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</p> <p>(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.</p>	<p>Section 235 (3). The auditors must state in their report whether in their opinion the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts</p>	