FRC

Accounting Standards Board

A Review of Narrative Reporting by UK Listed Companies in 2008/2009

October 2009

The key findings from our review of narrative reporting are contained in a shorter report called ***'Rising to the challenge: A review of narrative reporting by UK listed companies'*** published by the ASB on 29 October 2009.

This report provides some supplemental details on results and scores awarded as part of our review and is intended for those who still want more detail after reading the short report.

CONTENTS

1. WHY DID WE WRITE THIS REPORT?

The Accounting Standards Board (ASB), an operating body of the Financial Reporting Council (FRC), first undertook a review of narrative reporting in 2006. The review concluded that certain areas of reporting were a challenge for companies. Since then, further content requirements have come into force for quoted companies in the form of the enhanced business review requirements in the Companies Act 2006 (CA), prompting us to take another look.

Preparing a good quality annual report that communicates effectively all the important information is a major intellectual and logistical challenge. Many companies continue to devote significant time and effort to improving their narrative reporting, but there are always opportunities for further enhancement as experience and best practice develop. We hope this report, along with its companion document *Rising to the challenge,* will be helpful to companies.

We also have some internal goals as well. As the ASB is responsible for the UK best practice narrative reporting guidance in its *Reporting Statement: Operating and Financial Review* (RS), it is useful to continue to monitor the effects of the statement on current practice. In addition, another operating body of the FRC, the Financial Reporting Review Panel (FRRP), is responsible for ensuring that the annual accounts of public companies and large private companies comply with the requirements of the CA and applicable accounting standards. We hope these findings will provide a useful contribution to the FRRP's work.

2. WHAT WAS OUR RESEARCH PROCESS?

The staff of the ASB set out to assess how well listed companies were addressing the original CA requirements, as well as the new requirements, by reviewing the annual reports of a random sample of 50 listed companies. The sections below provide more detail about how we did this.

2.1 Our sample

The 50 companies in the sample are members of the following indices:

- FTSE 100 – 25 Companies
- FTSE 250 – 15 Companies
- FTSE SmallCap Index – 10 Companies

Given the new business review requirements are only effective for year ends beginning on or after 1 October 2007 and the need for reports to be published at the time of our review, all of the companies in our sample have year ends ranging from 30 September 2008 to 30 April 2009. Investment trusts were excluded from the sample.

For a list of the companies included in the sample and the further detail on the sampling method, see Appendix A.

2.2 Our approach to our review

Our approach to reviewing our sample of 50 annual reports focussed on three main areas: content, communication and clutter. These are described in further detail below:

CONTENT

The first reason for the review is to assess the content of annual reports – that is, the degree to which companies are complying with the new enhanced business review requirements in the CA, and going beyond this to apply the best practice principles detailed in the ASB's RS.

In order to assess the content of annual reports we looked at the following CA requirements:

1. Fair review: business description and strategy [CA 417(3)(a)]
2. Principal risks and uncertainties [CA 417(3)(b)]
3. Financial review: performance and position [CA 417(4)(a)&(b)]
4. Trends and factors [CA 417(5)(a)]
5. CSR: environment, employees, social & community [CA 417(5)(b)]
6. Relationships: contractual and other arrangements [CA 417(5)(c)]
7. Financial KPIs [CA 417(6)(a)]
8. Non-financial KPIs [CA 417(6)(b)]

An extract of the CA requirements is produced in Appendix B to this report and Appendix C illustrates how the CA and the RS link together so that if a company applies the RS, it will also be compliant with the CA.

As announced in the FRC's *2009/10 Plan and Budget*, we also considered the need for additional disclosure requirements relating to business models as a part of the review of business description.

COMMUNICATION

In June 2009 the FRC published a discussion paper (DP) on reducing complexity in corporate reporting entitled *Louder than Words.* We hope this review of narrative reporting will provide further evidence for a number of the major issues and proposals raised in the DP, particularly in relation to the proposed *Principles for Effective Communication*, which have been reproduced in Appendix D to this paper. The principles promote better quality reporting as an antidote to complexity with the idea that 'companies need to focus on communicating important messages rather than ticking regulatory boxes if investors are going to gain a full understanding of the business'.

We considered the *Principles for Effective Communication* as part of our review for each of the eight areas of the CA. For companies with best practice content, we awarded extra marks for effective communication. We looked at content first though because we believe impressive report designs are nothing without solid underlying content.

CLUTTER

One of the *Calls for Action* in *Louder than Words* was to cut immaterial clutter from annual reports. We have kept an eye on clutter during our review and highlighted some areas where we feel clutter can be reduced.

2.3 Our scoring method

In completing our assessment, we have scored each company against eight CA topics using a five point scoring system. The system is described below using risk reporting as an example:

1/5 – Not compliant with the law

Normally reserved for instances where there is a glaring omission of required information. For example, a company without a principal risk section would have received this score.

2/5 – Compliant but

The information included in the report technically complies but falls short of the spirit of the requirements. For example, one company listed 33 principal risks and we have trouble seeing how such a large number of risks could all be principal. Others merely made reference to

	the IFRS 7 *Financial Instruments: Disclosures* note in their financial statements.
3/5 – Compliant in spirit	Information is included to a good standard that meets with the spirit of the requirements. For example, companies give some company-specific explanation for a list of risks that are clearly principal.
4/5 – Best practice: content	Goes beyond compliance to provide the type of best practice reporting outlined in the RS. For example, some companies listed risks that were clearly principal and went on to provide context for the risk and its likely effect on the business along with risk mitigation.
5/5 – Best practice: content & communication	Has best practice content and demonstrates good communication according to the *Principles for Effective Communication* in Appendix D. For example, a company with a full description of risks presented in an easy-to-understand table would have received this score.

It is important to note in our scoring scale that, while we are suggesting improvements, a score of two is fully compliant with the law. The scores for the CA topics we reviewed range from 2.3 – 3.0, which means companies are complying with the law and many are going beyond this to provide best practice content and communication. The averages are relatively low for two reasons:

- in order to promote continual improvement, we were robust with the scoring; and
- there is a large gap between the best reporters and those at the other end of the spectrum, which lowers the overall average.

2.4 What are the limitations?

Any attempt to compare and score the reporting of a sample of companies is, of course, subjective. Even more difficult is assessing whether or not companies have actually complied with the law when there are several exemptions. For example, sections 417(5) and (6) require certain disclosures only to the 'extent necessary for an understanding of the development, performance or position of the company's business'. Trying to evaluate 'to the extent necessary' makes the process very judgemental and we have tried our best to give companies the benefit of the doubt.

2.5 Consulting with other experts

In exercises that involve a degree of subjectivity, it helps to consult with other experts and compare findings. So we met with a number of other organisations who champion high quality narrative reporting. This review also draws on discussions with and research completed by these other organisations. For a list of the other organisations, links to their reports on narrative reporting, and short summaries of each report, see Appendix E of this report.

3. WHAT DID WE FIND?

3.1 Fair review of the business

What is required?

CA 417(3)(a) *'a fair review of the company's business'*

And best practice?

RS 30-37 The Companies Act 2006 much like the Companies Act 1985 does not elaborate on what is meant by a 'fair review' of the business. We have assessed how Companies have met the 'fair review' requirement against recommendations in the RS that directors should include:

- a description of the business and the external environment in which it operates
- the objectives of the business and the strategies for achieving those objectives

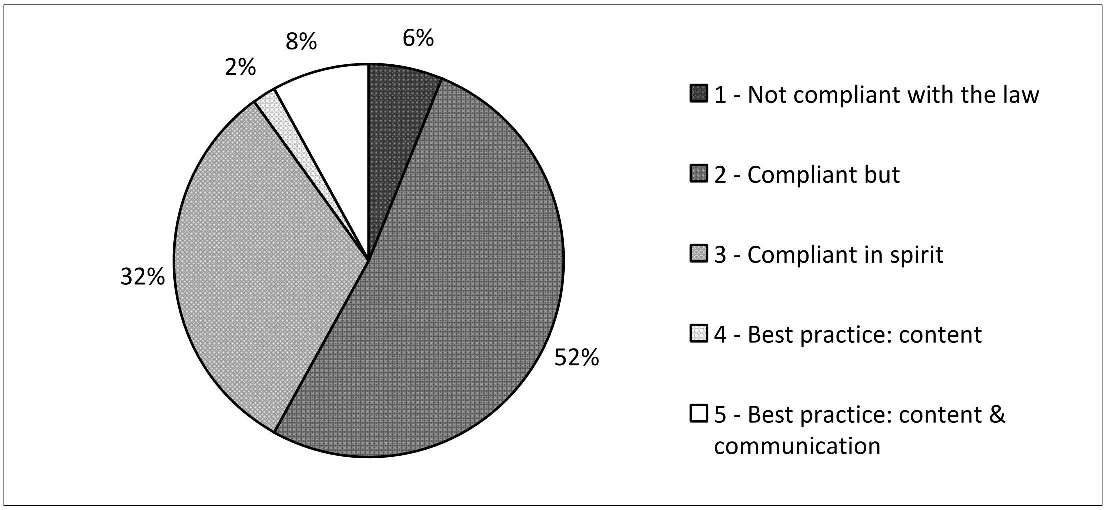
As outlined in paragraph 31 of the RS, we think that describing the business should go beyond just products, services and geography to include business processes, distribution methods and structure of the business – in other words the disclosure of the business model.

The credit crisis has highlighted the importance of companies articulating their business models in a clear and understandable way. Business models cannot be conveyed through numbers alone and it is up to narrative reporting to tell the story of what a company does to generate cash.

We have paid attention to both objectives and strategies – objectives tell us 'what' the company is aiming for and strategies tell us 'how' they will achieve this.

3.2 Business description

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.5	**2.8**	**2.2**	**2.3**



How are companies doing?

CONTENT

1/5 – 6% It is difficult to assess compliance in this area, but we think a basic understanding of the business is necessary for a 'fair review' and companies with this score did not give enough information to enable us to understand the main product or service. This is similar to Black Sun's finding that 13% of the FTSE 100 give no discussion of their main products and services.

Getting a 'not compliant' in this category made it an uphill battle for companies to score well in other categories – it is difficult to assess the quality of the strategy, KPIs, risks and relationships if we do not even understand the basics of the business.

Business description continued…

2/5 – 52%	Companies did not give a complete description of the business at this level, but we did understand the main product or service. Some attempts to describe the business were undermined by excessive use of jargon.
3/5 – 32%	We understood what they sell, where they sell it and who they sell it to but this generally fell short of describing the business model – that is a comprehensive explanation of how all of the different components of the business work together to generate cash.
4/5 – 2%	A full business model was disclosed and we understand the specifics of how the company generates cash. It is not surprising that there were few companies disclosing a business model since this is not an express requirement in the CA and it is only implied in the RS. We noted that many of the best reports contained a business model disclosure, which further supports the need for additional requirements in this area as a way of improving the quality of narrative reporting.
	COMMUNICATION
5/5 – 8%	Excellent communication was achieved through use of: • Illustrations of the different parts of the business and how they link together • Charts and tables to explain quickly and simply instead of dense narrative text • 'At a glance' tables and descriptions • Logical positioning in the report – it is much more useful if this information is provided upfront as opposed to buried at the back.

Business description continued…

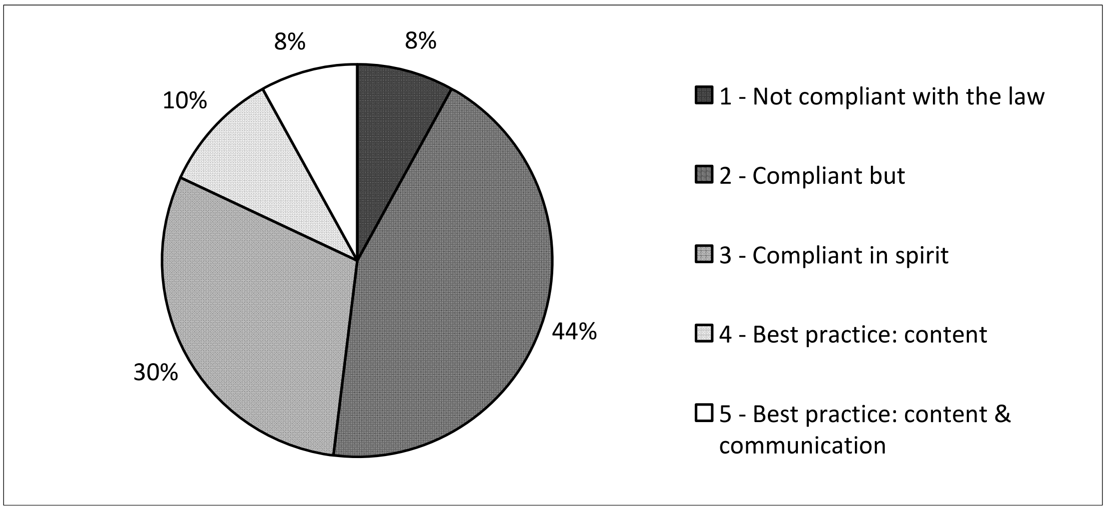
CLUTTER

This was not particularly a problem since we generally wanted more information and focus in this area.

A few companies provided many pages of pictures and case studies when a comprehensive explanation of the business would have been more helpful. Case studies are useful to add colour and make a report engaging, but they are not a substitute for quality explanations, particularly when it is unclear why a particular case study has been selected or when they are overused.

3.3 Objectives and strategies

Average scores			
Overall **2.7**	**FTSE 100** **3.0**	**FTSE 250** **2.5**	**SmallCap** **2.0**



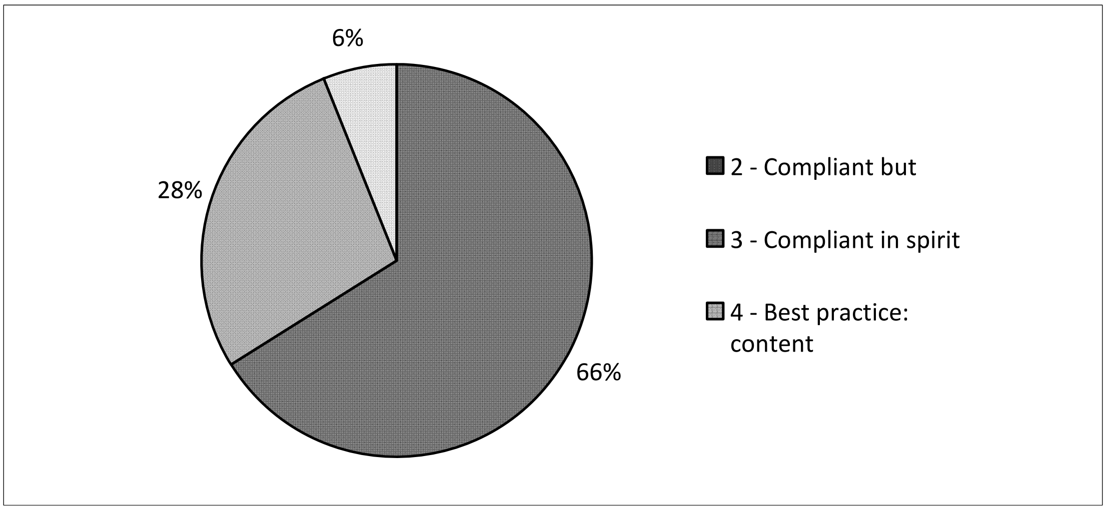
	How are companies doing?
	CONTENT
1/5 – 8%	Companies with this score gave no discussion of strategies or objectives, and we considered that some discussion was necessary for a 'fair review'. The Virtuous Circle noted 'often it is assumed that shareholders understand the strategy – in one case, we found it was last stated four years previously!'
2/5 – 44%	Companies with this score outlined some objectives but struggled to provide enough detail on strategies to enable us to understand 'how' the objective would be achieved. For example, 'our goal is to grow sales' is an objective but without an additional statement such as 'by expanding the number of retail shops we have in China' it is not a strategy.
3/5 – 30%	At this level, companies explained 'how' and could easily have moved into the 'best practice' ranks if they told us how they would monitor progress.

Objectives and strategies continued…

4/5 – 10%	Companies provided detail of their objectives, strategies to achieve to those objectives and, critically, how they would measure the progress – this was most often achieved by linking KPIs to strategy in a table.
	COMMUNICATION
5/5 – 8%	Excellent communication was achieved through: • An easy-to-see link between strategies, progress measures and plans for the future • A clear link to strategy throughout the annual report • An 'interesting and engaging' discussion. The principle that reports should be interesting and engaging is proposed in *Louder than Words*; while this is a challenge for some sections of the annual report, the best reporters in the sample proved it is achievable for strategy.
	CLUTTER It is difficult to visualise how quality insight into the direction management intend to the take the company could ever be clutter – but care needs to be taken to avoid boilerplate and generic statements like 'our goal is deliver value to our shareholders' unless they are an introduction to company-specific content setting out how this will be achieved.

3.4 Principal risks and uncertainties

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.4	**2.4**	**2.3**	**2.4**



	What is required?
CA417(3)(b)	*'a description of the principal risks and uncertainties facing the company'*
	And best practice?
RS 52	Best practice includes commentary on the directors' approach to risks – that is, how are risks managed.

	How are companies doing?
	CONTENT
1/5 – 0%	All companies included some information on risks, albeit sometimes minimal.

Principal risks continued…

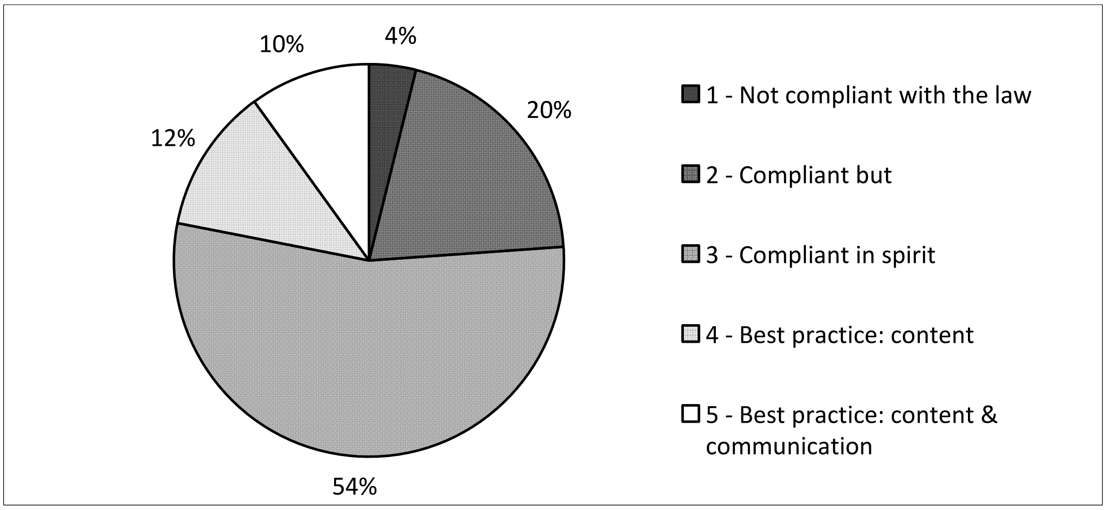
2/5 – 66%	A majority of the risks sections suffered from: • Too many risks to all be principal – one company had 33 and eight companies had 20 or more • Generic risks that could easily be cut and pasted into any report – for example, 'influenza outbreak' or 'terrorism' – although the RS may encourage this by observing reputational risk applies to everyone • Too little detail to understand the risk – for example 'insurance risk' with no detailed discussion is not enough for an insurance company when this is its business • Risk reporting only by reference to *IFRS 7: Financial Instruments Disclosures* in the notes to the financial statements. It was a shame that some companies started out really well but, in an apparent preference for a long list of risks, let their good start deteriorate to boilerplate.
3/5 – 28%	The majority of the risks were specific to the company rather than generic and boilerplate. Some companies provided risk management information. The concept of context is missing from most risk sections even though it is very important to understanding the section, perhaps because is it is not given due emphasis in the RS.

Principal risks continued…

4/5 – 6%	Best practice risk reporting means: • Discussing only risks that are clearly principal • Detailing why each risk is important • Providing context for the risk – is it increasing or decreasing • Providing some indication of the impact of the risk crystallising • Outlining risk management strategies that are specific to each risk as opposed to just generic statements like 'we have a risk management committee'. No companies managed all of the above for each risk, but a few provided good quantification and risk management discussion for some of their risks. Many reports do include this type of information, but it is dotted throughout the report, which makes it difficult to consider when reading through the risks. The answer here is referencing to help the reader.
	COMMUNICATION
5/5 – 0%	A number of reports contained a very appealing spread on risks, unfortunately, the content was not there and we did not end up with any top scores for risk reporting. The most appealing risk sections used a table to link each risk to related risk mitigation. However, many companies that attempted this ended up with an excessively abbreviated list of risks that we could not understand. We still think tables are a good idea, but the table needs to grow to fit the content, as opposed to shrinking the content to fit the table.
	CLUTTER Listing every conceivable risk adds clutter – with some risk sections extending to as many as 10 pages. In an attempt to deter this practice, Addison came up with a list of 'ridiculous risks' in its report *Risky Business,* which includes 'changes in accounting standards', and 'global nature of our operations'. Without additional specifics, these are clearly boilerplate and adding to clutter.

3.5 Financial review: performance and position

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
3.0	**3.2**	**2.9**	**2.7**



What is required?

CA417(4)(a) & (b) — *'a balanced and comprehensive analysis of…development and performance….during the financial year and the position …at the end of that year'*

And best practice?

RS 16-23 — The RS gives additional guidance on what it means to be balanced and comprehensive.

RS 43, 50-51, 60- 71 — The RS also provides additional guidance on performance and position as well as on cash flows and liquidity disclosures.

The CA does not make specific mention of off-balance sheet resources, for example those discussed at paragraph 51 of the RS. However, we believe understanding such off-balance sheet resources is crucial to understanding the position of a company and we considered this separately as part of our review.

Financial review continued…

	How are companies doing?
	CONTENT
1/5 – 4%	The two companies with this score did not attempt to discuss performance *and* position, instead discussing only performance.
2/5 – 20%	These companies discussed performance and position, but repeated the information in the financial statements as opposed to providing supplemental discussion. Especially given the current economic environment, we were expecting some discussion of liquidity, unless clearly not an issue for the company.
3/5 – 54%	Companies needed to go beyond repetition of financial statements to provide supplemental information in order to receive this score, but discussion of performance was generally better than cash flow and position. Radley Yeldar found that discussion of financial position was 'for the most part...an area where improvement was needed'.
4/5 – 12%	These companies provided a large amount of supplemental information and had a quality discussion of performance and position. Many presented net debt reconciliations and/or gave quality discussion of liquidity and funding.
	COMMUNICATION
5/5 – 10%	Excellent communication was achieved through: • Graphical illustration of debt maturities • Illustrations to show how key figures have changed from the prior year, instead of dense text. For example, a chart breaking down revenue growth into components such as currency changes, acquisitions, organic growth, etc.

CLUTTER

Quality supplemental information is never clutter but statements like 'revenue has increased 10%' with no further explanation of the reason for the change do not add any useful content. Reviews should focus on providing investors with the information they cannot see at a glance by reading the primary financial statements.

Balanced and comprehensive

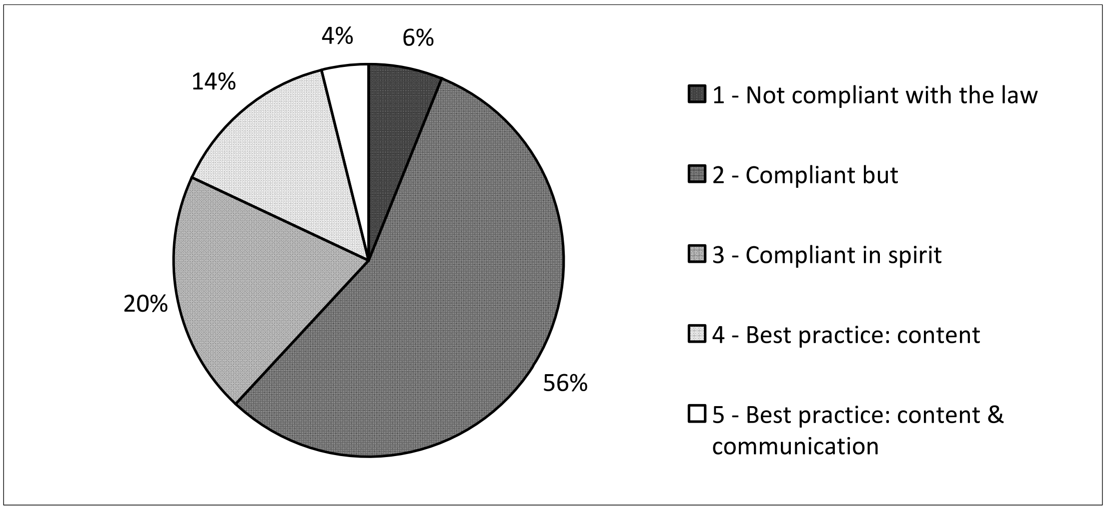
This was difficult to assess given we only performed a comprehensive review of the narrative reporting along with a limited review of the financial statements for each company – a more robust assessment of the extent that companies were balanced and comprehensive would require reading additional materials such as press coverage and analyst presentations. Our assessment is that approximately two thirds of companies made an attempt at a comprehensive discussion of the good and the bad. For many companies the dire state of the economy had a sizable impact on the health and profitability of the company and they had little choice but to 'own up'.

Off-balance sheet resources

Most companies discuss their employees; given this is a now a requirement 'to the extent necessary' this is not surprising. However, only 36% go beyond this to discuss other intangible assets such as brands, intellectual capital and natural resources. The off-balance sheet assets are often some of the most important to a company's future success; a comprehensive discussion of 'performance and position' should include this aspect as well as the resources on the balance sheet.

3.6 Trends and factors

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.5	**2.9**	**2.3**	**2.1**



What is required?

CA417(5)(a) *'to the extent necessary…the main trends and factors likely to affect the future development, performance and position of the company's business'*

And best practice?

RS 47-49 The RS provides some limited examples of the possible trends and factors companies may wish to disclose, such as development of new products or expected benefits from capital expenditure.

How are companies doing?

CONTENT

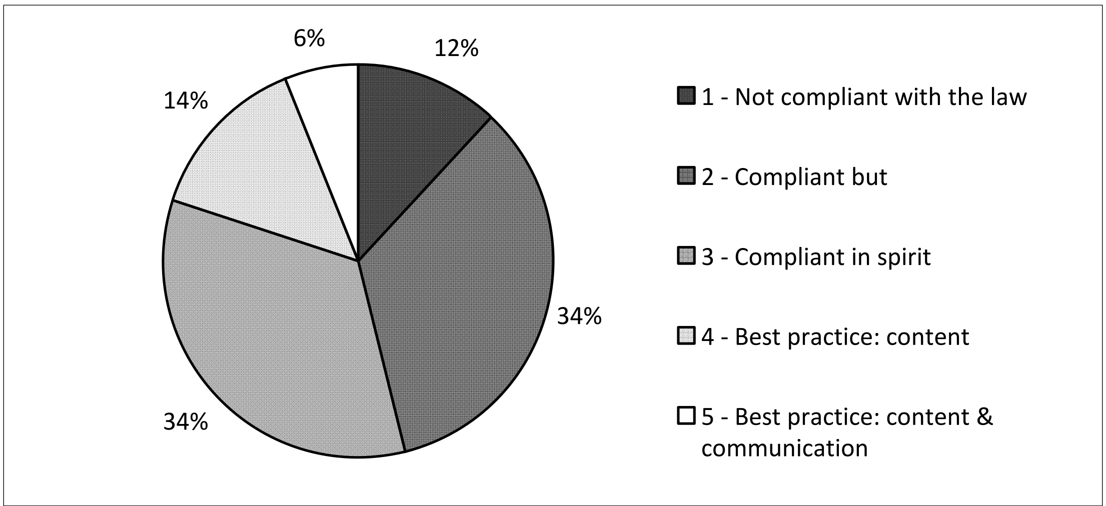
1/5 – 6% Companies with this score provided no relevant discussion of any trends and factors.

Trends and factors continued…

2/5 – 56%	Some trends and factors were discussed by the companies with this score, but only in narrative terms and using bland statements like 'the outlook for our industry is poor' without any supporting evidence. This area has historically been a struggle for companies, with 26% achieving a poor or very poor rating in our 2006 review. Black Sun says 'with the current market turmoil it is perhaps unsurprising that management are reluctant to provide any real detail into the outlook or future prospects of their companies'. There appeared to be some confusion regarding what 'trends and factors' means - is it the macro environment or company specific factors or both? Although the RS provides only company-specific examples, we think it's both. The RS may not be helping encourage a wider discussion of all relevant trends and factors.
3/5 – 20%	These companies discussed a number of relevant trends and factors with a true forward outlook. Information was not always supported or quantified, but was attempted in various sections throughout the report (or comprehensively in a single section) so the report had some level of forward feel to it.
4/5 – 14%	Relevance, quantification and evidence were the key to moving up to a best practice rating in this area.
	COMMUNICATION
5/5 – 4%	Excellent communication was achieved through: • Graphical illustration of trends • Good use of headings to break up dense text.
	CLUTTER The best reports are forward looking throughout, but multiple 'outlook' headings that each contain similar generic or boilerplate information just adds to clutter.

3.7 CSR: environment, employees, social & community

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.7	**3.0**	**2.4**	**2.1**



What is required?

CA417(5)(b) *'to the extent necessary…information about:*

environmental matters
the company's employees; and
social and community issues

Including information about any policies of the company in relation to those matters and the effectiveness of those policies'

CA 417(5) If the review does not include information on any of the above, it must state that it does not contain this information

And best practice?

RS 28 The CA is quite specific about what is required in this area, so the RS does not go any further than repeating these requirements.

CSR continued…

	How are companies doing?
	CONTENT
1/5 – 12%	One company did not provide any CSR information. The remaining companies with this score had a CSR section or some discussion, but limited this to only one or two of environmental, employees and social/community as opposed to all three and did not state which type of information the report did not include. All three types of information are not necessarily important enough to every company to warrant discussion, but technically, disclosure is required to achieve compliance (or disclosure that information has not been included). Two companies would have scored higher if not for the technical non-compliance. The Virtuous Circle notes 'examples of Boards explaining why they do not report more extensively on these areas (the "report or explain" principle) are seldom seen.'
2/5 – 34%	Companies discussed all three areas but discussion was either generic or related to matters that were clearly unimportant to the business. Merchant described this as 'too much box-ticking' and suggested that if companies are unsure what information shareholders find important, a solution is 'simply to ask them'.
3/5 – 34%	Companies provided relevant discussion of all three areas but many are still struggling to explain the reason why CSR is important to their business, other than by using boilerplate statements like 'integral to growth and sustainability' or 'doing our duty'. PwC noted that 'many companies appear to pay lip service to this area of reporting'.
4/5 – 14%	These companies managed to provide: • a convincing explanation of why CSR is important to the business • discussion of policies and procedures that were clearly important to understanding performance and position • goals and targets in the area of CSR.

COMMUNICATION

5/5 – 6%

The best companies:

- Outlined their priorities and progress against priorities in a table
- Highlighted the important items – for example, brokers may be most important for an insurance broker that has a relatively low environmental impact
- Steered clear of dense narrative
- Included only relevant related KPIs that were clearly key.

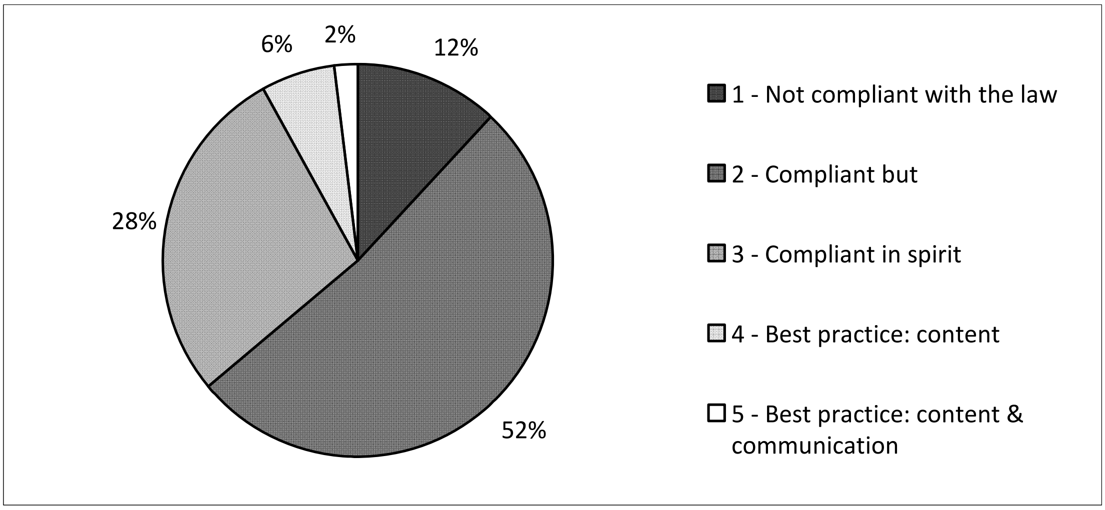
CLUTTER

Companies are feeling their way in developing their CSR reporting and there is significant social pressure in this area. But some have fallen into the trap of delivering unnecessary clutter such as: ‘football coaching’ for an insurance company and ‘donating chocolate gifts to the community at Easter’ for a service company – these are worthwhile activities but in our view are not material to understanding a company’s performance and position. There is potential for more companies to say, ‘we have no material social issues’ if they genuinely do not have material issues instead of adding clutter to the report.

Interestingly, nine companies had a CSR section that was longer than their discussion of performance and position – and since understanding performance and position underpins the business review requirements, this cannot have been the intended regulatory outcome.

3.8 Relationships: contractual or other arrangements

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.3	**2.4**	**2.2**	**2.2**



What is required?

CA417(5)(c) *'to the extent necessary…information about persons with whom the company has contractual or other arrangements which are essential to the business of the company'*

except

CA 417(11) *'Nothing in subsection (5)(c) requires the disclosure of information about a person if that disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest'*

And

CA 417(5) If the review does not include information on contractual or other arrangements, it must state that it does not contain this information.

There has been significant confusion over this requirement, prompting Lord Sainsbury to provide the following clarification during a session in the House of Lords in 2006:

Relationships continued…

'This is not a requirement on companies to list their suppliers and customers, or to provide detail about contracts. The provision is about reporting significant relationships, such as with major suppliers or key customers critical to the business, which are likely to influence, directly or indirectly, the performance of the business and its value. It is for the directors to exercise judgment on what is necessary to report. They need only include information to the extent necessary for an understanding of the development, performance or position of the business.'

And best practice?

RS 58

The RS provides examples of the different types of relationships that companies may wish to consider discussing in their reports such as with customers, suppliers, contractors, etc.

How are companies doing?

CONTENT

1/5 – 12%

These companies did not mention any relationships except for employees, which we did not count as it is already a CA requirement.

2/5 – 52%

The majority of the sample was at this score level where some relationships were mentioned in passing but no real detail was provided. Radley Yeldar observed a similar trend noting that 'few companies have embraced reporting of contractual arrangements'.

A handful of companies achieved this rating by stating they were not disclosing any relationships – while technically compliant, we struggle to understand how a business could have no important relationships.

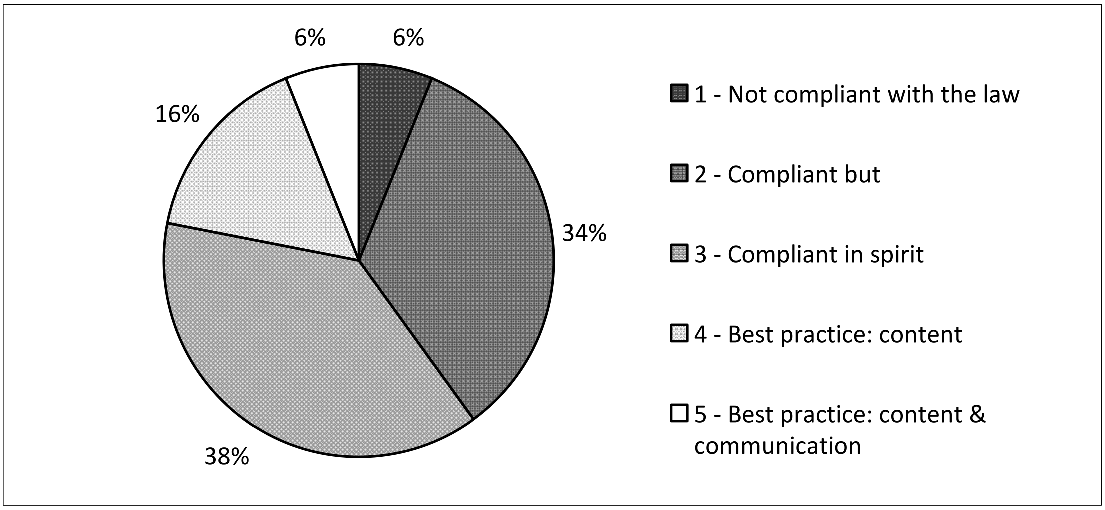
The CA qualifies the requirement twice ('to the extent necessary' and 'seriously prejudicial') and it is possible some companies could be taking advantage of the ambiguity.

Relationships continued…

3/5 – 28%	Some relationships are discussed in enough detail to understand how the relationship is important to the business but we still did not get the feeling that effort had been made to comprehensively consider and describe most important relationships.
4/5 – 6%	This score was awarded when we felt enough detail was provided on most important relationships. Companies with this score all disclosed their business model and as part of this disclosure, discussed important relationships.
	COMMUNICATION
5/5 – 2%	A graphical business process model that explained how the relationships featured in the process earned the only top score.
	CLUTTER
	Some companies noted the importance of customer relationships or supplier contracts – but every company has customers and suppliers so this is just boilerplate without company-specific discussion.

3.9 Financial KPIs

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.8	**3.0**	**2.8**	**2.3**



What is required?

CA417(6)(a) *'to the extent necessary…include analysis using financial key performance indicators'*

And best practice?

RS 75-77 For each KPI disclosure include definition, purpose, comparatives, commentary on targets, etc.

How are companies doing?

CONTENT

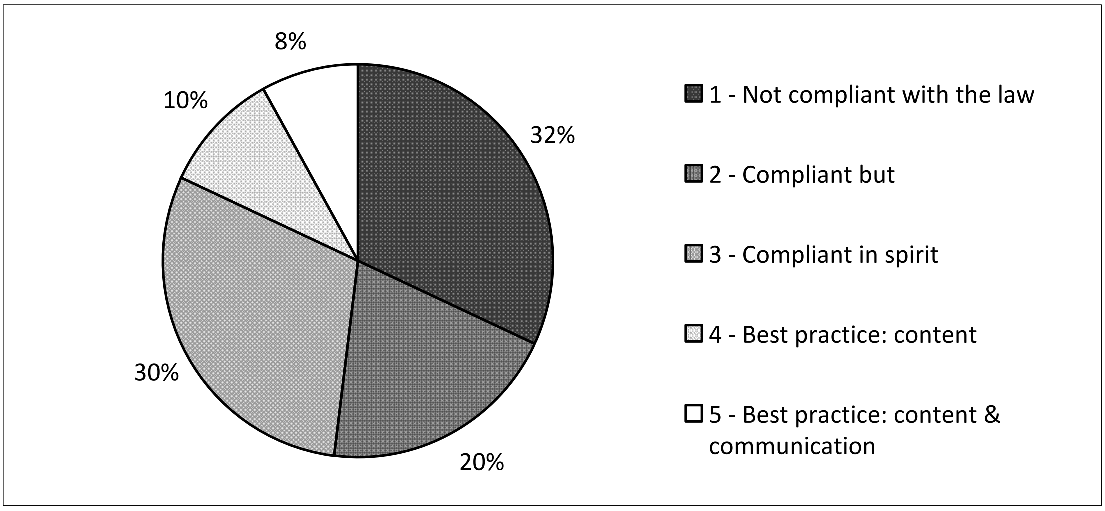
1/5 – 6% There was no explicit identification of financial KPIs. Given the requirement is only 'to the extent necessary' it is possible that some companies did not consider it necessary and that is why they did not make the disclosure – however, we find it difficult to envisage a situation when discussion of key metrics would not improve the overall quality of the narrative.

Financial KPIs continued…

2/5 – 34%	Companies were technically compliant because they explicitly identified some KPIs but: • measures were limited to reproduction of lines in the financial statements with no explanation of importance • it was 'ticking the box' by inserting a KPI table with no accompanying discussion or link to the remainder of the document • there were too many KPIs to all be key – for example, one company listed 68 measures throughout the report and there were several others with close to 20.
3/5 – 38%	The KPIs were clearly relevant to the business, clearly key and the purpose of the measure was easily understood.
4/5 – 16%	The KPIs were linked to strategy, well defined or easy to understand, and there was some discussion of targets or future intentions, also reconciliation to the financial statements was provided where appropriate. Deloitte observed a similar trend – they found that only 15% of companies include targets for KPIs and only 24% discussed the purpose of each KPI.
	COMMUNICATION
5/5 – 6%	The best communicators made their KPIs easy to understand at a glance by using: • Graphical illustrations of year-on-year comparatives • Tables to link KPIs to strategy and targets or future intentions.
	CLUTTER Aside from the obvious – companies with far too many measures for them all to be key – the biggest contributor to clutter was reproduction of most (or all) of the profit and loss under a KPI heading.

3.10 Non-financial KPIs

Average scores			
Overall	**FTSE 100**	**FTSE 250**	**SmallCap**
2.4	**2.7**	**2.2**	**2.1**



What is required?

CA417(6)(b) *'to the extent necessary…where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters'*

And best practice?

RS 75-78 For each KPI disclosure include definition, purpose, comparatives, commentary on targets, etc.

How are companies doing?

CONTENT

1/5 – 32% There was no explicit identification of non-financial KPIs, although seven companies disclosed some non-financial measures, leaving us to guess if the measures were 'key'. The 2006 review found 35% were doing a poor or very poor job in this area and there is no evidence of significant improvement. 'To the extent necessary' and 'where appropriate' provide an excuse for ignoring this requirement but we consider non-financial KPI's can always enhance the narrative.

Non-financial KPIs continued…..

2/5 – 20%	Companies explicitly identified KPIs, but measures appeared peripheral and there was no discussion to explain why the measure was important to the business – for example, some companies used number of employees as a non-financial KPI. It is possible the specific mention of employees and environment in the CA has lead companies to report KPIs in these areas over others that may be more important to their business because half the companies with this score only gave employee/environment measures.
3/5 – 30%	The KPIs were clearly relevant to the business and the purpose of the measure was easily understood – for example, measuring customer satisfaction when customer retention is a key element of strategy.
4/5 – 10%	The KPIs were linked to strategy, well defined or easy to understand, and there was some discussion of targets or future intentions.
	COMMUNICATION
5/5 – 8%	The best communicators made their KPIs easy to understand at a glance by using: • Graphical illustrations of year-on-year comparatives • Tables to link KPIs to strategy and targets or future intentions.
	CLUTTER Two companies had more than 15 non-financial KPIs and should consider whether all of these are key or just clutter. Even though the majority of companies had a reasonable number of KPIs, use of measures that are clearly peripheral contributes to clutter – unless measures are 'key' they should not be included.

Appendix A: Our sample

The companies in our sample were selected by assigning a random number to each company and selecting the 25 FTSE 100, 15 FTSE 250 and 10 SmallCap, with the largest random number. Because investment trusts do not share similar characteristics to other types of companies, we excluded them from our sample by selecting the next largest number. We also needed to exclude companies with year-ends between 1 May and 30 September since the enhanced business review requirements were not applicable to the 2008 report and the 2009 report was not yet available at the time of our review. The next largest random number was selected in these instances.

The companies in the sample are as follows:

FTSE 100	**FTSE 250**	**SmallCap**
Amlin Cable & Wireless G4S InterContinental Hotels Group International Power Invensys Kingfisher Lloyds Banking Group Marks & Spencer Group Next Old Mutual Pearson Pennon Group Prudential Reed Elsevier Rexam Rolls-Royce Group Royal Bank of Scotland Group RSA Insurance Group Shire Standard Chartered Standard Life Thomson Reuters Vodafone Group Xstrata	Beazley Group Big Yellow Group Bodycote Chloride Group Cookson Group Cranswick Dignity Filtrona GKN Great Portland Estates Logica London Stock Exchange Group Melrose Resources PV Crystalox Solar Spirent Communications	Chime Communications Cineworld Group Low & Bonar LSL Property Services Marshalls Photo-Me International ProStrakan Group Quintain Estates & Development Real Estate Opportunities Unite Group

Appendix B: Business review requirements

Extract from the Companies Act 2006

417 Contents of directors' report: business review

(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 company's business 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.

(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 which are essential to the business of the company.

If the review does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii) and (c), it must state which of those kinds of information it does not contain.

(6) The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, 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 company's business can be measured effectively.

Appendix C: Link between the Company's Act and Reporting Statement

Companies Act 2006: Elements of the Business Review	Section / Paragraph References:	
	Companies Act	Reporting Statement
For all companies (other than those subject to the small companies' regime), the business review must contain:		
A fair review of the business and information to enable users to assess how directors have performed their duties under section 172 of the Companies Act 2006 (duty to promote the success of the company)	417 (2) 417 (3)(a)	22, 30-32, 36-37
A description of the principal risks and uncertainties facing the company	417 (3)(b)	27(c), 52-56
A comprehensive analysis of the development and performance of the business during the financial year	417 (4)(a)	27(b), 30-32, 43-46
A comprehensive analysis of the financial position of the business at the end of the year	417 (4)(b)	27(d), 30-32, 50-51, 60-74
For quoted companies, the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:		
An analysis of the main trends and factors likely to affect the future development, performance and position of the business	417 (5)(a)	8-12, 27(b), 33-35, 47-49
Information regarding environmental matters and the impact of the business on the environment including any related policies and the effectiveness of those policies	417 (5)(b)(i)	28(a), 29, 35
Information regarding employees and social and community issues including any related policies and the effectiveness of those policies	417 (5)(b)(ii) & (iii)	28(b) & (c), 29
Information about persons with whom the company has contractual or other arrangements which are essential to the business of the company	417 (5)(c)	28(d), 57-59
For all companies (other than those subject to the small companies' regime), the business review must to the extent necessary for an understanding of the development, performance or position of the company's business, include:		
Analysis using financial Key Performance Indicators (KPIs) and, where appropriate, other KPIs, including information relating to environmental matters and employees. (Medium-sized companies need not comply with the requirements that relate to non-financial matters)	417 (6)(a) & (b) 417 (7)	38-42, 75-77
The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts	417 (8)	13-15

Appendix D: Principles for Effective Communication

From *Louder than Words:*

1.	2.	3.	4.
Focused	**Open & honest**	**Clear & understandable**	**Interesting & engaging**
Highlight important messages, transactions and accounting policies and avoid distracting readers with immaterial clutter.	Provide a balanced explanation of the results – the good news and the bad.	Use plain language, only well defined technical terms, consistent terminology and an easy-to-follow structure.	Get the point across with a report that holds the reader's attention.

Appendix E: Reports of other experts

We acknowledge the support and contributions of the following other organisations, and their reports:

Organisation	Publication title / web address
Addison Report summary **page 35**	*Risky Business: An overview of European Risk Reporting* **Website**: www.addison.co.uk/riskybusiness
Black Sun Report summary **page 36**	*100/08 Annual Analysis of FTSE 100 Corporate Reporting 2008* **Email:** corporatereporting@blacksunplc.com
Deloitte Report summary **page 37**	*A telling performance: Surveying narrative reporting in annual reports* **Website:** www.deloitte.co.uk/atellingperformance
FRC	*Louder than Words: Principles and actions for making corporate reports less complex and more relevant* **Website:** www.frc.org.uk/press/pub1994.html
Merchant Report summary **page 38**	"*Who's doing what*" series **Website:** www.merchant.co.uk/thinking_publications.html
PricewaterhouseCoopers Report summary **page 39**	*A snapshot of FTSE 350 reporting: Compliance mindset suppresses effective communication* **Website:** http://www.pwc.co.uk/eng/publications/a_snapshot_of_ftse_350_reporting.html
Radley Yeldar Report summary **page 40**	*How does it stack up? Annual reports 2009* **Website:**www.howdoesitstackup.co.uk
The Virtuous Circle	*Just how many greenhouse gas reporting (GHG) standards do we need?* *Update on narrative reporting* **Website:** www.thevirtuouscircle.co.uk/NEWS_SEPTEMBER09.html

Addison – Risky Business: An overview of European risk reporting

Addison is a corporate reporting agency that produces research and opinion pieces on European corporate reporting, which typically focus on developments in regulation, trends in corporate disclosure and innovations in corporate communications. In 2009 they published their findings on 2008 risk reporting by the Euro 100 companies (as published by The Times).

Data Used and Scoring Methodology
All 100 annual reports of companies within the Euro 100 were reviewed and assessed against the EU Accounts Modernisation Directive (AMD) relating to the 'description of the principal risks and uncertainties it faces'.

Results
Addison concluded that there was a lack of agreement about the basic purpose of risk reporting – is it to inform shareholders, or to protect the company? In addition, the competing guidance in this area – EU AMD, SEC requirements for foreign private issuers, and IFRS 7 – with little guidance on how they should be reconciled or prioritised, leads to further confusion.

Only just over a quarter of the companies complied with the EU AMD to describe their principal risks. The best performing countries were the Netherlands and the UK, where still only 50% of companies in those countries identified their principal risks. Furthermore, the articulation of risks was biased towards generic risks generally limited to disclosures required through IFRS 7, and little data was presented to provide context for the risk, or risk mitigation.

Addison also came up with a list of risks that they described as being 'from the sublime to the ridiculous'. Here are their ten favourites 'that definitely belong in the latter category':

- Competition
- Inaccurate or incomplete information used to manage our risks
- Changes in accounting standards
- Any major event on a scale that is difficult to predict
- Failure to manage a crisis
- Ethical misconduct or non-compliance with applicable laws and regulations
- Weather conditions
- Information technology systems may fail
- Global nature of operations
- Failure to deliver our strategy

Black Sun – 100/08:Annual Analysis of FTSE 100 Corporate Reporting 2008

Black Sun is a corporate reporting agency. Each year, Black Sun carries out a year-on-year analysis of FSTE 100 reports in order to observe how companies are responding to changing requirements.

The latest review of FTSE 100 annual reports looks at the 2008 year ends. Because companies in the FTSE 100 have a range of year-ends, the new CA business review requirements will not necessarily apply to all of the companies reviewed.

In this review the reports are not individually scored, rather data is collected to indicate how trends in corporate reporting are changing for the FTSE 100 population as a whole. No company specific information is provided.

Data Used and Scoring Methodology
The report sample includes all companies in the FTSE 100 as it stood at 1 March 2009.

Results
Black Sun observed that 'there continues to be progress in the quality of narrative reporting, although certainly not as significant as in previous years…the divide between the best and worst practice reporting remains.' Furthermore, they observed that 'The communication of key areas such as strategy, financial key performance indicators and CSR have improved steadily, whereas non-financial key performance indicators, risk reporting and outlook information still remain challenging.'

Specifically Black Sun found that:

- Strategy is the area of greatest annual report improvement in the last five years
- 78% of companies are identifying potential risk impacts but only 4% are quantifying these in any real detail.
- There is continued reluctance to discuss the future, particularly given the uncertain economic outlook
- 63% of companies have a group overview spread to explain the business
- 88% of companies are specifically identifying KPIs although this figure is only 58% in relation to non-financial KPIs
- 80% of companies have a dedicated CSR section within their report but it is difficult to see how CSR is aligned with overall group strategy.

Deloitte – A telling performance: Surveying narrative reporting in annual reports

The report published in October 2009, sets out the details of Deloitte's latest survey of narrative reporting by listed companies. Deloitte have been reviewing practice in this area since 1996.

Data Used and Scoring Methodology
The annual reports of 130 listed companies (30 investment trusts and 100 other companies) were surveyed. As in past surveys, the 100 companies were spread evenly between the largest 350 companies, smallest 350 by market capitalisation and those in the middle. The annual reports used were those that were most recently available for the sample companies and published in the period from 1 August 2008 to 31 July 2009.

Results
The survey addresses a number of areas, such as length of reports, placement of information, as well as a review of corporate governance reporting. Focusing on the areas in common between the Deloitte and ASB reviews, some conclusions were that:

- While some companies had clearly explained how each particular risk was pertinent to its business, other companies merely provided boiler-plate descriptions of risks which could have been applied to many a company.
- On average the larger companies tended to identify a larger number of KPIs, with an average of eleven, compared with six KPIs for the middle and smallest 350 companies.
- Most acknowledged the troubled economic environment but failed to specify what, if any, effect this had had on the company.
- Overall the disclosure around the environment, employees and social and community issues has not improved significantly on last year. The most helpful information provided in any area was by companies who clearly identified and set out their policies and discussed future targets or related non-financial KPIs alongside the policies.
- Compliance relating to the legal requirement to disclose specific information about contractual and other arrangements seems very low, with only 23 companies doing so (2008: 15 companies).
- A common approach to presenting information about the business was to provide a separate review of operations for each division, thereby enabling an overall description of each division to be clearly presented as well as facilitating discussion of both financial and non-financial performance.

Merchant – 'Who's doing what' series

Merchant is a design and communications agency. Based upon their review of corporate communications, including annual reports, both within the UK and globally, Merchant produce a periodic magazine entitled 'Who's doing what', which contains commentary and examples from annual reports.

Recent aspects of narrative reporting covered in 'Who's doing what'
Each issue addresses a number of topics. The most recent topics relating to narrative reporting in annual reports are set out below, along with Merchant's views:

- Making the narrative work: linking strategy to KPIs – 'What isn't always so evident, however, is the linkage between various parts of the story. For example, how does risk management feed into strategy? Is corporate responsibility important to the business as a whole?' – *Issue 41*
- Treating responsibility responsibly – 'Corporate responsibility (CR) reporting is changing. The new reporting requirements introduced in many markets over the last couple of years mean that environmental, social and community-focused content must now be covered at some level in the formal annual report. This raises the question of how to balance corporate responsibility reporting in the main report against a separate document or website.' – *Issue 41*
- Bringing market prospects to life – 'Whatever the effect of market conditions on a company, it is essential that the company communicates their impact to its stakeholders. Otherwise the central narrative is largely meaningless. So the very best annual reports explain the dynamics of the market and show clear links to how this impacts company performance and outlook…' – *Issue 42*

PricewaterhouseCoopers – A snapshot of FTSE 350 reporting: Compliance mindset suppresses effective communication

PricewaterhouseCoopers (PwC) have been reviewing and reporting on good practices in corporate reporting for a number of years. The latest review focused on the content and quality of narrative reporting, as well as alignment between elements of reporting such as strategy, performance and remuneration.

Data Used and Scoring Methodology
The report is based on a desk-top research project undertaken in the first half of 2009 to review the narrative reporting sections of the FTSE 350 companies' annual reports. Reports for the years ended between 1 April 2008 and 31 March 2009 were included. Six companies did not report during the period, so the final sample size was 344.

Results
PwC concluded that:

- Although companies have continued to cover key bases of narrative reporting, particularly around KPIs and risks, a compliance mindset is often suppressing effective communication.
- Perhaps due to uncertainty arising from the current economic environment, fewer companies feel comfortable with explaining the trends and factors likely to impact the future development, performance and position of the business.
- It is a concern to find that, despite covering key bases of narrative reporting, companies still fail to present a clear, credible and coherent picture of the direction of travel and short-term performance… Many struggle to use their strategy to underpin their reporting or to clearly align it with their risk assessment, KPIs and remuneration.
- There continues to be a large gap between the best and worst communicators.
- While the better communicators in the FTSE 250 are on a par with the FTSE 100, and good practice can be found in both populations, the majority of the mid-cap companies have further to go in presenting a joined up picture of the business and its performance.
- For FTSE 100 companies, the greatest opportunities arise for improving narrative reporting around external drivers, risks and sustainability reporting, with reporting of strategy being an additional area for FTSE 250 companies.

Radley Yeldar – How does it stack up? Annual reports 2009

Radley Yeldar is a corporate communications agency, specialising in corporate reporting. Radley Yeldar monitors best practice reporting and has published a number of reports on its findings, including an extensive review of the annual reports of all FTSE 100 companies, which it has produced every year since 2006, following the publication of the ASB's OFR guidelines.

The latest review of FTSE 100 annual reports looks at the 2008 year ends. Because companies in the FTSE 100 have a range of year-ends, the new CA business review requirements will not necessarily apply to all of the companies reviewed. The report explains the strengths and weaknesses of each of the reports in the FTSE 100 and identifies the top reports in each of several industry groupings and the top ten reports overall.

Data Used and Scoring Methodology

All 100 annual reports of companies within the FTSE 100 were reviewed and assessed against nine key areas of the ASB's RS, plus two communication criteria. The performance of companies in each area was graded between 1 and 10 with indications given in the report of what was required for top marks in each area.

Results

Radley Yeldar observed a continuing trend towards better more open reporting, specifically observing that the best reports just keep getting better.

Specific areas that are labelled as good work are:

- Strategic focus throughout the report
- Integrated employee reporting
- Marketplace commentary
- KPIs reported with context
- Risk reporting is still improving

Specific areas that are labelled as could do better are:

- More could provide a clear overview of the business
- Sketchy strategy descriptions, with no substantiation
- Non-financial KPIs are weak
- Environmental and social reporting is patchy
- Contractual arrangements largely ignored
- More engaging and accessible reporting

Appendix F: Glossary

ASB	UK Accounting Standards Board
CA	Company's Act 2006
CSR	Corporate Social Responsibility
DP	Discussion Paper
EU	European Union
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FTSE 100	A market-capitalisation weighted index representing the performance of the 100 largest UK domiciled blue-chip companies
FTSE 250	A market-capitalisation weighted index representing the performance of the next largest 250 UK domiciled blue-chip companies outside the FTSE 100.
FTSE SmallCap	The FTSE SmallCap index consists of companies outside of the FTSE 250 and 100 indices.
IFRS	International Financial Reporting Standard
KPI	Key performance indicator
RS	The ASB's Reporting Statement on Operating and Financial Review

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