

REPORTING STATEMENT:

OPERATING AND FINANCIAL REVIEW



**ACCOUNTING
STANDARDS
BOARD**

This Reporting Statement is designed as a formulation and development of best practice; it is intended to have persuasive rather than mandatory force and is not an accounting or reporting standard.

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**ACCOUNTING
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REPORTING STATEMENT: OPERATING AND FINANCIAL REVIEW (OFR)

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REPORTING STATEMENT: OPERATING AND FINANCIAL REVIEW (OFR)

INTRODUCTION

1. The Accounting Standards Board (ASB) originally issued the Statement 'Operating and Financial Review' in July 1993. The Statement built on the foundations of existing best practice by providing a framework within which directors could discuss the main factors underlying the company's performance and financial position. The Statement was updated and a revised version issued in January 2003 to reflect later improvements in narrative reporting.
2. Following a recommendation in the final report of the Company Law Review (CLR) Steering Group (2001) and the Government response on the White Paper 'Modernising Company Law' (2002), the Government decided to require quoted companies to prepare and publish OFRs. In May 2004, the Government issued proposals on the detailed implementation of this new requirement in a consultation document 'Draft Regulations on the Operating and Financial Review and Directors' Report'. The consultation document contained draft secondary legislation to implement a new statutory OFR as well as certain provisions of the EU Accounts Modernisation Directive requiring an enhanced review of a company's business (the Business Review) in the directors' report. Following consultation, the final OFR Regulations were passed into law in March 2005, taking effect for financial years beginning on or after 1 April 2005.
3. The Government also gave the ASB a statutory power to make reporting standards for the OFR. In November 2004, the ASB issued Reporting Exposure Draft (RED) 1 'The Operating and Financial Review'. Following

consultation, Reporting Standard (RS) 1 was issued in May 2005.

4. On 28 November 2005, the Chancellor of the Exchequer announced the Government's intention to remove the statutory requirement on quoted companies to publish OFRs, on the grounds that the central requirements of the Business Review are largely identical to those of the statutory OFR and the Government has a general policy not to impose regulatory requirements on UK businesses over and above the relevant EU Directive requirements. Regulations to repeal the requirement for the OFR were laid in December 2005 and came into force on 12 January 2006.
5. The statutory underpinning for RS 1 has been removed as a result of the removal of the statutory requirement for the OFR. As a consequence, RS 1 has now been formally withdrawn and the ASB has 'converted' RS 1 into a statement of best practice on the OFR, which is set out in this document. In preparing this statement, the ASB has sought to limit the changes to those required as a consequence of the repeal of the OFR legislation and to make the language consistent with a voluntary statement of best practice rather than a standard. Given the extensive consultation that took place in developing RS 1, and the need to continue to give entities guidance in preparing OFRs, the ASB is issuing this as a final Reporting Statement, rather than engaging in a further round of consultation.

REPORTING STATEMENT: OPERATING AND FINANCIAL REVIEW (OFR)

SUMMARY

- a. The Reporting Statement is designed as a formulation and development of best practice; it is intended to have persuasive rather than mandatory force. This Statement has been written with quoted companies in mind, but is also applicable to any other entities that purport to prepare an OFR.
- b. The Reporting Statement recommends that directors prepare an OFR addressed to members, setting out their analysis of the business, with a forward-looking orientation in order to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed. The information disclosed in the OFR will also be of relevance to other stakeholders. The OFR should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.
- c. The Reporting Statement sets out a number of other principles regarded as best practice in the preparation of an OFR, namely that the review should: both complement and supplement the financial statements; be comprehensive and understandable; be balanced and neutral; and be comparable over time.
- d. The Reporting Statement sets out the key elements of the disclosure framework that directors should address in an OFR, including details on particular matters that should be disclosed to the extent necessary to meet the objective of the OFR.
- e. Those Key Performance Indicators (KPIs) judged by the directors to be effective in measuring the development,

performance and position of the business of the entity should be disclosed, together with information that should enable members to understand and evaluate each KPI.

- f. The Reporting Statement recommends the inclusion of other measures and evidence to support the information included in the OFR.
- g. The Reporting Statement is accompanied by Implementation Guidance that provides illustrative examples of KPIs that might be disclosed in an OFR, as well as further guidance as to what is envisaged with regard to particular matters.

REPORTING STATEMENT: OPERATING AND FINANCIAL REVIEW (OFR)

OBJECTIVE

1. The objective of this Reporting Statement is to specify the best practice for an OFR, which should be a balanced and comprehensive analysis, consistent with the size and complexity of the business, of:
 - a. the development and performance of the business of the entity during the financial year;
 - b. the position of the entity at the end of the year;
 - c. the main trends and factors underlying the development, performance and position of the business of the entity during the financial year; and
 - d. the main trends and factors which are likely to affect the entity's future development, performance and position,

prepared so as to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed.

SCOPE

2. The Reporting Statement has been written with quoted companies in mind, but is also applicable to any other entities that purport to prepare an OFR.

DEFINITIONS

3. The following terms are used in this Reporting Statement with the meanings specified:

Directors

Reference to either “directors” or “board of directors” within the Reporting Statement is taken to be the entity’s governing body where the entity is not a company.

Key Performance Indicators (KPIs)

KPIs are factors by reference to which the development, performance or position of the business of the entity can be measured effectively. They are quantified measurements that reflect the critical success factors of an entity and disclose progress towards achieving a particular objective or objectives.

Operating and Financial Review (OFR)

An OFR is a narrative explanation, provided in or accompanying the annual report, of the main trends and factors underlying the development, performance and position of an entity during the financial year covered by the financial statements, and those which are likely to affect the entity’s future development, performance and position.

PRINCIPLES

- 4. The OFR should set out an analysis of the business through the eyes of the board of directors.**
5. The OFR should reflect the directors' view of the business. Accordingly, the entity should disclose appropriate elements of information used in managing the entity, including its subsidiary undertakings. Where appropriate, the review may give greater emphasis to those matters which are significant to the entity and its subsidiary undertakings taken as a whole. Such matters may include issues specific to business segments where relevant to the understanding of the business as a whole. Directors should develop the presentation of their OFR in a way that complements the format of their annual report as a whole.
- 6. The OFR should focus on matters that are relevant to the interests of members.**
7. Members' needs are paramount when directors consider what information should be contained in the OFR. Information in the OFR will also be of interest to users other than members, for example other investors, potential investors, creditors, customers, suppliers, employees and society more widely. The directors should consider the extent to which they should report on issues relevant to those other users where, because of those issues influence on the performance of the business and its value, they are also of significance to members. The OFR should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.
- 8. The OFR should have a forward-looking orientation, identifying those trends and factors relevant to the members' assessment of the current and future performance of the business and the**

progress towards the achievement of long-term business objectives.

9. The particular factors discussed should be those that have affected development, performance, and position during the financial year and those which are likely to affect the entity's future development, performance and position.
10. Given the nature of some forward-looking information, in particular elements that cannot be objectively verified but have been made in good faith, directors may want to include a statement in the OFR to treat such elements with caution, explaining the uncertainties underpinning such information.
11. The OFR should comment on the impact on future performance of significant events after the balance sheet date.
12. The OFR should also discuss predictive comments, both positive and negative, made in previous reviews whether or not these have been borne out by events.
13. **The OFR should complement as well as supplement the financial statements, in order to enhance the overall corporate disclosure.**
14. In complementing the financial statements, the OFR should provide useful financial and non-financial information about the business and its performance that is not reported in financial statements but which, the directors' judge, might be relevant to the members' evaluation of past results and assessment of future prospects.
15. In supplementing the financial statements, the OFR should where relevant:
 - provide additional explanations of amounts recorded in the financial statements;

- explain the conditions and events that shaped the information contained in the financial statements.

Where amounts from the financial statements have been adjusted for inclusion in the OFR, that fact should be highlighted and a reconciliation provided.

16. **The OFR should be comprehensive and understandable.**
17. Directors should consider whether the omission of information might reasonably be expected to influence significantly the assessment made by members.
18. The recommendation for the OFR to be comprehensive does not mean that the OFR should cover all possible matters: the objective is quality, not quantity of content. It is neither possible nor desirable for a Reporting Statement to list all the elements that might need to be included, since these will vary depending on the nature and circumstances of the particular business and how the business is run.
19. Directors should consider the evidence underpinning the information to be included in the OFR. Where relevant, directors should explain the source of the information and the degree to which the information is objectively supportable, to allow members to assess the reliability of the information presented for themselves.
20. Directors should consider the key issues to include in the OFR that will provide members with focused and relevant information. The inclusion of too much information may obscure judgements and will not promote understanding. Where additional information is discussed elsewhere in the annual report, or in other reports, cross-referencing to those sources will assist members.

21. The OFR should be written in a clear and readily understandable style.
- 22. The OFR should be balanced and neutral, dealing even-handedly with both good and bad aspects.**
23. The directors should ensure that the OFR retains balance and that members are not misled as a result of the omission of any information on unfavourable aspects.
- 24. The OFR should be comparable over time.**
25. Disclosure should be sufficient for the members to be able to compare the information presented with similar information about the entity for previous financial years. Comparability enables identification of the main trends and factors, and their analysis, over successive financial years. Directors may wish to consider the extent to which the OFR is comparable with reviews prepared by other entities in the same industry or sector.

DISCLOSURE FRAMEWORK

26. Paragraphs 27 to 74 below set out a framework for the disclosures to be provided by directors in an OFR. This framework is not a template, nor should the elements in paragraph 27 be taken as headings that should be included within an OFR. Its purpose is to set out the key content elements that should be addressed within an OFR. It is for directors to consider how best to use the framework to structure the OFR and the precise content, including the level of detail to be disclosed, relating to the key elements, given the particular circumstances of the entity. These circumstances may include:

- a. the industry or industries in which it operates;
- b. the range of products, services or processes it offers;
- c. the number of markets it serves.

27. The OFR should provide information to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed. The key elements of the disclosure framework recommended to achieve this are:

- a. the nature of the business, including a description of the market, competitive and regulatory environment in which the entity operates, and the entity's objectives and strategies;**
- b. the development and performance of the business, both in the financial year under review and in the future;**
- c. the resources, principal risks and uncertainties and relationships that may affect the entity's long-term value; and**

- d. position of the business including a description of the capital structure, treasury policies and objectives and liquidity of the entity, both in the financial year under review and the future.**

Details of particular matters

- 28. To the extent necessary to meet the recommendations set out in paragraph 27 above, the OFR should include information about:**
 - a. environmental matters (including the impact of the business of the entity on the environment);**
 - b. the entity's employees;**
 - c. social and community issues;**
 - d. persons with whom the entity has contractual or other arrangements with are essential to the business of the entity;**
 - e. receipts from, and returns to, members of the entity in respect of shares held by them; and**
 - f. all other matters the directors consider to be relevant.**
- 29. For items (a) to (c) in paragraph 28, the OFR should, in particular, include:**
 - a. the policies of the entity in each area mentioned; and**
 - b. the extent to which those policies have been successfully implemented.**

The nature, objectives and strategies of the business

- 30. The OFR should include a description of the business and the external environment in which it operates as context for the directors' discussion and analysis of performance and financial position.**
31. A description of the business is recommended in order to provide members with an understanding of the industry or industries in which the entity operates, its main products, services, customers, business processes and distribution methods, the structure of the business, and its economic model, including an overview of the main operating facilities and their location.
32. Every entity is affected by its external environment. Depending on the nature of the business, the OFR should include discussion of matters such as the entity's major markets and competitive position within those markets and the significant features of the legal, regulatory, macro-economic and social environment that influence the business. For example, an entity may disclose the fact that it has significant operations in a number of different countries, which could have an impact on the future development and performance of the business.
- 33. The OFR should discuss the objectives of the business to generate or preserve value over the longer-term.**
34. Objectives will often be defined in terms of financial performance; however, objectives in non-financial areas should also be discussed where appropriate.
35. The nature of the industry will affect the directors' determination of an appropriate time perspective for reporting in the OFR. For example, a business that focuses on large long-term projects must carry out its strategic planning over the full project lifecycle, which

may be 20 years or more. Furthermore, where a project has a long-term impact on the environment, this is likely to affect long-term value and should therefore determine the time perspective for reporting in the OFR. By contrast, a service industry with few physical assets and depending on the supply of particular employee skills for its source of competitive advantage, will plan over a period consistent with its ability to recruit, train and develop its staff, which may be much shorter.

36. **The OFR should set out the directors' strategies for achieving the objectives of the business.**
37. Disclosure of the directors' strategies is recommended in order for members to assess the current and past action undertaken by directors in respect of the stated objectives.
38. **To the extent necessary to meet the recommendations set out in paragraph 27 above, the OFR should include the key performance indicators, both financial and, where appropriate, non-financial, used by the directors to assess progress against their stated objectives.**
39. The KPIs disclosed should be those that the directors judge are effective in measuring the delivery of their strategies and managing their business. Regular measurement using KPIs should enable an entity to set and communicate its performance targets and to measure whether it is achieving them.
40. Comparability will be enhanced if the KPIs disclosed are accepted and widely used, either within the industry sector or more generally.
41. **Directors should also consider the extent to which other measures and evidence should be included in the OFR.**

42. These could be narrative evidence describing how the directors manage the business or quantified measures used to monitor the entity's external environment and/or progress towards the achievement of its objectives.

Current and future development and performance

43. **The OFR should describe the significant features of the development and performance of the business in the financial year covered by the financial statements, focusing on those business segments that are relevant to an understanding of the development and performance as a whole.**
44. Trends and factors in development and performance suggested by an analysis of the current and previous financial years should be highlighted. Development and performance should be described in the context of the strategic objectives of the business.
45. The OFR should cover significant aspects of the statements of financial performance and where appropriate should be linked to other aspects of performance.
46. The OFR should set out the directors' analysis of the effect on current development and performance of changes during the financial year in the industry or the external environment in which the business operates and of developments within the business. For example, changes in market conditions could have an impact on the development and performance of the entity during the period, as could the introduction, or announcement, of new products and services.
47. **The OFR should analyse the main trends and factors that directors consider likely to impact future prospects.**

48. The main trends and factors likely to affect the future development and performance will vary according to the nature of the business, but could include the development of known new products and services or the benefits expected from capital investment. The OFR should discuss the current level of investment expenditure together with planned future expenditure and should explain how that investment is directed to assist the achievement of business objectives. Any assumptions underlying the main trends and factors should be disclosed.
49. Directors should consider the potential future significance of issues in deciding whether or not to include an analysis of them in the OFR.

Resources

- 50. The OFR should include a description of the resources available to the entity and how they are managed.**
51. The OFR should set out the key strengths and resources, tangible and intangible, available to the business, which will assist it in the pursuit of its objectives and, in particular, those items that are not reflected in the balance sheet. Depending on the nature of the business, these may include: corporate reputation and brand strength; natural resources; employees; research and development; intellectual capital; licences, patents, copyright and trademarks; and market position.

Principal risks and uncertainties

- 52. The OFR should include a description of the principal risks and uncertainties facing the entity, together with a commentary on the directors' approach to them.**

53. While different industries and entities use different risk models or approaches for identifying and managing risk, all entities face and should disclose strategic, commercial, operational and financial risks where these may significantly affect the entity's strategies and development of the entity's value.
54. The principal risks and uncertainties facing entities will vary according to the nature of the business, although it is expected that some risks, such as reputational risk, will be common to all.
55. The description of the principal risks and uncertainties should cover both the exposure to negative consequences as well as potential opportunities. The directors' policy for managing principal risks should be disclosed.
56. The OFR should cover the principal risks and uncertainties necessary for an understanding of the objectives and strategies of the business, both where they constitute a significant external risk to the entity, and where the entity's impact on other parties through its activities, products or services, affects its performance. Directors should consider the full range of business risks.

Relationships

57. **To the extent necessary to meet the recommendations set out in paragraph 27 above, the OFR should include information about significant relationships with stakeholders other than members, which are likely, directly or indirectly, to influence the performance of the business and its value.**
58. Directors, in deciding what should be included in the OFR, should take a broad view in considering the extent to which the actions of stakeholders other than members can affect an entity's performance and thus its value. For

example, for many entities, relationships with customers, suppliers, employees, contractors, lenders, creditors and regulators will be important, as will the entity's broader impact on society and the communities affected by its activities. Strategic alliances with other entities can also affect the performance of the entity and its value.

- 59. Where necessary for an understanding of the business, the OFR should describe receipts from, and returns to, shareholders in relation to shares held by them. This should include a description of any distributions, capital raising and share repurchases.**

Financial position

- 60. The OFR should contain an analysis of the financial position of the entity.**
61. The analysis, whilst based upon the financial statements, should comment on the events that have impacted the financial position of the entity during the financial year, and future factors that are likely to affect the financial position going forward. The analysis should supplement the disclosures required in accounting standards, in particular those required by FRS 25 (IAS 32) 'Financial Instruments: Disclosure and Presentation' or FRS 29 (IFRS 7) 'Financial Instruments: Disclosures'.
62. The OFR should highlight accounting policies set out in the notes to the financial statements and discuss those accounting policies that are critical to an understanding of the performance and financial position of the entity, focusing on those which have required the particular exercise of judgement in their application and to which the results are most sensitive. In addition, it should draw attention to the accounting policies which have changed during the financial year under review.

63. The OFR should contain a discussion of the capital structure of the entity.

64. This could include the balance between equity and debt, the maturity profile of debt, type of capital instruments used, currency, regulatory capital and interest rate structure. The discussion should include comments on short and longer-term funding plans to support the directors' strategies to achieve the entity's objectives. In addition, the discussion should comment on why the entity has adopted its particular capital structure.

65. The OFR should set out the entity's treasury policies and objectives.

66. The OFR should also discuss the implementation of these policies in the financial year under review.

67. The purpose and effect of major financing transactions undertaken up to the date of approval of the financial statements should be explained. The effect of interest costs on profits and the potential impact of interest rate changes should also be discussed.

Cash flows

68. The OFR should discuss the cash inflows and outflows during the financial year, along with the entity's ability to generate cash, to meet known or probable cash requirements and to fund growth.

69. Any discussion should supplement the information provided in the financial statements by, for example, commenting on any special factors that have influenced cash flows in the financial year and those that may have a significant effect on future cash flows. This could include, for example, the existence and timing of commitments for capital expenditures and other known or probable cash requirements. Where entities have cash that is surplus to future operating requirements and

current levels of distribution, the discussion should include future plans for making use of the excess cash.

70. Although segmental analysis of profit may be indicative of the cash flow generated by each segment, this will not always be so – for example, because of fluctuations in capital expenditure and depreciation. Where segmental cash flows are significantly out of line with segmental revenues or profits, this should be indicated and explained.

Liquidity

- 71. The OFR should discuss the entity's current and prospective liquidity. Where relevant, this should include commentary on the level of borrowings, the seasonality of borrowing requirements (indicated by the peak level of borrowings during that period) and the maturity profile of both borrowings and undrawn committed borrowing facilities.**
72. The discussion on liquidity should discuss the ability of the entity to fund its current and future operations and stated strategies.
73. The discussion should cover internal sources of liquidity, referring to any restrictions on the ability to transfer funds from one part of the group to meet the obligations of another part of the group, where these represent, or might foreseeably come to represent, a significant restraint on the group. Such constraints would include exchange controls and taxation consequences of transfers.
74. Where the entity has entered into covenants in financing contracts which could have the effect of restricting the use of financing arrangements or credit facilities, and negotiations with the lenders on the operation of these covenants are taking place or are expected to take place,

this fact should be indicated in the OFR. Where a breach of a covenant has occurred or is expected to occur, the OFR should give details of the measures taken or proposed to remedy the situation.

KEY PERFORMANCE INDICATORS

75. An entity should provide information that enables members to understand each KPI disclosed in the OFR.

76. For each KPI disclosed in the OFR:

- **the definition and its calculation method should be explained;**
- **its purpose should be explained;**
- **the source of underlying data should be disclosed and, where relevant, assumptions explained;**
- **quantification or commentary on future targets should be provided;**
- **where information from the financial statements has been adjusted for inclusion in the OFR, that fact should be highlighted and a reconciliation provided;**
- **where available, corresponding amount for the financial year immediately preceding the current year should be disclosed; and**
- **any changes to KPIs should be disclosed and the calculation method used compared to previous financial years, including significant changes in the underlying accounting policies adopted in the financial statements, should be identified and explained.**

77. Quantification or commentary on future targets is about communicating the direction the entity is taking by, for example, setting out future strategies and goals.

OTHER PERFORMANCE INDICATORS

78. **Where a quantified measure, other than a KPI, is included, the OFR should disclose:**

- **the definition and its calculation method; and**
- **where available, corresponding amount for the financial year immediately preceding the current year.**

SERIOUSLY PREJUDICIAL

79. **Consistent with existing practice in informing the markets on such matters, no disclosure of information should be made about impending developments or about matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the entity.**

STATEMENT OF COMPLIANCE

80. **As this is a Reporting Statement of voluntary best practice, directors are not required to include in the annual report any formal confirmation that they have complied with this Reporting Statement. That said, as a matter of best practice, the OFR should include a statement as to whether it has been prepared in accordance with this Reporting Statement.**

IMPLEMENTATION GUIDANCE

This guidance accompanies, but is not part of, the Reporting Statement.

INTRODUCTION

- IG1. This Implementation Guidance:
- a. Outlines some suggestions and illustrations of the content recommended to be covered in the OFR with regard to the disclosure framework as set out in paragraph 27 of the Reporting Statement, and related Key Performance Indicators (KPIs) (paragraphs 38 to 40).
 - b. Provides some further “signposting” guidance as to the areas directors should consider with regard to the particular matters identified in paragraph 28 (a)-(e) of the Reporting Statement.

The format used for the illustrative examples of KPIs featured in IG Examples 1-23 should not be taken as a template. Its purpose is simply to demonstrate the information that could be provided for a particular measure. It is not envisaged that the layout presented in the Implementation Guidance will be replicated by an entity preparing an OFR. It is for the directors to consider how best to present the information, perhaps by providing some of the details within in footnotes, or in a separate section of the OFR.

Furthermore, these suggestions are non-exhaustive. Many further KPIs exist within different industries.

In addition, the definitions and other criteria set out in IG Examples 1-23 are illustrative and should not be taken to imply generally accepted definitions or calculations.

CONTENT RELATED TO THE DISCLOSURE FRAMEWORK AND RELATED KPIS

- IG2. The guidance in paragraphs IG11-IG35 suggests possible content envisaged for each element of the disclosure framework, whilst IG Examples 1-23 provide illustrative examples of KPIS and the disclosure recommended under paragraphs 75 and 76 of the Reporting Statement.**
- IG3. Paragraph 27 of the Reporting Statement requires that the OFR should provide the information to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed. To this end, the Reporting Statement provides a disclosure framework which sets out the areas to be considered by directors in preparing their entity's OFR. As acknowledged in the Reporting Statement, it is for directors to consider how best to use the framework to structure the OFR.**
- IG4. Paragraphs 75 and 76 set out the disclosure requirements relating to each KPI, which are dealt with in paragraphs 38 to 40 of the Reporting Statement.**
- IG5. Whilst IG Examples 1-23 are expressed as KPIS, they could also be considered as examples of quantified other measures as set out in paragraphs 41 and 42 of the Reporting Statement. If any of these examples were disclosed as quantified other measures, then the recommended disclosure would only cover the measures definition, its calculation method and the corresponding amount as set out in paragraph 78 of the Reporting Statement.**
- IG6. Other trends and factors monitored by the entity may also be considered quantified other measures, although they would not ever be KPIS as they are outside of the control of the entity. For example, an insurance company might monitor changing demographics as a key trend in the**

external operating environment, due to the impact of demographics on future demand for its products. Accordingly, in such circumstances, quantified demographic information would be included in the OFR as an example of a quantified other measure.

- IG7. Definitions and other criteria set out in IG Examples 1-23 are illustrative and should not be taken to imply generally accepted definitions or calculations. They are simply provided to demonstrate the information that could be provided for a particular measure. It is important that the information provided in the OFR with regard to any KPIs or quantified other measures makes explicit the definition and precise calculation method used by the entity.

PARTICULAR MATTERS

- IG8. **The guidance below includes some background material that might be useful to consider when developing an entity's OFR with regard to the specific "particular matters" set out in paragraph 28 (a)-(e) of the Reporting Statement. In addition, where the management of a particular matter has been identified as being essential to the successful implementation of a stated strategy or could have an effect on the entity's short or long-term value, the guidance provides some illustrations of areas that might be covered.**
- IG9. **Paragraph 28 (a)-(e) of the Reporting Statement requires that, to the extent necessary to meet the requirements set out in paragraph 27 of the Reporting Statement, the OFR should include information about a number of particular matters, e.g. employees, and environment. As explained in paragraph 27 of the Reporting Statement, the OFR should provide the information necessary to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed. Accordingly, where the management of a particular**

matter could significantly affect the entity's ability to successfully implement its strategies or the entity's short or long-term value, that matter should be addressed within the OFR.

- IG10. **Paragraph 28 (a)-(e) contains a non-exhaustive list of topics that directors should consider for inclusion in their OFR to the extent necessary. Accordingly, paragraph 28 (f) provides a further recommendation that directors, to the extent necessary, include within the OFR "all other relevant matters." The directors should consider what other topics also should be included in the OFR, as these will be specific to the entity, its objectives and strategies, as well as dependent on the industry in which it operates.**

Nature, objectives and strategies of the business

- IG11. The Reporting Statement recommends the provision of meaningful contextual information regarding the directors' objectives and strategies, along with a description of the business and its external environment, to assist members to assess the strategies adopted and the potential for those strategies to succeed.
- IG12. Specifically, the OFR should set out the objectives of the business and the directors' strategies for generating or preserving value for members over the long term. A number of economic measures exist that are commonly used by companies in order to assess the company's ability to create value over time, and which are likely to be considered a KPI. These include:
- Return on capital employed.
 - Incremental returns on investments.
 - Economic profit type measures.
 - Organic rates of growth and returns thereon.

IG Example 1: Return on capital employed (ROCE)

As an example of a measure of the creation of value, the recommended disclosure should incorporate the following:

- Definition and calculation: ROCE, measures the profit as a percentage of the total capital employed (invested) in the business.
- Purpose: The company's aim is to increase shareholder value. This is measured by the extent to which this goal has been achieved by using ROCE, as it is a measure of how well the money invested in the business is providing a return to investors.
- Source of underlying data: GAAP financial statement figures as adjusted below.
- Reconciliation of financial statement information:
 - Operating result for calculation of ROCE =**
 - Operating result as per financial statements
 - Plus interest from sales financing
 - Capital employed =**
 - Intangible assets/property, plant and equipment
 - Plus investments
 - Plus accumulated goodwill amortisation
 - Plus inventories
 - Plus trade accounts receivable
 - Plus other assets including prepaid expenses
 - Less non-interesting bearing provisions/liabilities
- Quantified target: 10%.
- Quantified data: 2005 – Consolidated ROCE – 10.4%, 2004 – 10.2%, 2003 – 9.8%.
- No changes have been made to the source of data or calculation methods used.

IG Example 2: “Economic profit”

Economic profit is a further example of a measure that a company might use to quantify the creation of value. The recommended disclosure should incorporate the following:

- Definition and calculation: Economic profit, being a measure of capital adjusted profit. Based upon operating profit after tax, adjusted for one-off items and the cost of capital.
- Purpose: The company’s key objective is to increase shareholder value, which is measured and managed using economic profit.
- Source of underlying data: GAAP financial statement figures as adjusted below.
- Quantified target: Economic profit for 2006 of £200 million, 2005 target was £150 million.
- Reconciliation of financial statement information:
 - Profit after tax and minority interests, excluding goodwill amortisation =**
 - Operating profit after tax and minority interests
 - Plus goodwill amortisation
 - Less tax credit on goodwill
 - Economic profit =**
 - Profit after tax and minority interests, excluding goodwill amortisation
 - Less cost of capital
- Quantified data: 2005 – £160 million, 2004 – £145 million, 2003 – £140 million.
- No changes have been made to the source of data or calculation methods used.

Market positioning

IG13. Directors may also set their long term objectives around market positioning. In such cases, KPIs commonly used by the board, and accordingly included in the OFR might include:

- Market position.
- Market share.

IG Example 3: Market Share

For a company reporting market share as a KPI, the recommended disclosure should incorporate the following:

- Definition and calculation: Market share, being company revenue over estimated market revenue.
- Purpose: To assess how the company is performing in its particular market.
- Source of underlying data: No external verifiable source for market share exists; accordingly data are internal estimates.
- Quantified target: Achieve market share of 25% within 5 years.
- Quantified data: Five year trend data, 2001 – 17%, 2002 – 18%, 2003 – 17%, 2004 – 19%, 2005 – 20%.
- No changes have been made to the source of data or calculation methods used.

Development, performance and position

IG14. The Reporting Statement recommends that the OFR should set out an historical and prospective analysis of the development, performance and position of the company. Whilst a number of the measures used to monitor the development, performance and position of the company may be traditional financial measures, directors often supplement these with other measures common to their industry to monitor their progress towards stated objectives.

IG Example 4: Average revenue per user (customer)

A telecoms company may measure average revenue per user (ARPU) by types of product offerings as a KPI. By doing this, the directors are able to monitor customer buying patterns as this is a key factor that is likely to affect the development of future revenues. Recommended disclosure should incorporate the following information:

- Definition and calculation: Average revenue per user (ARPU) by major product segments, e.g. pre-pay and post-pay customers.
- Purpose: In the mobile network industry, ARPU is one of the key drivers for future revenue growth.
- Source of underlying data: Internal company data.
- Quantified target: To increase ARPU by 15% per annum for pre-pay customers and 5% per annum for post-pay customers.
- Quantified data: ARPU graph showing comparatives and percentage change year on year e.g. Pre-pay 2004 – £121, 2005 – £141, growth of 16.5%, Post-pay 2004 – £503, 2005 – £525, growth of 4.4%.
- No changes have been made to the source of data or calculation methods used.

IG Example 5: Number of subscribers

A pay TV company with an objective of achieving revenue growth may monitor the effectiveness of their actions and progress towards their goal through measuring of the number of subscribers as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Number of subscribers by type of connection, i.e. direct to home (DTH) and cable.
- Purpose: In the pay TV industry, the level of subscribers is the key driver for future revenue growth.
- Source of underlying data: Internal company data.
- Quantified target: To increase the number of subscribers by 10% per annum for each type of connection.
- Quantified data: Table of number of subscribers and percentage increase from year to year e.g. 2005 – DTH 4,532 million, cable 3,241 million, 2004 – DTH 4,013, cable 3,004, growth of 12.9% and 7.9%.
- No changes have been made to the source of data or calculation methods used.

IG Example 6: Sales per square foot

A retail company with an objective of increasing revenues may monitor and measure revenue per square foot as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Average revenue per square foot (£ per week), with square footage measured as store space excluding storage/delivery space, checkout and administrative space.
- Purpose: In the retail industry, sales per square foot is one of the key drivers for future revenue growth.
- Source of underlying data: Internal company data.
- Quantified target: To increase sales per square foot to £20 per square foot/week.
- Quantified data: Graph showing weekly sales per square foot over the past five years, 2005 – £18.53, 2004 – £17.56, 2003 – £16.99, 2002 – £16.04, 2001 – £15.67
- No changes have been made to the source of data or calculation methods used.

IG Example 7: Percentage of revenue from new products

A consumer products company that has a strategy of providing innovation products to its customers may measure and monitor the percentage of revenue from new products as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Percentage of revenue from new products = revenue from those products launched over the past two years over total revenue for the year.
- Purpose: In order to continue to grow in the fast paced market of consumer products, the company needs to ensure that it is continually renewing its product portfolio. One way of measuring success is to look at the percentage of revenue generated by new products.
- Source of underlying data: Internal company data.
- Quantified target: To achieve 35% of revenue from new products per annum.
- Quantified data: Percentage of revenue from new products, 2005 – 37%, 2004 – 33%, 2003 – 36%.
- No changes have been made to the source of data or calculation methods used.

IG Example 8: Number of products sold per customer

In the financial services industry, a company may have an objective to increase margins by increasing the number of products sold to existing customers. Directors may monitor the number of products sold per customer, or “customer penetration” rates as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Customer penetration rates by geographic segment. Penetration rates are measured by taking the number of products sold to each customer on an annual basis.
- Purpose: Increasing customer penetration rates, leads to increased revenues without incurring significant customer handling costs.
- Source of underlying data: Company data from UK and South Africa.
- Quantified target: To increase customer penetration rates to 5.0 products per customer territory.
- Quantified data: Penetration, 2005 – UK 4.3, South Africa 4.9, 2004 – UK 4.5, South Africa 4.5, 2003 – UK 4.0, South Africa 4.1.
- No changes have been made to the source of data or calculation methods used.

IG Example 9: Products in the development pipeline

In the pharmaceutical industry, for example, future revenues may be greatly affected by the launch of new products from the company's product development pipeline. Directors may monitor number of products at each stage of development and the markets/timing for future launches as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Product development pipeline being the key products currently under development, and the stage of development (Phase I, II or III). Phase I initial evaluation, Phase II determination of dose and initial evaluation of efficacy, Phase III large comparative study in patients to establish clinical benefit and safety.
- Purpose: In order to achieve a strategy of continuing growth, the company must have a productive product development pipeline.
- Source of underlying data: Company data.
- Quantified target: To have 5 new products launched annually.
- Quantified data: Phase I – 25 projects, Phase II – 18 projects, Phase III – 12 projects, number of new products launched this year 4. Detailed information for those projects in Phase III and those launched during the year, e.g. name of product, description, projected market launch dates by territory.
- No changes have been made to the source of data or calculation methods used.

IG Example 10: Cost per unit produced

The directors in a utility company may measure costs per unit produced as a KPI in order to monitor progress towards becoming a low cost producer. Recommended disclosure should incorporate the following information:

- Definition and calculation: Exploration and production finding and development unit costs, being costs per £ per boe (E&P F&D costs (£/boe)). Boe means barrel of oil equivalent, which is a standard method of equating oil, gas and natural gas liquids by converting gas and natural gas liquids to oil based on their relative energy contents.
- Purpose: One of the key drivers to strong economic returns is to reduce E&P F&D costs.
- Source of underlying data: Internal company data.
- Quantified target: To be in the top quartile of low cost producers in Europe as compared to benchmarking studies produced by Evaluate Energy for 2004.
- Quantified data: E&P F&D unit costs (£ per boe) graph showing comparatives for three years e.g. 2003 – 3.22, 2004 – 3.20, 2005 – 3.08.
- No changes have been made to the source of data or calculation methods used.

Resources, principal risks and uncertainties and relationships

- IG15. The Reporting Statement recommends that the OFR should set out the resources, principal risks and uncertainties and relationships that may significantly affect the company's short and long-term value. A number of the examples highlighted in the Reporting Statement could be considered either resources, risks or a relationship, or all

three. Key resources of an entity may also be key stakeholders and accordingly lead to risks and uncertainties.

- IG16. The KPIs used by directors will be those used to monitor the effective management of their resources, risks and relationships, as these will be the areas that may significantly affect the company's short and long-term value.

Persons with whom the entity has relations

- IG17. The decisions of those with whom the entity has relations – regulators, customers, suppliers, employees, community and society at large – can affect a company's prospective performance and accordingly its value. For example, in regulated sectors, the risk of non-compliance with regulatory requirements could lead to the loss of a licence to operate. Accordingly the effective management of these relationships could significantly impact on the success of the entity's strategies and affect the long-term value of the entity.
- IG18. The directors should consider whether such relationships could have a significant impact. The directors could do this by seeking the answers to a number of key questions, such as:
- a. How do our customers view the service we provide?
 - b. How do our employees' feel about the entity?
 - c. How do our suppliers view the entity?
 - d. How do our regulators view the entity?
- IG19. For example, in considering the first question above, IG Example 11 provides an illustration of how an entity could measure the customers' relationship with the entity, by measuring "customer churn" rates as a KPI. Ultimately, the selection of appropriate customer measures will depend on

the nature of the business and the strategies adopted by the board.

IG20. Areas of importance relating to employees, the community and society at large, including environmental matters, are addressed in paragraphs IG25-IG33. For other stakeholders with which the entity has relations, such as customers, suppliers, regulators, contractors and pensioners, some areas of interest might be:

- Profile of the stakeholder and nature of the relationship (length of relationship, is it subject to contract, if so when does the contract expire).
- Level of dependency.
- Satisfaction with relationship – feedback results, levels of complaints, fines etc.

IG Example 11: “Customer churn”

In the telecoms industry, future prospects are greatly affected by the number of customers they can retain. Directors may monitor “customer churn” rates by the types of products offered as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Churn rates by geographical market. Churn measured as the percentage of customers who do not renew their contract with the company at the end of the contract, over the total number of customers under that contract type.
- Purpose: Reducing churn rates means there is less pressure to increase customer acquisitions in order to improve revenues. Lower churn rates lead to direct savings in the form of savings in marketing, sales, installation and disconnection costs.
- Source of underlying data: Company data from UK, Germany and France.
- Quantified target: To reduce customer churn by 5% per annum in each territory.
- Quantified data: Churn rate, 2003 – UK 15%, Germany 18%, France 22%, 2002 – UK 14%, Germany 21%, France 25%, 2001 – UK 15%, Germany 24%, France 26%.
- No changes have been made to the source of data or calculation methods used.

Environmental matters

- IG21. Environmental matters, particularly environmental risks and uncertainties, impact to some extent on all businesses, as they can affect investment decisions, consumer behaviour and Government policy. Poor management of energy,

natural resources or waste can affect current performance; failure to plan for a future in which environmental factors are likely to be increasingly significant may risk the long-term future of the business. Proper attention to the environmental impacts of supply chains and products and to regulatory compliance of the company's own operations are both important for a business' public reputation and for its licence to operate.

IG22. Environmental matters cover a very wide range of areas. The matters that will be of concern to a particular entity will vary depending on both the industry in which it operates and the strategies it has adopted. However, some consensus as to the generic environmental concerns facing all companies has been reached*, which might serve as a useful reference point for directors:

- Water use;
- Energy use;
- Waste;
- Climate change, including global warming contribution or emissions management;
- Ozone depleting substances.

IG23. Entities in industries that have a significant environmental footprint may set objectives and adopt strategies to specifically address key environmental risks, as illustrated in IG Examples 12 to 14. For others, whilst the management of environmental risks will impact the company's reputation, monitoring of performance in this area will not be considered a KPI. However, as set out in paragraph 19 of the Reporting Statement, the directors should support

* *UN Conference on Trade and Development (2000) Integrating Environmental and Financial Performance at the Enterprise Level*

the information provided in the OFR with other evidence, for example consumption rates of scarce resources (energy and/or water) if this significantly impacts the entity's reputation, by providing the information recommended in paragraphs 41 and 42 of the Reporting Statement.

IG Example 12: Environmental spillage

A company involved in the transportation of hazardous materials may monitor "significant spills" as a KPI due to the potential impact of a spill on the reputation of the company. Recommended disclosure should incorporate the following information:

- Definition and calculation: Significant spills, being spills exceeding 100,000 litres.
- Purpose: To assess the effectiveness of the management of hazardous waste.
- Source of underlying data: All data from 100% controlled companies, representing 85% of the total group on a revenue basis.
- Quantified target: Reduce significant spills to below 10 per annum within 3 years.
- Quantified data: In 2005 there were 25 significant spills, in 2004 there were 30 spills, all due to leaking tanks.
- No changes have been made to the source of data or calculation methods used.

IG Example 13: CO₂ emissions

A company involved in energy production may monitor CO₂ equivalent emissions due to both potential fines and the impact of growing emissions on the reputation of the company. Recommended disclosure should incorporate the following information:

- Definition and calculation: CO₂ emissions, being on-site greenhouse gas emissions measured in million of tonnes of CO₂ equivalents (CO₂-e)
- Purpose: To assess the effectiveness of the management of the company's impact on greenhouse gas emissions.
- Source of underlying data: Data from 100% controlled companies within Europe and Africa, representing 95% of the company on a revenue basis.
- Quantified target: A 5% annual reduction in CO₂ equivalents
- Quantified data: 2005 CO₂-e 5.7, 2004 6.0, 2003 6.2
- No changes have been made to the source of data or calculation methods used.

IG Example 14: Waste

A retail group that promotes its ‘green credentials’ might monitor waste due to packaging, as this may impact on the reputation of the company. Recommended disclosure should incorporate the following information:

- Definition and calculation: Amount of waste (measured in kg) arising from packaging on each £1,000 of products we sell.
- Purpose: As the retail businesses in the group handle large amounts of packaging for transporting and presenting the goods sold, the group has established processes to minimise packaging waste.
- Source of underlying data: Data from all retail businesses in the group, representing 80% of the company on a revenue basis.
- Quantified target: To reduce the trend of increasing the amount of packaging to at least, or below, the levels in 2000, being 11.1kg packaging waste per £1,000 of sales.
- Quantified data: 2005 13.4, 2004 14.0, 2003 13.8, 2002 12.9, 2001, 12.1
- No changes have been made to the source of data or calculation methods used.

Employees

- IG24. Employees may be a particularly key resource – and accordingly a key risk – for many entities. The strengths of a company’s workforce and the ways it is managed can play a major role in both current and future company performance. Entities will need to be able to recruit and retain the staff they need to achieve their business strategies. Accordingly, the risks and uncertainties associated with the

management of recruitment and retention of staff with the particular skills required for the entity's strategies could have a significant impact on the entity's future development and performance. For example, poor employment relationships can carry the risk of costly litigation, low workforce morale and ultimately affect company reputation. In addition, directors should consider their employment policies and practices and to assess which aspects are relevant to an understanding of the entity. For example, the degree to which the human resources of the entity represent a significant competitive advantage or are critical to a key product, service or process.

IG25. The employee matters that will be of concern to directors will vary from entity to entity, depending on the industry in which the entity operates and the strategies it has adopted.

IG26. In order to assess employee performance and development, the following areas, along with related performance measures, may be helpful:

- Employee health and safety (which could also be considered a “social matter” see paragraph IG30) – details of RIDDOR (Reporting of injuries, diseases and dangerous occurrences regulations 1995), lost days to injury, levels of occupational related diseases in the workforce, compliance levels with working hours directives;
- Recruitment and retention – employee turnover, retention rates, remuneration policies, number of applicants per post, offer/acceptance statistics, levels of skills shortages;
- Training and development – hours spent on training, number of courses taken, leadership/career development;
- Morale/motivation – employee feedback results, absence rates, levels of employee engagement;

- Workforce performance and profile – employee productivity, revenue/profit per employee, diversity (see also IG30), number of professionally qualified employees.
- IG27. IG Examples 15 and 16 provide some illustrations of where entities might set objectives relative to employees and monitor their progress as KPIs. Alternatively, the board may monitor employee measures to assess how effectively the entity is managing its employees' resources, development and performance to ensure that adequate resources are available to the entity, even though these performance measures are not considered KPIs. In such circumstances, it would be appropriate for the OFR to include these performance measures as other evidence, as set out in paragraphs 41 and 42 of the Reporting Statement.

IG Example 15: Employee morale

A professional services company may measure “employee satisfaction” in order to monitor employee morale, as decreasing levels of morale indicate higher levels of leavers in the future. Recommended disclosure should incorporate the following information:

- Definition and calculation: Employee satisfaction on a scale of 1 to 5 where 1 is low and 5 is high.
- Purpose: A professional services company needs to ensure it retains its best and brightest employees in order to properly service clients.
- Source of underlying data: Annual employee surveys in the UK, France and Germany, representing 85% of the total client facing employees.
- Quantified target: For 2006 to achieve a rating of 4.5, with the populations surveyed to cover at least 95% of client facing employees.
- Quantified data: Employee satisfaction graph showing comparatives e.g. 2004 – 4.1 rating, 2005 – 4.4 rating.
- Comparability: The 2004 survey results were based on surveys in the UK and France, representing 65% of total client facing employees.

IG Example 16: Employee health and safety

In an industry such as mining, where the “licence to operate” is based on effectively managing a myriad of issues, including health and safety, the directors may monitor “lost time injury frequency rate” as a KPI. Recommended disclosure should incorporate the following:

- Definition and calculation: Lost time injury frequency rate (LTIFR) – the number of lost-time injuries per million hours worked.
- Purpose: As the industry involves large equipment and working with hazardous materials, safety is a core value and a major priority.
- Source of underlying data: Injury data returns from 100% owned facilities only.
- Quantified target: To reduce LTIFR by 10% per annum.
- Quantified data: LTIFR table showing comparatives e.g. 2004 – 10 injuries/million hours worked, 2005 – 8.4 injuries/million hours worked.
- No changes have been made to the source of data or calculation methods used.

Social and community matters

- IG28. The management of an entity’s social and community matters can affect its reputation and licence to operate in a similar way to the management of environmental matters. Social concerns with regard to product safety, e.g. genetically modified foods, product responsibility, e.g. underage drinking or smoking, and the ethical management of the supply chain are all examples of issues that can significantly impact on the reputation of an entity.

Furthermore, disregard for local community concerns can result in successful opposition to development applications.

IG29. As with the other areas noted under particular matters, the areas that will be of concern to a particular entity will vary depending on both the industry in which it operates and the strategies it has adopted.

IG30. Currently, there is no commonly held definition of social and community matters*, nor is there a common understanding of the generic issues. It is also the case that specific matters within the broad social and community category can change as new issues arise. However, areas that directors might want to consider include:

- Public health issues, such as obesity, perceived safety issues related to high use of mobile phones, smoking;
- Employee health and safety (can also be considered an area under employees, see IG26);
- Social risks existing in the supply chain, for example the use of child labour and payments of “fair wages”;
- Diversity in either the employee (see IG26) or customer base;
- Impact on the local community, for example noise, pollution, transport congestion (these areas could also link to environmental matters);
- Indigenous and human right issues relating to communities local to overseas operations.

IG31. Entities where reputation is a key concern might set objectives and adopt strategies that specifically address key

* As noted in the International Organisation for Standardization (ISO) document 'Working Report on Social Responsibility' (2004), page 67.

social or community concerns, as illustrated in IG Examples 17 and 18. Alternatively, the monitoring of social and community matters may not be considered a KPI, however, directors will still monitor their performance in these areas. In such situations, it would be appropriate for the OFR to include these performance measures, as set out in paragraphs 41 and 42.

IG Example 17: Monitoring of social risks in the supply chain

A company that sources its branded products from overseas could face additional risks relating to stakeholder, in particular customer, concerns around local labour practices. In this situation, a company might have put in place a system to validate and monitor supply chain performance, specifically related to adherence to stated policies. The directors may monitor the extent of the programme and compliance rates as KPIs. Recommended disclosure should incorporate the following:

- Definition and calculation: Number of factories subject to ratings by independent accredited monitors, number of factories in each rating category, where one star signifies numerous severe non-compliance issues and four stars reflects those factories with no non-compliance issues.
- Purpose: Whilst the company has outsourced its supply chain, it wants to reassure customers that it has not outsourced its moral responsibility for the way its products are made. The objective is for all parts of the business – including suppliers – to share a common set of values and live up to them.
- Source of underlying data: Results of assessments made by accredited monitors in the current year.
- Quantified target: To increase the number of suppliers monitored by 20% per annum and reduce non-compliance to below 3%.
- Quantified data: Geographical split (for current year and prior year) of results for overseas suppliers, by Asia, Americas and Europe. Total factories in each of the four rating categories.
- No changes have been made to the source of data or calculation methods used.

IG Example 18: Noise infringements

An airport operator might want to measure the number of noise infringements as a KPI in order to monitor the success of its management of this “licence to operate” and reputational risk issue. Recommended disclosure should incorporate the following information:

- Definition and calculation: Number of noise infringements being the number of aircraft exceeding Department of Transport take-off noise limits.
- Purpose: Our ability to expand any airport is dependent on continuing support from local communities. If we fail to ensure aircraft using our airports comply with local noise limits, we are putting at risk future developments which are necessary given the growth in the airline industry in the country.
- Source of underlying data: Internal company data.
- Quantified target: Reduce noise infringements by 5% per annum.
- Quantified data: Annual noise infringements table showing comparatives, e.g. 2005 – 55, 2004 – 57, 2003 – 60, 2002 – 64, 2001 – 63.
- No changes have been made to the source of data or calculation methods used.

Receipts from, and returns to, shareholders

- IG32. Paragraph 59 of the Reporting Statement recommends that the OFR should include information relating to receipts from, and returns to, shareholders. This would include details of, and the rationale behind, any of the following:

1. Receipts from shareholders resulting from capital raising activities;
2. Distribution via dividends or special dividends;
3. Return of capital by means of share repurchases and share reconstructions.

Other resources

IG33. Paragraph 50 of the Reporting Statement recommends that the OFR should include a description of the resources available to the entity and how they are managed. In addition to employee and customers already featured in IG Examples 11 to 13, other resources could include areas such as corporate reputation and brand strength; the condition of infrastructure; research and development; intellectual capital; licenses, patents, copyright and trademarks; market position and reserves of natural resources, as illustrated in IG Example 19.

IG Example 19: Reserves

In an extractive industry, future revenues are greatly affected by the reserves controlled by the company. Accordingly, proven and probable reserves may be monitored by the directors as a KPI. Recommended disclosure should incorporate the following:

- Definition and calculation: Reserves are defined as those quantities of petroleum which are anticipated to be commercially recoverable from known accumulations from a given date forward. Reserves are reported net of the gas required for processing and transportation to the customer. The reporting process is in line with reserves definitions and resource classification systems published by the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC).
- Purpose: The most critical driver of growth of any oil and gas company is reserve replacement.
- Source of underlying data: Internal company data reviewed by an independent expert (who should be named, along with professional qualifications).
- Target: To replace current year's sales volume through reserve growth in the year.
- Quantified data:
Proven at end of 2004 = 316, less production 57, add revisions 27, add exploration additions 41, Proven at end of 2005 = 327.
Proven and probable at end of 2004 = 724, less production 57, add revisions -4, add exploration additions 69, Proven and probable at end of 2005 = 732.
- No changes have been made to the source of data or calculations methods used.

Other business risks

- IG34. As set out in paragraph 52 of the Reporting Statement, the OFR should include a description of the principal risks and uncertainties facing the entity, together with a commentary on the directors' approach to them. In addition to risks related to environmental, social and community matters addressed in IG Examples 12 to 14, and 17 and 18, other risks might arise due to the external environment, dependencies on others, and the management of resources, both non-financial and financial, as illustrated in IG Examples 20 and 21.

IG Example 20: Market risk

A bank might measure market risks arising from uncertainty about changes in market prices and rates, such as interest rates, equity prices, exchange rates, commodity prices) by using “value-at-risk” approaches as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Value-at-risk (VaR) uses a Monte Carlo simulation process. Volatilities and correlations of market parameters are observed over the most recent twelve-month period and used on an unweighted basis. The VaR estimates are made at a 99% confidence level for a one-day time horizon.
- Purpose: Tracking the daily VaR allows the bank to derive a quantitative measure of market risk in order to monitor the risk profile it has taken on related to all market risk areas.
- Source of underlying data: VaR of trading units in the UK and of the units responsible for management of interest rate and foreign exchange risks of non-trading units.
- Target: The goal is not to exceed the limit set by the VaR calculation on any day of trading during any year.
- Quantified data: VaR histogram, showing the number of days VaR was at certain levels.
- No changes have been made to the source of data or calculation methods used.

IG Example 21: Business Continuity Management

A company providing computer services may monitor its compliance with business continuity plans. Recommended disclosure should incorporate the following information:

- Definition and calculation: Number of business units in each rating category, where an 'Pass' rating signifies full compliance with stated business continuity plans, whilst 'Fail' rating signifies numerous non-compliance issues.
- Purpose: As the provider of computer services, the company wishes to provide assurance of their ability to withstand events that would interrupt the provisions of such services.
- Source of underlying data: Data from all business units within the company.
- Quantified target: To achieve full compliance with stated business continuity plans, ie nil 'fail' ratings.
- Quantified data: 2005 98% Pass, 2% Fail, 2004 95% Pass, 5% Fail, 2003 93% Pass, 7% Fail.
- No changes have been made to the source of data or calculation methods used.

Financial position

- IG35. The Reporting Statement recommends that the OFR should set out an analysis of the position of the entity both in the financial year and the future, including a description of the capital structure, treasury policies and objectives, and liquidity of the entity. Whilst a number of the measures used to monitor the position of the company may be traditional financial measures, directors often supplement these with other measures common to their industry to monitor their progress towards stated objectives. Such disclosures may include sensitivity analysis in respect of financial instrument disclosures.

IG Example 22: “Economic capital”

The directors of a financial institution may measure economic capital, in addition to regulatory capital, as a risk management tool and to monitor risk positions in individual business units. Recommended disclosure should incorporate the following information:

- Definition and calculation: Economic capital is the amount of capital that a transaction or business unit requires in order to support the economic risks it creates. A 99.95% confidence interval and a one-year time horizon are used to calculate economic capital. The economic capital calculation is subdivided into five distinct risk types: credit risk, market risk, transfer risk, business risk and operational risk.
- Purpose: The directors measure economic capital in order to monitor the efficient use of group’s capital base.
- Source of underlying data: Internal company data.
- Quantified data: Economic capital for each business unit, reconciling to total economic capital for 2004 and 2005.
- No changes have been made to the source of data or calculation methods used.

IG Example 23: Cash conversion rate

To supplement the cash flow information provided in the financial statements, directors may measure operating profit cash conversion rates as a KPI. Recommended disclosure should incorporate the following information:

- Definition and calculation: Cash conversion rate being cash flow from operations as a percentage of operating profit.
- Purpose: One of the key drivers to strong economic returns is the ability to convert operating profits into cash.
- Source of underlying data: Internal company data.
- Quantified target: A minimum target of 85% cash conversion for any year.
- Quantified data: Cash conversion 2001 – 74%, 2002 – 101%, 2003 – 92%, 2004 – 85%, 2005 – 92%.
- No changes have been made to the source of data or calculation methods used.

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