Title: Reforming UK Narrative Reporting	**Impact Assessment (IA)**
IA No: BIS 0284	**Date:** 18/06/2012
Lead department or agency: Department for Business	**Stage:** Final
Other departments or agencies:	**Source of intervention:** Domestic
	Type of measure: Secondary legislation
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Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£2.54m	£2.75m	- £0.30m	yes	out

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

Annual reports are designed to provide the information shareholders need to understand how the companies they invest in are being run. Reports have been getting longer and more complex and have become less useful to stakeholders. Essential strategic information is being diluted and reports are more difficult to navigate. Existing regulatory requirements are limiting the development of best practice in this area and have not helped focus companies on the strategic information that shareholders require. There is a coalition commitment to "reinstate an Operating and Financial Review (OFR)" and "investigate further ways of improving corporate accountability and transparency".

What are the policy objectives and the intended effects?

To improve corporate transparency, re-focus reporting on strategic issues and allow companies to communicate key information in a way that is right for them and their shareholders. The intended effect is to provide shareholders with the information they need to be effective stewards, to enable investors to make better decisions based on company strategy and to provide interested parties access to the data they need to effectively hold companies to account. The benefits for companies come from simplifying reporting requirements and improving the structure of reporting and the guidance.

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

1). Require companies to produce a focused strategic report, simplifying reporting requirements and improving guidance (*preferred option*).
2). Reintroduce the 2005 mandatory reporting and audit regime for the Operating and Financial Review.
3). Do nothing.

Options (1) and (2) involve modifying the existing reporting regime, as set out in the Companies Act 2006. Option (1) is preferred, as it best meets the goals of improving transparency of reporting while minimising the regulatory burden. Option 2 imposes a large regulatory burden and may stifle innovative reporting. 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:** 04/2018

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: Jo Swinson Date: 6 June 2013

Summary: Analysis & Evidence

Policy Option 1

Description: Introduce a new strategic report

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.84	**High:** 94.25	**Best Estimate:** 2.54

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0.4		0	**0.4**
High	0.8		0	**0.8**
Best Estimate	0.6		0	**0.6**

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

Transitional costs to business are estimated to be £421k and will occur in the first year only. It is assumed that it will take every UK quoted company, of which there are approximately 1000, 15 hours of managerial time to become familiarised with the new strategic report. In addition, providing improved voluntary guidance is estimated to cost the FRC, the Financial Reporting Council, in the region of £200,000. There will be no ongoing annual costs.

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

None.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0		0	**0**
High	0		11.0	**94.7**
Best Estimate	0		0.4	**3.2**

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

As part of the reforms to UK narrative reporting, certain disclosures will be removed from reporting requirements, thereby reducing the compliance burden companies face. Based on direct consultations with affected companies, it is estimated that the benefits from the removal of such disclosures range between £0 and £11k per quoted company. Truncating the sample to remain cautious yields an average annual saving of £367.5 per quoted company. For 1000 quoted companies this gives total annual benefits of £0.4m .

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.. It will also lead to improved confidence in UK reporting and the corporate governance regime as a result of more meaningful disclosure and greater comparability between companies. Similar benefits will accrue to 60k medium and large (mainly private) companies who will also benefit from the reduced reporting requirements but there is insufficient information available to monetise these benefits..

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

The upper and lower cost estimates are based on a 10% sensitivity analysis around the cost per hour and cost to the FRC, and the time required for familiarisation was calculated with a sensitivity analysis of 10, 15 and 20 hours. It is assumed that the costs to the FRC are taken from their current budget and not passed on to companies. Based on stakeholder engagement, it is assumed that the annual monetised benefits to each affected company range from £0 to £11,000.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m: -£0.4m			In scope of OIOO?	Measure qualifies as
Costs: 0.0	**Benefits:** 0.3	**Net:** 0.3	Yes	OUT

Evidence Base (for summary sheets)

I. Problem under consideration

One of the core strengths of the UK corporate governance system is the power that shareholders and investors have to challenge company directors. Providing shareholders and investors with the information they need to do this is one of the main purposes served by the annual report. Previously the main focus of the annual report was the financial information but there is increasing emphasis placed on nonfinancial, or narrative, information which gives a broader picture of a company's position and future prospects.

In 2005 the Government introduced an Operating and Financial Review to implement requirements in the EU Accounts Modernisation Directive. The requirement to do an OFR was repealed in December 2005 and in 2006 the Companies Act introduced a requirement to prepare a business review, and for quoted companies an enhanced business review. The enhanced business review was similar to the OFR, but it required a lower level of audit and did not cover strategy and business model.

There have been growing concerns expressed about the clarity and focus of narrative information in reports, and about the usefulness of this information to shareholders. This was clearly expressed by stakeholders in their response to the 2010 BIS narrative reporting consultation[1] and is the driving force for the current proposed changes.

Another key message we have heard is that the structure of annual reports in the law isn't clear and doesn't match current best practice which has developed significantly since the business review was introduced. The law requires companies to produce a directors' report, and for non-small companies the business review is part of this. However, for companies and investors, the business review is by far the most important element of reporting and companies tend to present it as such. The law does not prohibit this, but neither does it recognise or encourage the importance of strategic reporting.

Companies often use their annual reports to communicate messages beyond the reporting requirements required by law. Reports are seen as a good place to showcase a variety of achievements. This has contributed to make reports longer and longer. The figure below, taken from the annual Deloitte survey of corporate reporting[2], shows a steady rise in the average number of pages in annual reports.

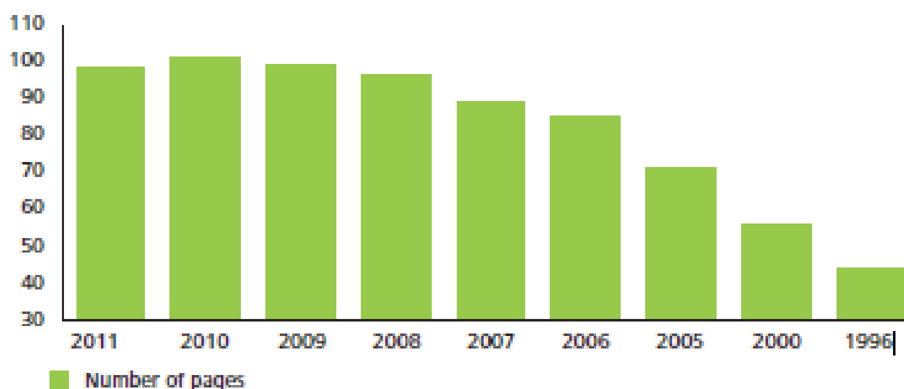

Figure 1 – Average length of annual reports.

The corporate reporting consultancy, Black Sun report[3] said that

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

[2] Available at : http://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Services/Audit/uk-audit-gems-and-jetsam.pdf

[3] Black Sun "Rethinking Reporting, Annual Analysis of FTSE 100 Corporate Reporting Trends 2009"

"*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*".

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.

Commentators[4] 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.

The excess of information and lack of clear structure 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). 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.

Another issue that has contributed to a lack of clarity in reporting is that the guidance that companies rely on to produce their reports, written by part of the Financial Reporting Council, the Accounting Standard’s Board, although almost universally regarded as very useful by companies, is guidance that relates to the OFR, rather than the business review that replaced it.

II. Rationale for intervention

The underlying market failure rationale addressed by the existing company reporting regime is that of information asymmetry between shareholders and company directors, which if left unaddressed might discourage investment in the UK’s corporate sector. Good quality reporting allows shareholders to hold management to account and increase corporate returns. As set out above, recent developments in company reporting suggest that current requirements are not fully addressing this long-standing market failure, especially in the largest and most economically significant quoted companies.

BIS launched the 2010 consultation “The Future of Narrative Reporting”[5] 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 where a ‘box-ticking’ approach is limiting the value of disclosures.
- 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

[4] Including FRC (2009) “Louder than Words”

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

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. 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.

In 2011 the Department consulted[6] on a new format for reports, focusing on strategic reporting. This consultation found that:

- Of those who responded to the question about the new format, around four fifths supported it. Many felt that this was a good way of simplifying the information that investors get and ensuring that the strategic view can be given without losing the information that the more specialist audience wants.

- The report suggested several disclosure requirements that could be removed and around two-thirds of those who responded to this question supported the removal of all the requirements.

- There was little appetite to change the level of audit or assurance given to narrative reporting with around three quarters opposing this. However, there was general support to require audit committee reports to set out how long the current auditor has been in place and when a tender was last conducted.

- There was a strong consensus that guidance should be updated.

III. Policy Objectives

The policy objectives are to:

- enable investors to better understand the direction the company is taking to facilitate better engagement
- improve the structure of reports to make them more useable
- remove unnecessary reporting requirements.

[6] This can be found at http://www.bis.gov.uk/Consultations/future-of-narrative-reporting-further-consultation?cat=closedawaitingresponse

This will allow those companies at the forefront of reporting continue to innovate, experiment and provide a benchmark for other companies. The latter will benefit from the increased clarity in the legislative requirements and the guidance.

IV. Description of options considered (including do nothing)

Three high level policy options have been considered;

1. Require companies to produce a focused strategic report, simplifying and harmonising the reporting requirements and guidance (*preferred option*).
2. Reintroduce the 2005 mandatory reporting and audit regime for the Operating and Financial Review.
3. Do nothing.

As described below, option 1 is the preferred option because it achieves the best balance of satisfying the government's key objectives for reforming the narrative reporting framework, is supported by stakeholders and avoids the disproportionate costs imposed by option 2.

Option 1 (preferred option) – Require companies to produce a focused strategic report, simplifying the reporting requirements and guidance.

The preferred policy option proposed a strategic report to replace the business review, the removal of unnecessary reporting provisions, and improved guidance.

Specifically, the preferred policy option would make changes that will:

- Create a strategic report to replace the business review.
- Require quoted companies (those incorporated in the UK and listed on certain UK, EU or US markets) to report, to the extent necessary for an understanding of the business, on their strategy, their business model, and any human rights issues.
- Require quoted companies to report on the number of women on the board and in the organisation as a whole.
- Deregulate by removing certain reporting requirements (see table at annex 3 which is an updated version of the list proposed in the 2011 consultation following stakeholder engagement[7]).
- Require Audit Committees to set out in their reports how long the current auditor has been in place and when a tender was last conducted. The FRC produce the guidance for Audit Committees and have consulted on making this change this year.
- Provide new guidance on the strategic report. The FRC will produce this.

The material changes to the content and format of the reporting framework will fall only on quoted companies, of which there are currently approximately 1000. Non-small non-quoted companies will not be required to produce anything different from what they are currently doing. Although we are changing the title of the report used in legislation, there is not now and will not be in the future a requirement for companies to use any particular title in their report, so we have assumed a zero cost from this change of title. Furthermore, small companies are currently exempt from the requirement to produce a business review, and we are proposing that this exemption should in future apply to the strategic report.

In creating a clear 'go-to' place where investors and others can find out about a company's strategy, making it clear in the legislation that quoted companies must cover their strategy and

[7] The consultation document is available at www.bis.gov.uk/assets/biscore/business-law/docs/f/11-945-future-of-narrative-reporting-consulting-new-framework.pdf.

business model, and by removing a raft of unnecessary and outdated requirements this option meets all the policy outcomes set out above.

The 2011 consultation suggested some other changes that could be made to the regime. Following the consultation, and the workshops that were held after the consultation, the following proposals are no longer recommended:

- We proposed creating an Annual Director's Statement through producing a template for on-line material. There was support for this in the consultation, but much debate there and in the workshops that followed the consultation, about the best format for it and how worthwhile it would be. In particular there were concerns that whatever was agreed might then fix reports in-time, which would then be unable to develop with technology. We will continue to work with the industry to see if it is possible to design a template for this information, but to avoid stifling innovation we will not be making any legislative changes.

- The 2011 consultation also proposed requiring each director of the company to sign-off the strategic report, but there was almost no support for this. Some felt that it would undermine the collective responsibility of the board.

- Increasing the level of audit or assurance that applies to reporting. As described in the rationale for intervention section, there was very little support for this in the consultation responses.

- In 2011 we consulted on removing a requirement on companies that employ more than 250 people to report on how they involve employees, through giving them information, consulting them and through share schemes. However, given the importance the Government attaches to encouraging employee engagement, we have decided not to remove this requirement.

- In the 2011 consultation we identified several areas of possible overlap between company law and listing rule requirements. Following consultation we have identified that there is little scope to make alterations through company law, since many of the requirements are derived from EU law,

Option 2 - Reintroduce the 2005 mandatory reporting and audit regime for the Operating and Financial Review.

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 the EU Accounts Modernisation Directive was implemented in the UK in 2005[8], introducing a mandatory OFR for quoted companies. The Regulations required companies to disclose their strategies and included 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.

[8] By the Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005.

The Business Review requires companies to provide broadly the same information on non-financial matters as the earlier OFR but did not include some of the specific requirements, including to disclose strategies or to carry out the enhanced audit. 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 2005 OFR regime was also accompanies by mandatory guidance (the "reporting standard") and companies were required to state whether the report was prepared in accordance with that standard and describe any departure from the standard.

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 3 – Do nothing.
This option represents no change from the current regime.

V. Costs and Benefits of Options

Option 1 (preferred option) - Require companies to produce a focused strategic report, simplifying and harmonising the reporting requirements and guidance.

Although the strategic report will be required from all non-small companies (a population of approximately 60,000 companies), as mentioned above there will be negligible net cost to most of these companies. Specifically, except for quoted companies, the only effect would be a change to the title used in law of a document companies produce (the law will state that they must produce a 'strategic report' rather than a 'business review'). For non-quoted companies, the content will not have to change **at all**. Furthermore, current practice is that companies do not reflect the title given in legislation in the documents that they produce. They call the document a variety of things, including 'operating review ', 'business review', 'operating and financial review' and 'strategic report'. Changing the title used in the law from one of these to another need have no impact at all on companies, and we expect them to continue to title the document as they wish.

Costs

The main costs associated with the introduction of the new **strategic report** will be one-off familiarisation costs for those preparing annual reports; these include additional management time to ensure that the report meets statutory requirements. We do not expect that there will be any systems costs to companies as a result of these relatively minor changes. We have estimated that it will take a quoted company 15 hours of managerial time to familiarise itself with the new requirements. Using Annual Survey of Household Earnings data, the mean gross labour cost per hour for corporate managers[9] is £24.22, which is then adjusted for a 16% uplift to reflect non-wage costs to give a total hourly cost of £28.10.

In order to arrive at an aggregate cost to business, the above total hourly cost is multiplied by the population of UK quoted companies as defined in section 385 of the Companies Act 2006.

[9] The 2 digit Standard Occupation Classification (2000) code for corporate managers is 11. The data used are available at www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-235202.

This definition includes UK incorporated companies that are not listed in the UK but are listed in an EEA member state or admitted to dealing on the NYSE or Nasdaq. According to the FAME[10] database, there are approximately 100 such companies. The UKLA's Official List suggests that there are approximately 850 UK companies listed on the London Stock Exchange (LSE). We therefore assume that there are approximately 1000 UK quoted companies.[11] 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 solely to changing two headings in their narrative reports. The cost for changing two headings is assumed to be zero.

The total cost of familiarisation to business is therefore;

Total familiarisation cost = companies x hours x cost per hour = 1000 x 15 x £28.10

which gives £421k as our best estimate. Such costs are expected to occur only during the year of policy implementation. A sensitivity analysis performed on this estimate using an upper and lower bound of 10 and 20 hours and a 10% range on cost per hour gives a range of £253k to £618k.

We have discussed these cost estimates with a range of quoted companies. It has been difficult to obtain more refined estimates of costs given their limited magnitude and lack of relevant data collected by companies and we have not received any feedback that these estimates are not realistic. Furthermore, these figures were included in the consultation stage Impact Assessment and the consultation responses did not raise any queries with them.

Our intention is that the new framework will be drawn up in a manner which will be simple to understand so that annual compliance costs will be no higher than they are under the existing regime.

There will also be costs to the FRC for revising their **guidance**. Previously, the one-off cost of a completely new mandatory guidance was estimated to cost £200,000 as part of the OFR RIA.[12] We expect the FRC's costs of revising existing voluntary guidance to be significantly less but have used this as our working assumption for this IA with a sensitivity analysis of +/- 10%. We understand that costs of this order would currently be absorbed within the existing FRC budget rather than being passed on to companies and that the FRC would not have reduced its cost to business in the absence of the current policy proposal. As the guidance remains voluntary the use of it would impose no costs to companies.

Total one-off costs of the proposed changes are therefore £421k + £200k = £621k (with a range of £433k to £838k)

This option does require quoted companies to include some additional information in their strategic reports:

- Information about a company's strategy and business model – the FRC guidance already suggests companies describe their strategies and the economic model that describes its business. So in practice we would expect all quoted companies to already provide this information. The Corporate Governance Code that applies to companies with a premium listing on the London Stock Exchange also explicitly requires this information. So this is already a mandatory requirement for more than 80% of quoted companies and the 20%

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10 FAME database provided by commercial provider Bureau van Djik which incorporates accounts and other information filed by all companies at Companies House.

11 This allows some leeway to account for some EEA exchanges which are not captured by the FAME database.

12 Available at http://www.bis.gov.uk/files/file21361.pdf

for whom this is not a mandatory requirement are likely to do it anyway in line with the guidance.

- We will also be requiring quoted companies to include information about the number of men and women that are directors of the company and the number of women the company employs in the UK, in line with a recommendation from the Davies Review[13]. We have confirmation from our meetings with company secretaries of FTSE100 companies that this proposal will not significantly increase their administrative burden as the requirements are relatively minor and the data readily available within companies.
- We will also make explicit that quoted companies should consider and report on any relevant human rights issues. At the moment they must cover any relevant social and community issues, and from our consultation we understand that most companies have interpreted this to include human rights issues. However, we believe it is appropriate to make this explicit. Since companies already interpret this as an implicit requirement, we don't believe this creates any additional costs. Any costs it did create would only fall on companies whose operation created human rights issues.

We do not therefore anticipate any significant measurable costs from these additional requirements given that data will be readily available and in many cases already reported.

Benefits

A key aspect of the proposals is to allow companies to create a separate strategic report. This document should contain most of the information the average investor would wish to see. Although much of the content is not new, the focus on strategy through this report, to be achieved in three ways: through naming it the strategic report, through stating it should cover strategy and through giving it a separate identity; will change the emphasis of reporting. This key aspect of the proposals will generate largely non-monetised benefits. In particular, as this document can be looked at separately from the other documents, it will be easier for investors to look through this shorter document to find the information they want. This will make it easier for shareholders to hold management to account, contributing to the Government's aim of encouraging greater stewardship of companies by their owners. Ultimately, a more effective reporting regime which encourages engagement and the holding of management to account might encourage more thoughtful management of UK companies and a better balance of returns between shareholders and company executives. These benefits are expected to be significant but are difficult to monetise.

It is proposed that the **reporting requirements in Annex B are removed** from the regulations. In this Final Stage IA, we update the analysis in the Consultation Stage IA by monetising the benefits that would accrue to companies from simplifying these reporting requirements. In order to monetise the benefits of removing the disclosure requirements listed in Annex B, the Department for Business contacted numerous companies directly in order to solicit the necessary information. Companies were asked for their estimated cost savings that would arise from not having to disclose the information contained in the table in Annex B, which builds on the original proposals set out in the BIS consultation paper of September 2011.

BIS approached the FRC and ICAEW to forward our request to quoted companies to obtain an indication of annual cost savings. 5 companies volunteered the information. The estimated annual cost savings ranged from minimal to approximately £11,000. Three of the five companies either stated that there would only be minimal cost savings or savings less than £1000.

Overall, therefore, our survey produces a range of annual savings between £0 and £11,000. Even the upper end of the range, £11,000, is not a large amount even in the context of a

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

relatively small quoted company. In light of this, it is considered to be disproportionate to obtain more detailed cost estimates and sufficient for the purposes of this IA to take an average of the estimates received in order to arrive at a best estimate of the cost savings associated with the policy proposals. However, in order to remain cautious and not overstate the likely benefits, the sample is truncated by ignoring the £11k estimate, which is relatively high. The truncated average (mean) is then equal to £367.5 per quoted company per year. This is our best estimate. In order to reflect the uncertainty around this point estimate, a lower bound of £0 (no benefits) and an upper bound of £11,000 are assumed, as indicated by the feedback we received.

This gives total annual benefits of 1000 * £367.5 = £0.4m with a range of £0 to £11m

Other non-monetised benefits include:

The benefits from simplifying the requirements outlined above will also be enjoyed by large and medium UK companies that are not quoted companies (a population of around 60,000 companies). However, we did not conduct further analysis with these companies given the difficulties of obtaining cost estimates from much larger companies, where these reporting requirements would be more significant. These remain unmonetised benefits.

The current **guidance** relates to the Operating and Financial Review rather than to the existing legislation. Updating the guidance will improve the usefulness of it, and thus make it a more valuable tool for companies.

- The proposals represent an evolution, rather than a revolution, in narrative reporting requirements, and as such will allow companies to continue to build on the best practice that has developed. They recognise and develop the best reporting practise around today, and will encourage reporters who's annual reports need to improve to do so.
- Maintaining 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.
- Not preventing any future changes to the CA06 company size criteria.

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 both consultations that such an approach is considered beneficial.

Option 2 - Reintroduce the 2005 mandatory reporting and audit regime for 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[14] 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 **£62.4 million** per annum for all quoted companies (£55.1 million for increase in audit fees and £7.3 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.

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

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	650	3.3	3.6	2.9
		1000	**7.3**	8.1	6.6

A 10% sensitivity analysis was carried out around the average cost per company giving upper and lower bound estimates of £8.1 m and £6.6 m respectively. The best estimate figure of £7.3 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 on OFR costs to quantify that increase – the sensitivity analysis reflects the degree of uncertainty in this figure.

It is reasonable for the preparation costs of option 2 to exceed the preparation costs for option 1 for the following reasons; (i) the OFR requires an enhanced level of audit, thereby requiring companies to expend more resources on ensuring compliance with the reporting requirements, and (ii) the OFR would also be accompanied by a mandatory reporting standard and companies would be required to state whether their reports were prepared in accordance with that standard and describe any departure from it, which would further contribute to the amount of time and resources involved in the reporting process.

The costs for option 2 are based on the original 2005 RIA that was drawn up to assess the impact of introducing the OFR and would have reflected the above points. However, the 2005 RIA suggests that forward-looking narrative information was a relatively small component of company reporting at that time, and so the introduction of the OFR would have represented a significant departure from business as usual. This has now changed, with companies now reporting narrative information to a much greater extent. However, the 2005 RIA does not provide a breakdown of preparation costs which is sufficient to determine what proportion of preparation costs are due to enhanced audit requirements or adherence to a mandatory reporting standard and so it is not possible to adjust the preparation cost figures for option 2 without substantial further analysis.

It is deemed to be disproportionate to undertake this further analysis for the following reasons. Our consultation revealed a lack of support for a mandatory reporting standard on the grounds that it would stifle reporting innovation. The consultation also revealed a lack of support for an enhanced audit regime from both users and preparers of accounts. Therefore, even though the preparation costs for option 2 may be overstated, this would not change our choice of selecting option 1 as the preferred option since both preparation and audit costs, the latter forming the vast majority of the costs, are unambiguously higher under option 2 and these costs are deemed to be unjustifiable by stakeholders.

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.

				Increase in 2009 Audit Fees (£m)		
	Average Audit Fee	Number of Companies	Total Audit Cost(£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	650	177	14.2	7.1	10.6
All Quoted		1000	919	73.5	36.8	**55.1**

Total Cost

Best estimates therefore give a total potential cost of Option 1 of £62.4m (comprising increased audit costs of £55.1 m and increased preparation costs of £7.3 m).
Upper and lower bound estimates based on the sensitivity analysis above are £81.6m (comprising increased audit costs of £73.5m and increased preparation costs of £8.1 m) and £43.4m (comprising increased audit costs of £36.8m and increased preparation costs of £6.6m).

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

Mandating a standard report for all quoted companies would enhance the comparability of company reports for the users of such reports, including investors and the wider public. The combination of a mandatory reporting standard and increased audit requirements would meet NGO requests for greater legal requirements for companies to provide standardised CSR information. It would also increase users' ability to rely on narrative information. More widely, enhanced comparability and confidence in narrative information would aid investment decisions and contribute to more efficient financial decision making.

Option 3 – Do nothing.

If nothing is done, existing informational inefficiencies arising due to complex reporting will not be addressed as narrative reporting practices are unlikely to become simplified without intervention. The benefit to doing nothing would be the absence of an adjustment burden on companies as there will be no push to reform the current system.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

This Final Stage IA has attempted to provide quantified estimates of the main costs and benefits associated with the preferred policy option. Narrative reporting is a dynamic corporate activity which routinely undergoes significant changes as technology progresses and industry practice evolves. That is to say, it is not exceedingly difficult for companies to adapt to new reporting practices regarding format and small changes to content, particularly the relatively minor reforms put forward by current policy. The principle reform contained in the current proposal is to require companies to more clearly bring forth key strategic non-financial information in a manner that is more useful for stakeholders by conveying it in a separate new document called the "strategic report". This is largely a change in the structure of reporting – companies already provide the information to be contained in the strategic report under the current regime, just not in the proposed format.

Therefore, the policy proposal is neither contentious nor irreversible, nor is there a large degree of potential downside risk regarding its impact. Taking this into account, we have sought to quantify the impact of the policy in accordance with OIOO methodology in a suitably proportionate manner.

The monetisation of the benefits associated with the policy proposal relied on a relatively small sample. However, the data that is required to make a more detailed calculation is deemed to be disproportionately refined relative to the scale of the policy impact. The simplification to existing disclosure requirements listed in Annex B are relatively minor and it is not realistically conceivable to expect their removal to result in substantial economic benefits to business. The estimated annual benefit to business of £2,550 is not large even in the context of a relatively small quoted company.

It is therefore unlikely that a more refined analysis of the impact of the policy will substantially change the outcome of the impact assessment, particularly in light of the large regulatory burden associated with option 2.

Risks and assumptions

There is a risk that these proposals will only have a limited impact on the quality of reports if companies do not take the opportunity to present information in a meaningful way for investors. Furthermore, it is ultimately up to shareholders, investors and other interested parties as the primary beneficiaries of the proposed reform to the narrative reporting framework to avail themselves of the improvement in the quality of available information.

The IA has assumed that there are limited transition costs for companies. We believe this to be a reasonable approach for the reasons explained in the above section on the rationale for the level of analysis used in the IA.

We have assumed zero costs for some additional reporting requirements on the basis that stakeholder discussions have suggested that such additional information is readily available and easily reported.

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

The policy put forward in this IA is within the scope of OIOO methodology. Both transitional and annually recurring costs are included in the equivalent annual net cost to business. The costs and benefits calculated for the preferred option in section V above are considered to result directly as a consequence of the proposed policy and therefore relevant for OIOO purposes. The transitional cost borne by the FRC is excluded from the equivalent annual net cost to business (EANCB) calculation. Accordingly, we find an EANCB of -£0.4 million as reported in the summary sheets above. These benefits accrue to the population of quoted companies. Similar benefits but of a likely lower order of magnitude will also accrue to the larger population of large and medium companies for whom we have not been able to estimate a quantified benefit suggesting that the policy is clearly net beneficial to business.

Wider impacts

By enhancing the quality of information available to users of annual reports, the policy proposal has the potential to foster greater engagement between investors and companies as well as enabling investors to make better informed judgements regarding company performance. This would contribute to a better performing corporate sector in general. In this regard, the policy proposals contained in this IA support other BIS initiatives on the transparency of executive remuneration reporting (IA no. BIS0355) and enhanced shareholder voting rights (IA no. BIS0341).

We also hope that in improving reporting in the UK, we might set a standard that will influence the EU model. The Commission are currently considering narrative reporting, and we believe they might recommend, for instance, a consideration of human rights issues.

The proposed policy reforms apply mainly to UK quoted companies and will not affect small businesses.

Summary and preferred option with description of implementation plan

Summary

Option 1 is preferred as it best meets the goals of highlighting important strategic information, making reports more transparent and usable while avoiding imposing a large regulatory burden on companies as would be the case under option 2. Net benefits to the population of UK quoted companies are calculated at £0.4m a year. There are also significant unmonetised benefits from this policy including the impact of improved company reporting and the benefits to the larger population of large and medium non-quoted companies. The extensive consultation process that BIS has engaged in and that has been cited as evidence in this IA is consistent with this conclusion. The principal source of costs to business in option 2 is a result of the enhanced audit requirement. The latest BIS consultation revealed that there is little appetite for change to the level of audit or assurance that should be applied, and little consensus amongst those who did want to see a greater level of assurance about what it should cover.[15] Therefore, although relatively high costs do not necessarily imply that an option is undesirable, we have found only limited support for implementing the changes described in option 2.

There is little or no support from stakeholders for option 3.

Implementation Plan

We intend to bring forward legislation later in the year which will come into force in April 2013. We are working with the FRC to develop the accompanying guidance.

[15] See the summary of consultation responses at www. bis.gov.uk/assets/biscore/business-law/docs/f/12-588-future-of-narrative-reporting-government-response.pdf.

Post Implementation Review (PIR) Plan

There is a political commitment to review the policy within five years of implementation. This will be proportionate check to ensure that the changes to the narrative reporting framework are having the desired effect.

There is expected to be an evaluation using data on the length and content of company narrative reports examining quality of disclosure. It will also include a scan of stakeholder (principally company, shareholder and NGO) views on the effectiveness of the new framework. The baseline position will be as measured by the recent BIS consultation "The Future of Narrative Reporting". Monitoring information will be provided by routine information collected and analysed on company reporting by BIS, the FRC and others.

Success criteria for the policy include; significant improvement in stakeholder perceptions of the narrative reporting framework. Surveys of the content of narrative reporting show better disclosure of company risks, strategy and business model.

Annex 1 - 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 2 Specific Impact Tests

Statutory Equality Duties - Equality Impact Assessment

Disclosure of information about women on boards and in the company

The draft regulations include a requirement to disclose information about the number of women who are directors of the company, and the number of women in the company as a whole.

This requirement will implement Lord Davies recommendation in his report "Women on Boards" which was published on 24 February 2011[1]. The purpose of this recommendation was to drive up the number of women with top jobs in business. As this report has the support of the Government Equalities Office we do not believe there are any equalities issues from implementing it.

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

Annex 3 – Removals from reporting requirement.

The table below sets out the disclosures which the Government proposes to remove from the current reporting regime.

Topic	**Reference**	**Reason**
Principal activities of the company	Directors' report CA 2006 s. 416 (1) (b) and (2)	This has been consulted on. The Strategic Report will include this as part of the business model.
Information about essential arrangements	Business review CA 2006 s. 417 (5)	Anything of relevance would be covered by a consideration of principal risks.
Asset values	Directors' report S.I. 2008/410 Schedule 7 part 1	This has been consulted on. Already required for companies either by IFRS or UK GAAP, depending on company size and listing.
Charitable donations	Directors' report S.I. 2008/410 Schedule 7 part 1	This has been consulted on.. There is no evidence of continuing conflicts of interest in respect of corporate charitable donations or that this requirement has increased levels of charitable giving from companies.
Acquisition of own shares by private companies	Directors' report S.I. 2008/410 Schedule 7 part 2	This has been consulted on. To remove gold plating of EU 2nd Directive (Article 1.1) which was intended to apply only to public companies.
Policy and practice of payment to creditors	Directors' report S.I. 2008/410 Schedule 7 part 5	This has been consulted on. This does not provide useful information to either creditors or shareholders.