

Operating and Financial Review

Give yourself a head start*

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Give yourself a head start

“For those who embrace the spirit of the new regulations rather than the letter of the law, the opportunity exists to use them as a basis for creating real competitive advantage.”

Company executives often bemoan the fact that they barely have time to actually run their business due to the ever-increasing mountain of regulatory and legislative demands being made of them. Under such pressure, it is not surprising that companies often adopt a narrow compliance-based response to these demands. However, the new Operating and Financial Review (“OFR”¹) is actually focused as much on how businesses are run, as on reporting. For those who embrace the spirit of the new regulations, rather than the letter of the law, the opportunity exists to use them as a basis for creating real competitive advantage.

The OFR offers a mechanism to support the creation of a more commercially attractive and differentiated picture of the business which can lead to better investor understanding and improved stakeholder relationships. Furthermore, the underlying process necessary to produce an OFR can also enhance Board effectiveness and improve governance.

Forward-looking companies are already seeking ways to turn a mandatory requirement from a burden into an opportunity by going beyond mere compliance. However, if these opportunities are not grasped and the process is not planned adequately, businesses run the risk of damaging

their reputation among stakeholders, their market rating and ultimately their competitive positioning; never mind the risk of legal and regulatory challenges.

So how can executives identify and maximise the opportunity the OFR provides while ensuring the risks are managed? At PricewaterhouseCoopers, we have used our expertise to create this essential guide to preparing the OFR in order to help executives meet this challenge and enable them to generate the benefits. The task of realising the opportunities needs time and effort, but our 10 point plan (see pages 12-18) provides clear guidance on where this should be directed.

The OFR is coming and the sooner companies start to prepare for it, the better positioned they will be to avoid the pitfalls and reap the benefits – act now and the benefits are there for the taking!

More of the same? Far from it

How the regulations differ from existing practice

The Operating and Financial Review has been around for many years. The Accounting Standards Board (“ASB”) issued its first statement on the Operating and Financial Review in 1993, and two-thirds of listed UK companies already prepare something they refer to as an ‘Operating and Financial Review’.

However, you would be wrong to think the Government’s new initiative to improve companies’ reporting to shareholders represents a minor amendment to existing practice. The reality of the new regulations are that they will, over time, extend the scope, transparency and content of corporate reporting and in doing so will challenge the quality, reliability and availability of information provided by companies’ internal management systems.

Why the regulations represent more than a minor amendment to existing practice

- For the first time an OFR will be mandatory for all quoted companies
- It demands greater transparency on the information needed by investors to assess the strategies adopted by a company and the potential for those strategies to succeed
- All of the risks, resources and relationships important to successfully implement strategies and achieve goals and objectives need to be explained
- It requires not only historical analysis, but an explanation of the main trends and factors likely to impact future performance
- Directors will be required to exercise judgement to determine what information is important – a mere checklist will not suffice
- Directors will be required to communicate financial and non-financial Key Performance Indicators (KPIs) and other measures, as appropriate, consistently year on year

The new regulations will require companies to reveal just what information Directors rely on to manage their business. Some of this information may already be reported, but not necessarily in the annual report, whilst other information may currently be used internally, but not reported. If this is the case, Directors will need to assess whether the information is considered robust enough to disclose publicly. At the extreme, a review of the information-set available to understand strategic progress may highlight information that is missing. In this situation, Directors will need to consider how to close the information gap(s) that exist and how to improve the nature and quality of information used to manage the business.

The Operating and Financial Review in a nutshell

A summary of the new regulations

The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005 introduces a new requirement for Directors of quoted companies to prepare an OFR for financial years beginning on, or after, 1 April 2005.

The Government has determined that this statutory requirement should be supported by a reporting standard ("RS1") issued by the ASB. Companies that are compliant with RS1 will be presumed to be compliant with the corresponding requirements of the regulations. Directors will be required to state in the annual report whether the OFR has been prepared in accordance with RS1 and explain any departures. Auditors will be required to state in the auditors' report whether, in their opinion: the OFR is consistent with a company's accounts; and any other matters that have come to their attention in the performance of their functions as auditors of the company are inconsistent with information in the OFR.

Objective of the OFR

The key objective of the OFR, as set out in the regulations, and reinforced in RS1, is to provide "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 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."

Principles of the OFR

Unlike traditional financial reporting standards, RS1 does not represent an accounting technical challenge. There are no hard and fast rules for what information a company must include in its OFR. Companies can only make this decision on the basis of their own unique business dynamics and those of the industry sectors in which they operate. However, RS1 does set out seven key principles which should be applied by companies when they are preparing an OFR.

The OFR shall:

1. "set out an analysis of the business through the eyes of the Board of Directors
2. focus on matters that are relevant to the interests of investors

3. have a forward-looking orientation, identifying those trends and factors relevant to the investors' assessment of the current and future performance of the business and the progress towards the achievement of long-term business objectives
4. complement as well as supplement the financial statements, in order to enhance the overall corporate disclosure
5. be comprehensive and understandable
6. be balanced and neutral, dealing even-handedly with both good and bad aspects
7. be comparable over time"

Disclosure Framework

To assist companies, RS1 also sets out a Disclosure Framework (see Exhibit 1) for Directors to apply in order to meet the requirements of the regulations and which may assist them to structure the information more effectively. It emphasises that Directors' judgement should be used in "determining how best to use this framework" when structuring the OFR

and considering the level of detail required as it will depend on the "particular circumstances of the entity".

The framework set out below builds on the one featured in RS1 to create a more logical flow:

Exhibit 1: Disclosure Framework

The nature, objectives and strategies of the business	Resources, risks and uncertainties, and relationships	Current and future development of performance	Financial position
<p>Description of business and external environment</p> <p>Objectives to generate or preserve value over the longer term</p> <p>Strategies for achieving the objectives</p>	<p>Description of resources, tangible and intangible, available and how they are managed</p> <p>Description of principal risks and uncertainties and the Directors' approach to them</p> <p>Information about significant relationships with stakeholders other than investors who may directly impact performance</p>	<p>Significant features of the development and performance of the business</p> <p>Main trends and factors likely to impact future performance</p>	<p>An analysis of the financial position and critical accounting policies</p> <p>Discussion of the capital structure</p> <p>Discussion of the treasury policies and objectives</p> <p>Discussion of the cash inflows and outflows, ability to generate cash to meet commitments and fund growth</p> <p>Discussion of current and prospective liquidity</p>
<p>Underpinned by the financial and non-financial KPIs used to assess progress against stated objectives, as well as other measures and evidence</p>			

Companies will get out what they put in

The risk of ignoring the regulations, the benefits of embracing them

While the new regulations will not apply to annual reports for another year, many companies already provide an OFR-type section in their annual report. Furthermore, by requiring management to provide information routinely used to manage their business, the regulations imply that the information should already be available. Surely with all the other reporting pressures placed upon companies, Directors will not have to consider the implications of the new regulations for another year? The risks and benefits outlined below suggest they will.

Risks

The OFR raises many risks for the Directors of any company. Nevertheless the greatest of these risks lies in failing to plan and respond to the regulations – resulting in long-term damage to the company's investor relations, its reputation among stakeholders, its level of public trust, its market rating and ultimately its competitive positioning.

Information gaps may be identified too late in the process

Consideration of the content at the last minute may highlight information gaps which cannot be addressed in the time available. Even if the content of a company's OFR is comprehensive, it may have the effect of highlighting strategic and operational weaknesses in its business which could have been identified, and actions taken to address them, earlier in the process.

Competitors may achieve first mover advantage

The OFR will open up new areas of corporate reputation to scrutiny and debate. Failure to paint a convincing picture on this broad canvas will expose companies to unjustified comparisons and difficult questions from investors and other groups who monitor business performance on behalf of society. If competitors gain first mover advantage they will be able to help shape the

information demanded by these investors and other groups. Companies will then be encouraged, if not forced, to provide similar information, regardless of whether it is appropriate to their business model.

Regulatory challenge

Directors may risk legal or regulatory challenges if their OFR appears factually wrong, or contains an opinion that no reasonable Board could have formed. The Financial Reporting Review Panel, which has regulatory responsibility for overseeing the quality and compliance of company reports, will start to look at the content of OFRs for financial years starting on, or after, 1 April 2006.

Benefits

While the OFR brings a number of risks there are also benefits for those companies who truly embrace the spirit, and not just the letter, of the new regulations in a timely fashion.

Enhanced business understanding, improved governance and Board effectiveness

The OFR process can provide an opportunity for Boards to question the depth and breadth of information they use and, as a result, assess whether the limited time available in Board meetings is being focused on the right issues. How many Boards routinely receive lead performance indicators that go beyond traditional financial numbers and how much time is devoted to strategy and activities critical to value creation? Over time, the OFR will provide Directors with a more comprehensive picture of corporate performance, which will provide new insights into the health and sustainability of the business.

Enhanced investor understanding and improved relationships with key stakeholders

A company with an effective OFR will give investors and other stakeholders deeper and clearer insights into what really drives value in its business, and demonstrate clearly why its chosen strategy is the right one to take the business forward. Among other advantages this will enable it to improve its reputation and market rating, lower

its cost of capital, and attract and retain the best talent.

Aligned reporting and communication strategy

Corporate reporting is going through a period of unprecedented change. As reported earnings become more volatile under International Financial Reporting Standards, corporate governance guidelines become more extensive, and socially-responsible investment indices become more challenging, the discipline of the OFR offers Directors a common framework for articulating underlying corporate performance.

Internally the OFR provides companies with an opportunity to reassess the practical aspects of how information is channelled into the outside world both in terms of the messages being given, but also the costs incurred by various groups (from corporate communications, investor relations, environmental and social reporting, employee communications etc).

What are the challenges?

The key implementation challenges companies will face

The introduction of the OFR regulations has implications both internally and externally for companies.

Internally, the disclosures required by the OFR will necessitate that companies challenge the degree to which they have robust and timely processes capable of collecting, validating and reporting a wide variety of information on a timely basis, some of which may not have been collated, or reported externally before.

Externally, it will shift the relationship with shareholders and other stakeholders onto an entirely new footing – one in which the transparency and credibility of the business's strategy as expressed through the OFR will become a key competitive differentiator.

A cohesive team

Do you know which “information owners” should have input into the OFR?

The annual report has traditionally been the domain of the CFO and finance team. Given the breadth of information encouraged by the OFR regulations, it will now require the input of a number of other key individuals and teams to make it happen. From those involved in strategy, to those involved in human resources, R&D, customers, brands and marketing and the environment.

The challenge for Directors will be to connect these various “information owners” with potentially competing agendas and to manage their expectations as the overall structure and content of the OFR is developed and finalised. Only in this way will a fully integrated and coherent OFR be produced.

Meeting investor needs

Do you understand what information your investors need?

Directors will need to exercise much greater judgement than historically to determine what information investors need to assess the strategies adopted and the potential for those strategies to succeed. They will also need to consider the extent to which issues relevant to other stakeholders (such as: customers; suppliers; employees; and the wider society) are also of significance to investors, because of their influence on performance and value creation.

But what exactly are the needs of investors and the issues affecting other stakeholders? Have they been asked? Understanding their reaction to the last analyst presentation may not be enough. Do competitors have a better understanding of, and response to, these needs or issues? It is vital that Directors understand from the outset what investor needs are if they are to be appropriately addressed and peers aren't given the opportunity to steal a march and extract competitive advantage.

“The regulations aren’t just about transparency, they are as much about the effectiveness of the Board”

FTSE 100 Finance Director

A picture of sustainable value

Do you understand what actions drive sustainable value in your business and can you articulate this?

For the first time Directors will be required to identify, quantify and report publicly on the areas of their business which drive sustainable value – both financial and non-financial. This presents the challenge of whether companies truly understand how the effective management of their risks, resources and relationships (e.g. employees) actually creates value in their business and whether they can articulate this?

Directors will have to consider, ‘to the extent necessary’, what information relating to key relationships (e.g. customers and suppliers), brands, innovation, employees,

suppliers and social and environmental issues are important in evaluating strategy and performance. Furthermore, they will need to consider whether robust, quantifiable financial and non-financial KPIs, or other measures, are available to support assertions made in respect of this information.

A review of the internal information-set may identify gaps in the information available for disclosure. Companies will need to consider the extent to which the gaps need addressing in order to present a coherent picture of sustainable value.

Information used to manage the business

Are you comfortable enough with the robustness of the information to place it in the public domain?

Most companies will already have systems and procedures in place to produce information which enables Directors to determine and manage the risks to achieving strategic success, and to assess and challenge performance against strategic objectives. But, critically, some of this information may have never been reported externally before.

a) How relevant?

The appropriate areas to be covered may differ for every industry and for each company within an industry. The ability for a generic template to be developed which Directors may usefully apply as an input into their OFR development process will therefore be limited to an industry-level at best. Accordingly Directors may consider meeting with competitors to form consortia to help develop and define appropriate industry KPIs and agree on how information should be reported.

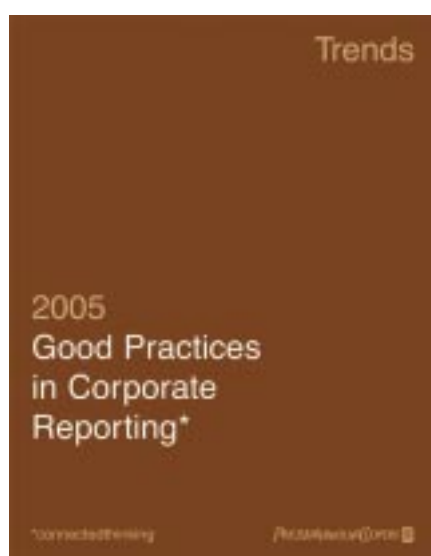
Other guidance on what to report and how best to structure it may be sought from examples of good reporting practice from companies in the same industry, or indeed, other industries (see Exhibit 2).

b) How reliable?

Directors will have to decide whether they feel comfortable enough with the reliability of the information to place it in the public domain. The information presented in accordance with RS1 should be the information that Directors use to manage their business. Accordingly, what gets reported externally will need to be the output of a formalised process, both in the determination of the shape and nature of the content and in the actual production of the information itself. Directors will therefore need to consider whether, or not, the information to be disclosed is derived from established management processes and whether, or not, this information is sufficiently reliable and has been subject to adequate controls, Board scrutiny and governance.

Clearly, in determining what information to report there may need to be a trade-off between relevance and reliability.

Exhibit 2: Trends 2005: Good Practices in Corporate Reporting



UK listed companies anticipating the preparation of their first mandatory OFR face a tough challenge: they must transform regulatory requirements into useful reports, with little direction as to what good reporting under these new requirements might look like.

Trends 2005: Good Practices in Corporate Reporting (Trends 2005) is intended as a guide and source of inspiration for all preparers of corporate reports. It is a compendium of good practice reporting examples from forward-thinking companies that appear to have recognised the value and competitive advantage to be gained from improved communication of both financial and non-financial information.

The good practice examples featured in *Trends 2005* are structured around the PricewaterhouseCoopers Value Reporting Framework (see Exhibit 3 on page 18), which is the codification of nearly a decade of

capital markets research into the information needs of management and investors. Drawn from 42 companies worldwide, the publication outlines in detail some of the companies that are already embracing demands for greater transparency.

The examples featured illustrate how companies can provide a linkage in their reporting between the external marketplace, strategies adopted to compete in that market, how the risks, resources and relationships are managed to deliver on these strategies and ultimately the resulting financial and operational performance. Precisely the outcome that the OFR is trying to achieve.

“If you can’t positively respond to the OFR regulations, you don’t deserve to be in business”

FTSE 100 Non-executive Director

Structure and coherence

Have you considered the impact of the OFR on the overall structure and content of your annual report?

Current reporting of strategy is not something many companies typically do well. When reporting is extended to an explanation of all the risks, resources and relationships that are critical to the successful implementation of business strategies and achievement of stated goals and objectives, there are even fewer examples of good practice.

The information required by the OFR challenges the traditional structure of an annual report. At present most annual reports focus on reviewing historical financial performance within their OFR, and cover information on strategy, and the risks, resources and relationships necessary to successfully implement the strategy in varying degrees of detail elsewhere, such as in the Chairman/CEO

statement. Much of this information, however, will now fall under the requirements of the OFR.

Directors will therefore have to consider how transparent they wish to be and what format the front of their annual report takes. Do the Chairman and CEO continue to produce their statements separately from the OFR, potentially leading to excessive repetition, or will the whole of the front end of the annual report, excluding the remuneration and corporate governance reports, become known as an OFR?

Alignment and corporate consistency

Is your communication strategy fully integrated?

As Directors reflect on the depth and breadth of information that might be included within their OFR and how it should be structured, they may identify that much of the information is already reported elsewhere; whether it be on the web site, in corporate responsibility reports or analyst/investor briefings.

Whilst not all information presented through these other media will be entirely relevant for the OFR, the presentation of a broader information set may provide Directors with an opportunity for a review of their wider reporting and communication strategy.

The content in these other media used to communicate with a wider group of stakeholders may need to be reassessed for on-going relevance, in the light of the OFR. Where information reported in the OFR continues to be presented through other channels there will be a need to ensure overall consistency of message.

What should companies be doing now?

10 key steps

to a successful
implementation
of the regulations

- 1 Adopt the right mindset
- 2 Obtain Board sponsorship and buy-in
- 3 Develop a picture of possible content
- 4 Build a blueprint report
- 5 Benchmark the blueprint
- 6 Identify the information gaps
- 7 Assess adequacy of supporting systems and procedures
- 8 Determine the level of accuracy and reliability
- 9 Create cohesion and clarity
- 10 Develop an implementation plan

As with any regulatory change, there is a temptation to wait until the OFR is upon us before responding. The challenges, risks and benefits outlined earlier should persuade companies that delaying their response could well be a serious error – not least because the OFR involves not just the way information is reported, but its reliability and the quality of the processes and controls supporting it.

Set out below are 10 key steps that Directors may practically undertake over the coming months to successfully implement the OFR regulations while avoiding the pitfalls.

1 Adopt the right mindset

The first step lies in adopting what we have termed an 'OFR mindset' – one that is quite distinct from the compliance-based approach usually taken with traditional financial reporting.

The OFR mindset has three major components. It involves seeking out, ensuring there is sufficient comfort over the reliability of, and reporting information that is:

- seen through the eyes of the Board of Directors
- focused on matters that are important for investors
- forward-looking in its implications for the business

This approach, when applied consistently across all areas of the business, will enable companies to produce an OFR that fulfils the fundamental requirements.

Companies will also need to consider the degree to which they respond to the OFR regulations. Will they be a leader, a follower, or simply take the middle ground? Given the risks and benefits highlighted earlier this is not a decision which should be taken lightly. The answer will not negate the need to follow the steps set out below, but it will impact the degree to which they are followed.

2 Obtain Board sponsorship and buy-in

Meeting the requirements of the OFR needs to be treated as a project in its own right, with sponsorship from a member of the Board and ownership clearly taken by the Board or a Board sub-committee. Whoever takes responsibility will need to oversee a planned and transparent process.

A first step should be to nominate an individual with responsibility for understanding the implications of the new regulations and for coordinating the OFR's development. This individual should then brief the Board on what the implications are for their company.

It will also be important at this stage to identify the relevant "information owners" who may be required to contribute to the OFR. Some individuals may not have contributed to the OFR, or worked together, before, some may have alternative agendas. It is therefore important that this individual should be of sufficient authority to manage the variety of influences and personalities which may exist among the contributors.

The breadth of the OFR will also require a new approach at Board level if an integrated response to issues is to be generated. Directors will need to access a broad range of skills and knowledge in order to filter and challenge every item of information, not just for its accuracy, but also for its relevance to their own decision-making and value creation. At the outset, the Board should determine whether they have the appropriate skill set, or whether they will need to obtain it from elsewhere (e.g. cross-functional advisory panels or external parties).

It is critical at this stage that Directors debate and agree what it is they are trying to achieve, their expectations for the OFR, their level of ambition and how transparent they wish to be. Furthermore they need to express their views on the importance and relevance of information, financial and non-financial, up front so as to avoid wasted time and effort.

3 Develop a picture of possible content

Having formed a view on the level of ambition, Directors should apply RS1's disclosure framework (see Exhibit 1, on page 5) as a basis for developing a broad picture of possible content for the OFR. However, it will need to be tailored to reflect the unique dynamics of the company's industry and business. A number of sources of information internally may be applied in building this broad picture, including the corporate risk matrix, stakeholder surveys, monthly Board reports, analyst presentations and corporate responsibility report.

Having created this picture, it may be necessary to question again whether the right individuals are involved in the development of the OFR.

4 Build a blueprint report

Having built a skeletal picture of the information which may be included within an OFR, the next step is to calibrate the content by applying a strategy filter to determine what information is critical to assess the existing strategy and the potential for that strategy to succeed. This filtered picture should then act as the blueprint against which the content of the OFR being developed should be constantly compared and challenged.

The blueprint should not be a static tool, but something which can be flexed to accommodate changes in companies' circumstances and developments in the availability of internal information.

5 Benchmark the blueprint

The blueprint should now be compared against the information currently reported externally. In performing such a comparison Directors should take into account all mediums of communication used to report information internally and externally, including web site, corporate responsibility report, investor/analyst briefings and marketing publications.

In building up a comprehensive picture of current reporting, consideration should also be given to assessing where companies stand in relation to

competitors, industry norms and good practice (see Exhibit 2 on page 10) and the extent to which they wish to align themselves with these benchmarks.

Directors may also find it beneficial to challenge the contents of the blueprint against an objective reporting framework, such as Kaplan and Norton's Balanced Scorecard or PricewaterhouseCoopers industry-tailored ValueReporting framework (see Exhibit 3 on page 18), for completeness.

6 Identify the information gaps

An output from the benchmarking exercise should be an analysis of the gaps between current reporting, competitors and the information set required for the OFR. Some gaps may simply point to information which is available, but not reported. Other gaps may relate to more fundamental issues such as data quality, or where information is simply not produced within the existing systems

or consistently across business units. This is considered further below.

Creating a gap analysis will be very revealing and should provide the basis for developing an implementation plan for both the short and the medium term. It is critically important to remember the development of the OFR is an evolutionary process, not one of immediate revolution.

7 Assess adequacy of supporting systems and procedures

Once the blueprint has been developed, an assessment of the supporting systems and procedures should be undertaken to determine whether they can provide the relevant information and whether it is sufficiently robust to achieve Board comfort and publish externally. A useful first step is to start at the top of the organisation and consider the scope, and nature, of the information being presented to the Board in routine meetings, and the degree of process, control and assurance applied to it in its journey up the organisation.

Where this analysis highlights shortcomings consideration should be given to the actions which are necessary to remedy the situation, ranging from rethinking the Board agenda, to establishing robust and reliable systems and controls.

Questions which Directors may like to consider include:

- Is standard group-wide information available?
- What degree of segmental information will have to be provided to make the data meaningful?
- Are systems in place to gather financial and non-financial information?
- Are there appropriate KPIs and other measures to support all strategic drivers and are they consistently calculated?
- Is both qualitative and quantitative information available and is it sufficiently developed?
- Is there sufficient transparency in areas of judgement?
- Who is routinely challenging and vetting the information?

8 Determine the level of accuracy and reliability

Directors must determine the level of accuracy and reliability they wish to achieve for the information to be included within the OFR. This may vary depending on the strategic importance, nature, or source of the different information provided. In forming a view, Directors must balance the risk of publishing valuable information, which may be difficult to obtain with complete accuracy, with remaining silent.

Factors to consider include:

- whether the data is routinely used in the management of the business and is subject to sufficient challenge and validation

- whether a greater level of assurance is required for non-system generated information/data (e.g. spreadsheets or stand-alone analyses)
- whether external sources of data can be used and referred to, to support the overall picture of performance
- the degree to which some information necessitates the involvement of internal audit or independent third party assurance

In reaching a decision it will also be important to consider the margin of error Directors are willing to accept and to what extent that might differ depending on the nature of the information reported.

9 Create cohesion and clarity

The introduction of the OFR provides a real opportunity for Directors to consider what impact it will have on the existing structure of the annual report. Will the historical format used allow for the effective communication of the company's strategy, management activity and performance? Or will it simply result in excessive repetition, increased length and an unclear story?

Two extremes which Directors might consider are:

- use the traditional format of Chairman's/CEO statement and financial review but wrap the whole front end of the report under the umbrella of the OFR

- radically restructure the front end of the report around a logical framework which helps to tell a coherent and clear story

Each has their pros and cons, but RS1 cannot provide any guidance on what format is most appropriate. We strongly believe, however, that the report should be personalised and that this can be achieved without necessarily following the traditional model. The approach taken will ultimately depend on the culture of each company, the depth and breadth of information available and above all, the leadership provided by the Board.

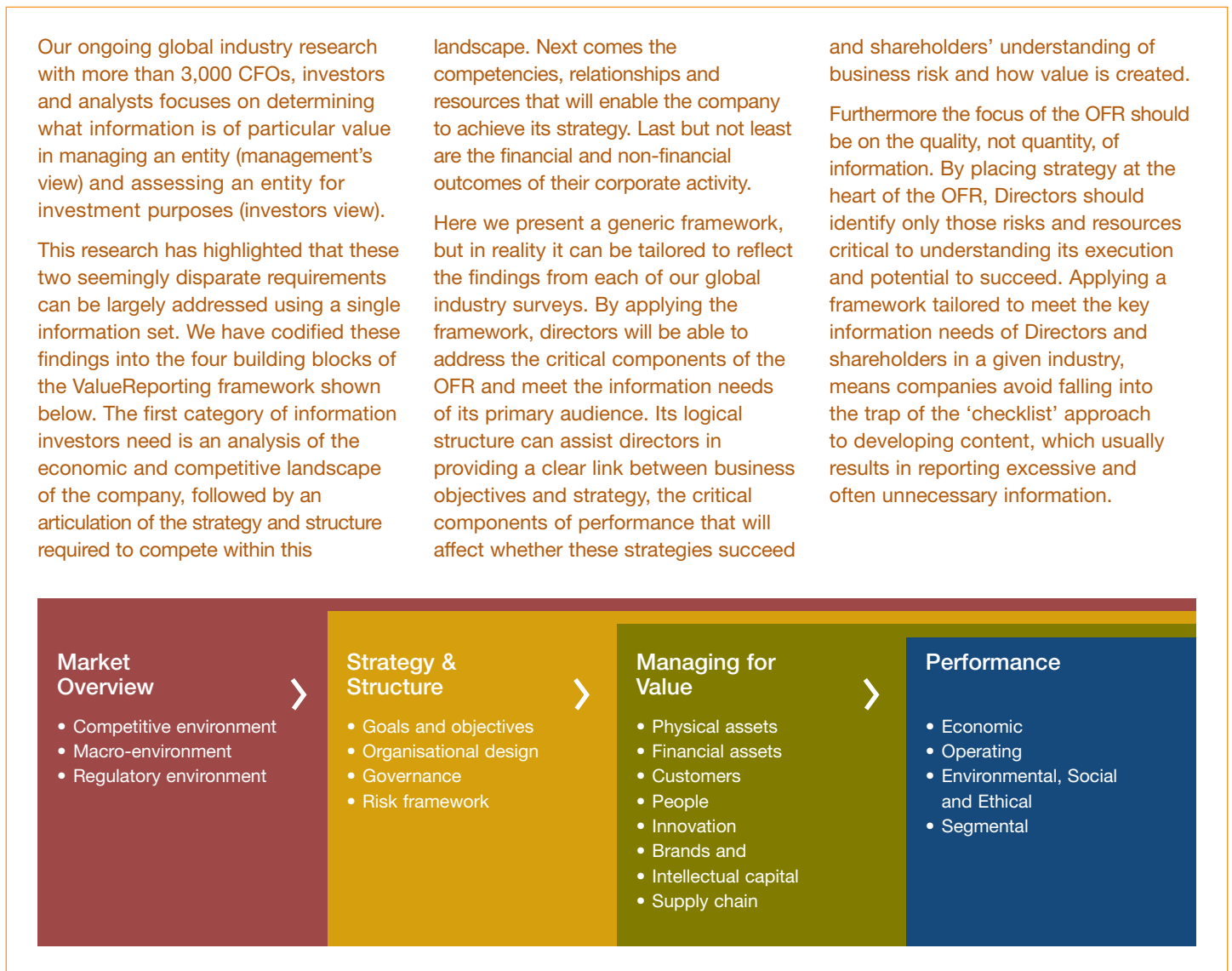
10 Develop an implementation plan

Following steps 1 to 9, Directors will be in a position to develop a short/medium-term implementation plan to address the gaps identified and deliver on their overall objective for the OFR.

For information that is currently unavailable Directors need to consider whether to seek to obtain the information and, if so, to provide disclosure of their intent to report on these matters in future reporting cycles.

For information that is available, but not sufficiently robust and comparable to publish, Directors must determine how they obtain the appropriate level of comfort on the reliability of the information. This may range from the development of new internal controls and processes to independent verification.

Exhibit 3: The ValueReporting™ Framework



Process of evolution, not revolution

Recognition that change will not happen overnight

The challenge should not be underestimated

The OFR regulations apply for financial years beginning on, or after, 1 April 2005, yet ultimately, the breadth and depth of reporting in the OFR cannot change overnight. The development of an OFR should therefore be seen as a process of evolution, not revolution.

However, the challenge to some companies should not be underestimated. Information may need to be captured and its reliability challenged. Or, if information does not exist, reporting systems may need to be enhanced. It is therefore important that companies prepare themselves for the new regulations now, even if it is deemed inappropriate to communicate the information externally until it is mandatory to do so.

Critically, information should not be reported unless it is used to routinely manage the business. Directors should also constantly reassess the nature and scope of what is being reported against their blueprint, the actions of their competitors and other external developments. There will be an expectation that the information provided in the OFR will need to be consistent over time. Yet the content of the OFR cannot remain static as information needs will shift as a result of changes in the business, its strategy and risk profile, and the overall market environment in which it operates.

The OFR is coming; there is no time to lose. The sooner companies start to prepare for it, the better positioned they will be to avoid the possible pitfalls (e.g. competitor pressure, regulatory challenges, unreliable and incomplete data) – and reap the potential benefits (e.g. competitive advantage, improved board effectiveness, enhanced investor understanding).

Contacts

Specialist support for the Operating and Financial Review and their areas of expertise

Set out below is a list of individuals who can help you to begin to consider the implications of the new OFR regulations, both internally and externally, and how you might address them. In particular they have specific expertise around the following areas critical to the OFR:

OFR strategy

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Environmental, social and community issues

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