Guide to forward-looking information

Don’t fear the future: communicating with confidence*

*connectedthinking
The new OFR requirements should provide investors with far greater transparency on a company’s internal performance targets and how management assesses the company’s performance against those targets. This publication provides very useful guidance on how management can provide the information valued by investors, in a practical way.

Lindsay Tomlinson
Vice-Chairman, Barclays Global Investors Europe

“..."
Introduction

This guide was first published prior to the Government’s decision to repeal the requirement for quoted companies to publish an Operating and Financial Review (OFR) and instead comply with the existing business review requirements. Accordingly it contains references to specific OFR regulations relating to the requirement to provide forward-looking information.

In spite of these developments, we believe the provision of forward-looking information, and consequently the contents of this guide, remains relevant for quoted companies. First, it is clear from the DTI’s proposed amendments to the Company Law Reform Bill, announced in May 2006, that the requirement for quoted companies to provide a view of the future remains very much on the agenda. Second it is our view, supported by others including a number of investor groups, that quoted companies should publish a voluntary OFR in accordance with the Accounting Standard’s Board Reporting Statement on OFRs.

In our experience many companies find the reporting of forward-looking information to be a real challenge. But what does the need to have a forward-looking orientation mean in practice? Will it require providing competitively-sensitive information? What about the reliability of such forward-looking information? Will this mean making profit forecasts?

Put simply, the reporting of forward-looking information is a critical component of effective communication to the market and this “how to” guide has been developed to provide practical guidance on how it can be achieved.

This guide is not just a theoretical paper – progressive companies, both in the UK and elsewhere, are already adopting a forward-looking orientation in their corporate reporting.

To bring forward-looking reporting alive, we have included a collection of examples from some of these companies that demonstrate aspects of what we believe is effective communication of the future that others can learn from.

So regardless of whether it is described as an OFR, a business review or something else, the issue remains “how well does your reporting articulate the direction of travel, in relation to the markets in which you operate, your chosen strategy and the performance that is delivered?”
As a strong supporter of the OFR, CIMA has an active interest in ensuring that concerns of Directors surrounding their legal liabilities do not result in boilerplate statements. This publication provides Directors with a practical approach to reporting appropriate forward-looking information.

Charles Tilley
Chief Executive, Chartered Institute of Management Accountants
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The Operating and Financial Review

A profound change in mindset towards reporting

The OFR’s primary purpose is to improve companies’ reporting to investors* by requiring them to provide a broader picture of their performance. It is not an option – Directors of all quoted companies (excluding AIM and OFEX) must prepare a new-style OFR for financial years beginning on, or after, 1 April 2005.

This brings with it significant implications. For the first time, Directors are legally required to identify, quantify and report publicly on their strategy, the resources and relationships – financial and non-financial – that they rely upon to implement their strategy, and the risks they face. All with an emphasis on the past and the future.

The OFR’s requirement for companies to provide investors with a broader picture of their performance has raised a number of concerns amongst Directors. Some fear that the publication of Key Performance Indicators (KPIs) could compromise competitive advantage. Others think the quality of information provided could provoke legal and regulatory sanctions. Whilst these fears are understandable, if the OFR is approached with the right mindset – one of transparency – they should prove groundless. As we explain in our companion ‘Preparers’ Guide’**, companies that embrace the spirit of the new regulations, rather than the letter of the law, have a real opportunity to use the OFR to enhance board effectiveness, improve governance, increase investor understanding and build competitive edge.

Fear of the future

Probably the most far-reaching concerns have been raised by the requirement that OFRs should have a forward-looking orientation. This is unsurprising given the traditional focus of the majority of Annual Reports on the past [see Exhibit 1].

Many Directors fear they will now be forced to disclose competitively-sensitive information, make profit forecasts and may expose themselves to the threat of litigation.

Exhibit 1: The OFR challenge

Although two-thirds of listed UK companies already prepare something they refer to as an OFR in their annual reports, the majority of these have remained stubbornly backward-looking. According to a 2004 survey of FTSE 100 companies conducted by HBOS, only 5% of the average OFR is currently devoted to the future of the business.

Notes: * The Accounting Standards Board Reporting Standard 1: uses the term ‘members’ to denote current shareholders. For the purposes of this guide, we use the term ‘investors’.
“The OFR is designed to give shareholders the information they need, setting out the principal drivers of a company’s performance, both in the past and in the future.” Patricia Hewitt, as Secretary of State for Trade and Industry

Directors need to understand what this mandatory requirement for forward-looking information really means.

The danger is that, without such an understanding, they will take fright at the call for ‘forward-looking’ statements, taking refuge instead in bland and highly-caveated reviews that provide no benefits to investors, or to the companies themselves.

Like any major new regulation, the OFR will bring a number of risks for companies that fail to prepare adequately for its introduction. But it should also bring real business benefits – notably, enhanced business understanding, governance and board effectiveness; improved relationships with key stakeholders and heightened efficiencies flowing from the proper alignment of reporting and communications strategies.

Fear of the future (continued)

For readers requiring more detailed information on what the OFR means in practical terms, we have published a companion ‘Preparers’ Guide’ (Operating and Financial Review: Give yourself a head start*).

Briefly, the reality of this new regulation is that it will, over time, transform corporate reporting. The OFR demands far greater clarity in the information provided for investors to assess companies’ strategies – the information that Directors themselves rely on to manage their businesses. By extending the scope, transparency and content of corporate reporting, the OFR challenges the quality, reliability and availability of information provided by companies’ internal management systems.

By going beyond mere compliance, progressive companies are already seeking ways to turn a mandatory requirement from a burden into an opportunity. However, by failing to plan for the OFR, other companies are running the risk of damaging their reputation, market rating and competitive positioning.
Why the future matters

Giving investors what they need

“Shareholders can exercise effective control only if they have clear and meaningful information about the main drivers of a company’s past and future performance. The OFR is designed to arm shareholders with that information.” Draft Regulations on the Operating and Financial Review and Directors’ Report: A consultative document

Why financial reporting is not enough

Financial reporting today addresses a shrinking percentage of the information the market considers important. The current reporting status quo is unsatisfactory. Investors know this – and so do the regulators. In its ‘Framework for the Preparation and Presentation of Financial Statements’ the International Accounting Standards Board (IASB) says:

“The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.”

“Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all information that investors may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.”

Investors need forward-looking information

Transparent information on current and future corporate performance is the raw material of effective decision-making in the investment markets. As things stand, existing financial statements only address the first part of this need. Information that enables investors to assess the sustainability of future corporate performance is conspicuous by its absence.

That this is the case is demonstrated by the comments highlighted in this section, all drawn from research conducted by PricewaterhouseCoopers with buy- and sell-side analysts.

“… As much forward-looking information as possible. That’s the most interesting thing.”

“…But really what we are trying to do is to get a view of the economic picture of the company and how that is going to change into the future.”
Investors need more contextual and forward-looking information. The OFR requirements have been introduced to steer UK companies on an evolutionary journey to meet this need. The crucial first step is to understand how the OFR aims to address these needs by requiring:

- a picture of how a company has performed in a year and historically, to provide a track record of its performance and the quality of management;

- a view of the key underlying drivers of performance, which tend to be non-financial, and how these resources, risks and uncertainties and relationships are being managed; and

- a forward-looking orientation in the information companies communicate, in order to assess the sustainability of a company’s performance and make an adequate assessment on whether to increase, hold or sell their investment in an entity.

The next step – just as crucial – is to understand what the OFR does (and does not) require where forward-looking information is concerned.

“How does the OFR help?”

I couldn’t stress more the two things that I spend most of my time doing: trying to understand what’s happening to the underlying business and getting any help I can to understand how it will look in five to ten years’ time.” — Herb Brody

“Telling the future by looking at the past assumes that conditions remain constant. This is like driving a car by looking in the rear-view mirror.” — Herb Brody
The OFR’s view of the future

Going beyond historical financial reporting

Ever since companies first voluntarily started to prepare OFRs 12 years ago, the Accounting Standards Board (ASB) has been encouraging them to go beyond financial reporting by incorporating a forward-looking orientation.

As noted previously, although two-thirds of UK companies now include an OFR in their annual reports, only 5% come close to providing the breadth of information called for by the ASB in their earlier guidance, and now in Reporting Standard 1: Operating and Financial Review (“RS1”). Instead of providing a clear and balanced discussion of the trends and factors likely to impact future prospects, Directors have continued to take refuge behind historical information. From now on, with the new-style OFR in force, a different approach will be called for.

What is required?

There are no hard and fast rules dictating what information a company must provide in its OFR. Directors must decide which information to include – and which to leave out – on the basis of their own unique business dynamics and those of the industry sectors in which they operate. Our companion ‘Preparers’ Guide’ goes into further detail on what should be considered in reaching this decision.

There is, however, an unequivocal requirement that the OFR should have a forward-looking orientation. This means identifying and communicating whatever trends and factors are relevant to an investor’s assessment of current and future business performance. It also means communicating the progress that has been made towards achieving long-term business objectives.

Relevant factors will be those that have affected a company’s development, performance and position during the financial year – as well as those likely to affect its future development, performance and position. These might include the development of new products and services, current and planned levels of investment expenditure, and clear explanations of how that expenditure is to be used to achieve business objectives.

For the first time, Directors are required by law to identify, quantify and report on the areas of their business – financial and non-financial – that drive sustainable value. They must then consider whether robust, quantifiable financial and non-financial KPIs are available to support whatever assertions have been made and, to the extent necessary, whether they should be disclosed. Assuming that they are, the OFR must include information on future targets. As we explain later however, this does not mean that profit forecasts must be provided.

As you can see, the OFR is uncompromising in its requirement for a forward-looking orientation. The page opposite sets out a summary of the key OFR requirements relating to forward-looking information.
Principles of the OFR

One of the seven key principles, as set out in RS1*, that should be applied by Directors preparing an OFR, relates to setting out an analysis of the business, with a forward-looking orientation:

“The OFR shall 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.”

Disclosure framework

The disclosure framework** set out in our companion ‘Preparers’ Guide’ builds on the one featured in RS1 to present a more logical framework. Elements where a forward-looking orientation is particularly relevant are:

1. Description of business and external environment
   - Objectives to generate or preserve value over the longer term
   - Strategies for achieving the objectives

2. Analysis of key trends and factors
   - Identify those trends and factors Directors believe are likely to impact future prospects.

3. Information on future targets
   - To be provided for each KPI disclosed in the OFR.

In the following section we highlight the issues and challenges facing Directors tasked with preparing this information.

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Note: * The regulation introducing the OFR is supported by a Reporting Standard (RS1) issued by the ASB. Companies that comply with RS1 will be presumed to have complied with the corresponding requirements of the regulations. For further information on RS1 please visit www.frc.org.uk or to purchase a copy please visit www.frcpublications.com. ** See page 5 of our companion OFR Preparers’ Guide for further information on the Disclosure Framework.
The OFR’s requirement for a forward-looking orientation has raised a number of frequently-voiced concerns amongst the Directors of UK companies (see below). The fact is, that by concentrating too closely on these perceived risks, real opportunities are being overlooked. The value, for companies, of providing a clear forward-looking picture lies in the potential it has to challenge internal perceptions and reporting, as well as the insights that it provides investors into the health and sustainability of the business and the way in which it helps put financial performance into context.

The danger is that companies may miss out on these benefits and expose themselves to real risks by seeking to avoid the requirement for a forward-looking orientation. By resorting to bland statements in their OFR, these companies will do nothing to enhance investors’ understanding of their business, while exposing themselves to potential liability for non-compliance.

Amongst the most commonly-heard concerns provoked by the OFR’s requirement for a forward-looking orientation, the following stand out:

- Does this mean having to provide potentially competitively-sensitive information?
- What is the possible exposure to litigation due to lack of “safe harbour”?
- What can be done to ensure the supportability of forward-looking information?
- Does this mean that we have to publish profit forecasts?

The following sections address each of these concerns.
For any company, there will be certain information which – were it to be disclosed – would undermine its market position. The OFR recognises this and there is, accordingly, no requirement to disclose information about impending developments that would “in the opinion of the Directors, be seriously prejudicial to the interests of the company”.

However, this should not be seized upon as a convenient smokescreen for avoiding full and frank disclosure. The test here is likely to be high-level, in line with the UK Listing Rules where information can only be withheld if its disclosure would be ‘seriously detrimental’ (and where the omission of that information would be unlikely to mislead investors).

Companies need to approach the disclosure of forward-looking information with the right mindset. Instead of adopting a compliance-based approach and asking ‘What are we going to report?’, Directors need to ask themselves: ‘What should we withhold?’. For example, pharmaceutical companies disclose details of their products – in terms of pipeline, stage of development, planned launch and potential market size – without prejudicing their competitive position. Specific information on the underlying patent formulations are, however, withheld. With this approach, they provide investors with information which is critical to understanding the sustainability of their performance, without compromising the interests of the company.

Arriving at a balancing point between disclosing and withholding forward-looking information needs to be a realistic process. In reality, competitors are already likely to be better informed than people realise, as the flow of people and information from one organisation to another has never been greater.
Failure to comply with the requirements for the preparation and content of an OFR is a serious matter, raising the twin spectres of criminal prosecution and civil liability. Where forward-looking information is concerned, the unfamiliar nature of this disclosure raises real concerns for Directors, not least because of the lack of a “safe harbour” provision in the regulations.

The risk – for companies and investors – is that, without a safe harbour, Directors will err on the side of caution, providing bland forward-looking statements with minimal value e.g. “We expect the market to continue to grow.”

The real issue is not whether forward-looking statements turn out to be accurate, but whether they were made in good faith and with due care and attention. The DTI and ASB both suggest: “Companies may wish to advise members of the need to treat with caution good faith judgements, in particular those relating to future events or prospects,” within the OFR.

This is further emphasised in the recently published letter of advice to the Chartered Institute of Management Accountants from Allen & Overy LLP, extracts from which are summarised in Exhibit 3. The letter also sets out additional steps Directors can take to minimise their exposure to litigation in the preparation of forward-looking statements.

Exhibit 3: Allen & Overy

A letter of advice prepared by international legal practice Allen & Overy LLP for the Chartered Institute of Management Accountants (CIMA) sets out key steps that Directors can take to reduce the risk of liability in the preparation of forward-looking statements. These can be summarised as:

- underlining the fact that the OFR is only addressed to shareholders as a group, and disclaiming liability to others;
- highlighting the fact that the OFR has been prepared solely to assist shareholders assessing the company’s strategies and the potential for those strategies to succeed;
- ensuring that all forward-looking statements are appropriately qualified to clarify the degree of reliance that should be placed upon them;
- stressing that forward-looking statements reflect information that was available to Directors when the OFR was prepared, and that although the OFR will not be updated for a year, these statements will be considered in the preparation of the next OFR.

Summary based on “Operating and Financial Review and Directors Liabilities” letter of advice issued by Allen & Overy LLP and dated 7 July 2005; © 2005 Allen & Overy, and used with kind permission. The full letter of advice can be viewed at www.cimaglobal.com/ofrlegalopinion.
Clearly, forward-looking information cannot, by its nature, be 100% supportable. But companies that attempt to rely on this as a reason for opting out of the OFR’s requirements are missing the point. Forward-looking information contained in an OFR is different from information found in historical financial statements. Because it is based on assumptions that might prove to be wrong (rather than being based on actual facts), there is no expectation that it should be 100% accurate.

Obviously though, the fact that information has been disclosed in an OFR may raise an expectation of reliability in investors. Directors are therefore expected to scrutinise whatever evidence has been used to underpin this information and, where appropriate, to explain its source and the extent to which it is objectively supportable.

The overall intention is for investors to assess this information themselves before deciding whether or not to rely on it. For them to do so effectively, it is important that they should have a clear understanding of how certain (or uncertain) it is.

Supportability of forward-looking information

The requirement that OFRs should incorporate KPIs has led many companies to believe – erroneously – that they will be expected to report profit forecasts. Given the level of concern this has caused amongst UK companies, it should be stressed that profit would not normally be expected to be a KPI. Profit is often the overall objective towards which a company’s strategy is geared. KPIs are there to enable a company to monitor progress in implementing its strategies and managing the business towards the achievement of its overall objective.

In other words, the business community’s overriding concern with OFRs – that they will expose Directors to the rigorous policing of published prospective financial information (PFI) – is misplaced. Forward-looking information, properly presented, can be used to provide investors with a broad-based view of corporate performance – without having to disclose sensitive PFI. Non-financial drivers of performance can be used as lead indicators of future financial performance. Similarly, market trends and clearly presented strategic priorities will provide investors with valuable insights on which to base their investment decisions. And, of course, targets can also be important aspects of this information, communicating companies’ aspirations to the market – without straying into the realms of PFI.

What about profit forecasts?
The key message here is that, along with KPIs, targets can and should be used to provide annual reports with the forward-looking orientation demanded by the OFR. Provided Directors understand the difference between publishing targets and publishing PFI, they will have limited their exposure. The guidance on PFI issued by Institute of Chartered Accountants in England & Wales ("ICAEW") is helpful on this point:

“It is important to differentiate PFI, which comprises one or more statements about the future, from a target, which is a statement of the company’s current intentions or objectives. Targets are aspirational and should not be judged against the principles of PFI set out in this Guidance. It is therefore important that the user should not be led into thinking that a target is PFI, and the issuer should make the status of the information clear.”*

The distinction between PFI and targets is usually clearcut. For example, if a company says that it is “aiming for 5% sales growth”, this is a target. If, however, it says that “sales will grow by 5%”, the statement becomes PFI [see Exhibit 4].

Exhibit 4: When targets become PFI

Once disclosed information crosses the line into PFI, it is vital Directors are aware of the stringent regulations surrounding the publication of profit forecasts. One of the most helpful definitions of what actually constitutes a profit forecast is to be found in the EU’s Regulation on Prospectuses no.809/2004:

- “…Any form of words which expressly or by implication indicates a figure or minimum or maximum figure for the likely level of profits or losses for the current financial period and/or subsequent periods, or contains data from which a calculation of such a figure for future profits or losses may be made…”

Another helpful definition is to be found in the City Code on Takeovers and Mergers:

- “…Whenever a form of words puts a floor under, or a ceiling on, the likely profits of a particular period or contains the data necessary to calculate an approximate figure for future profits, it will be treated by the Panel as a profit forecast which must be reported on.”

Keen to encourage the market’s access to forward-looking information (financial and non-financial), regulators recognise that there is often a fine line between what constitutes a profit forecast and what constitutes trend information (a general discussion of the future or prospects of the issuer will not normally constitute a forecast).

However, once PFI in prospectuses and similar documents is determined to be a profit forecast, it triggers requirements for Directors and third-parties, such as auditors, to confirm or determine that the Directors have undertaken a process of due and careful enquiry.

Note: * Extracts from “Prospective Financial Information: Guidance for UK Directors”, published by the Institute of Chartered Accountants in England & Wales, dated September 2003 © The Institute of Chartered Accountants in England & Wales, and used with kind permission.
Facing up to the OFR challenge

Realising the benefits

Nothing to fear – much to gain

Businesses that are well run on the basis of comprehensive and accurate information about all aspects of their operations have nothing to fear from the OFR. Indeed, they have much to gain. Provided management can adopt the right mindset – one of transparency, communicating financial and non-financial information as a way of increasing genuine market understanding of the business and its sources of value – they have an opportunity to secure significant competitive edge.

If they take advantage of this opportunity, they will be able to:

- improve the quality of management by making sure the information that really matters is available, aired and acted upon at board level;
- help stakeholders to differentiate good management from bad, skill from luck;
- simplify and clarify their corporate reporting, particularly where the presentation of non-financial information is concerned; and
- start to move beyond the ‘earnings game’, where a company is only considered to be as good as its latest figures.
Making it happen

The seven pillars
for effective communication of the future
1. Explain the resources available to your company that help to attain your objectives and how they are managed.

2. Describe the principal risks and uncertainties that may affect your company’s long-term value or prospects.

3. Clarify the significant relationships with stakeholders that are likely to influence the performance of your company and its value.

4. Provide quantified data relating to trends and factors likely to affect your company’s future prospects.

5. Spell out any uncertainties underpinning forward-looking information.

6. Communicate targets relating to those key performance indicators (KPIs) used to manage your business.

7. Demonstrate the linkage of other content areas within your OFR to your longer-term objectives and the strategies to achieve those objectives.
Making it happen

The seven pillars for effective communication of the future

By considering the following factors, Directors will be providing investors with the forward-looking orientation required by the OFR.

1. Explain the resources available to your company that help to attain your objectives and how they are managed

An explanation of your company’s principal resources, both tangible and intangible, employed in executing your strategies, is a key pillar to providing forward-looking information. Simply stating, for example, that “our employees are our greatest asset” without articulating how employees are vital to your future success provides little information of use to investors. Instead, an explanation of the resources currently available, how you expect them to develop going forward, as well as how they are managed and how success is measured, using quantifiable data, provides valuable insights into future prospects.

2. Describe the principal risks and uncertainties that may affect your company’s long-term value or prospects

A description of your principal risks and uncertainties is an essential aspect of providing a forward-looking orientation. Providing a generic list of all the risks facing companies in your industry, that fails to reflect the changing external environment, your company’s particular circumstances, or how the risks are managed, results in bland, ineffective reporting. Effective reporting of risk within an OFR will set out how your company identifies its principal risks, what these risks are, whether the level of risk, or opportunity, is increasing or decreasing, and your approach to mitigating them.

3. Clarify the significant relationships with stakeholders that are likely to influence the performance of your company and its value

The behaviour of your stakeholders, from regulators through to suppliers and customers, can have a considerable impact on your future prospects. Accordingly, explaining which stakeholders are significant to your company is an essential feature of effective forward-looking information. The explanation should include the nature of the relationship, the current profile of significant stakeholders and how these relationships are managed. Articulating, and quantifying where possible, any dependency on stakeholders and how well the relationship is being managed is also important.
4. Provide quantified data relating to trends and factors likely to affect your company’s future prospects

Analysing current and future development, performance and position of any company is impractical without the provision of relevant contextual information, including the quantification of appropriate trends and factors impacting the business.

Whether these are, for example, demographics for an insurance company, buying habits for a consumer products company, or raw material costs for a manufacturing company, quantifying prospective trends provides investors with a better understanding of the environment your company operates in.

5. Spell out any uncertainties underpinning forward-looking information

Forward-looking information cannot, by its nature, be 100% supportable.

Where appropriate, you should explain the source of the information and any uncertainties, to allow investors to assess for themselves the extent to which they wish to rely on the information. Further, you might consider providing a statement of caution.

6. Communicate targets relating to those key performance indicators (KPIs) used to manage your business

A simple narrative description of the key resources, risks and relationships that are fundamental to the successful implementation of your strategies is not sufficient. It is only by providing the KPIs used by you in managing your business that investors will be able to assess the potential for your strategy to succeed.

For each KPI, trend information should be provided, including information for at least the current and prior year, along with quantification and/or commentary on future targets.

7. Demonstrate the linkage of other content areas within your OFR to your longer-term objectives and the strategies to achieve those objectives

The objective of the OFR is to “assist members to assess the strategies adopted … and the potential for those strategies to succeed.”

Accordingly, it is essential you demonstrate and communicate how the external environment, and management of resources, risks and relationships, underpin the achievement of your objectives and strategies. These elements are related and should not be presented in isolation.
Bringing the seven pillars alive

Practical examples of reporting on the future

Although we have set out seven pillars, each of these pillars should not be considered in isolation. Each one represents a logical building block for effective communication of the future.

The challenge for Directors is to communicate their view of the future across all pillars relevant to their business, thereby demonstrating the forward-looking orientation required in an OFR in a consistent and coherent way.

Exhibit 5 sets out how each pillar relates to RS1’s disclosure framework and stresses the importance of providing a complete and coherent view of the future.

Exhibit 5: A complete and coherent view of the future

- Explain the resources available to your company that help to attain your objectives and how they are managed
- Describe the principal risks and uncertainties that may affect your company’s long-term value or prospects
- Clarify the significant relationships with stakeholders that are likely to influence the performance of your company and its value
- Communicate targets relating to those key performance indicators (KPIs) used to manage your business
- Provide quantified data relating to trends and factors likely to affect your company’s future
- Significant features of the development and performance of the business
- Description of principal risks and uncertainties and the Directors’ approach to them
- Information about significant relationships with stakeholders other than investors who may directly impact performance
- Underpinned by the financial and non-financial KPIs used to assess progress against stated objectives, as well as other measures and evidence
- Spell out any uncertainties underpinning forward-looking information
- Demonstrate the linkage of other content areas within your OFR to your longer-term objectives and the strategies to achieve those objectives

Explain the resources available to your company that help to attain your objectives and how they are managed

Describe the principal risks and uncertainties that may affect your company’s long-term value or prospects

Clarify the significant relationships with stakeholders that are likely to influence the performance of your company and its value

Communicate targets relating to those key performance indicators (KPIs) used to manage your business

Provide quantified data relating to trends and factors likely to affect your company’s future

Significant features of the development and performance of the business

Description of principal risks and uncertainties and the Directors’ approach to them

Information about significant relationships with stakeholders other than investors who may directly impact performance

Underpinned by the financial and non-financial KPIs used to assess progress against stated objectives, as well as other measures and evidence

Spell out any uncertainties underpinning forward-looking information

Demonstrate the linkage of other content areas within your OFR to your longer-term objectives and the strategies to achieve those objectives
Some companies are already incorporating the spirit of the OFR requirements into their annual reporting, publishing broad-based information that provides valuable insights into the sustainability of their business performance – succinctly, effectively and persuasively. In the following pages we set out examples from the reporting of some of these companies. While no single company has communicated their view of the future across all seven pillars, these examples clearly demonstrate that each company has genuinely embraced the spirit of providing a forward-looking orientation by reporting one, or more, of the seven pillars of effective reporting on the factors affecting future business performance.

We urge you to look through the following good practice extracts to get a feel for what is already being achieved by progressive companies.

To the companies that allowed us to feature their work, PricewaterhouseCoopers expresses its sincere appreciation.


1 Explain the resources available to your company that help to attain your objectives and how they are managed

Many companies give general statements about “their important assets”, for example, customers and people, but without explanations of how those resources will help them attain their objectives. British Land clearly identifies active development of the Group property portfolio as key to enhancing property returns and thereby long-term growth in shareholder value.

British Land goes on to quantify its development prospects, including the potential impact on future rental income.

Furthermore, this is a good example of a company explaining how it manages its resources – in this case the process of obtaining planning permission for its development prospects.

The British Land Company PLC

Corporate Strategy

British Land seeks to achieve long-term growth in shareholder value by:

- enhancing property returns through active management and development;

Operating and Financial Review

Development prospects

Development prospects, as shown below, are those sites and properties where we have identified opportunities and are progressing with design, planning applications and site preparation for development projects. For example, at The Leadenhall Building, a detailed planning consent has been obtained for a new 47 storey tower to provide 55,800 sq m (601,000 sq ft) of office accommodation; that is three times the floor space of the existing building.

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<tr>
<th>Project</th>
<th>Sector</th>
<th>sq ft</th>
<th>Cost (£m)</th>
<th>Planning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bishopsgate</td>
<td>City office</td>
<td>836</td>
<td>279</td>
<td>Revised</td>
</tr>
<tr>
<td>The Leadenhall Building</td>
<td>City office</td>
<td>601</td>
<td>270</td>
<td>Detailed</td>
</tr>
<tr>
<td>Regent’s Place</td>
<td>West End office</td>
<td>1,034</td>
<td>210</td>
<td>Submitted</td>
</tr>
<tr>
<td>Blithe Valley Park</td>
<td>Business Park</td>
<td>751</td>
<td>115</td>
<td>Detailed</td>
</tr>
<tr>
<td>New Century Park</td>
<td>Business Park</td>
<td>657</td>
<td>88</td>
<td>Outlined</td>
</tr>
<tr>
<td>Meadowhall Casino</td>
<td>Leisure</td>
<td>409</td>
<td>24</td>
<td>Pending</td>
</tr>
<tr>
<td>Thame</td>
<td>Residential</td>
<td>254</td>
<td>46</td>
<td>Submitted</td>
</tr>
<tr>
<td>Blythe Valley Park</td>
<td>Distribution</td>
<td>355</td>
<td>5</td>
<td>Outlined</td>
</tr>
<tr>
<td>Redditch (LLG)</td>
<td>Distribution</td>
<td>227</td>
<td>4</td>
<td>Detailed</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>5,239</td>
<td>1,360</td>
<td></td>
</tr>
</tbody>
</table>

*Estimated costs of construction excluding land and interest costs.

We have planning permission for 58% of the development prospects for commercial properties which, if they were built at a total cost to the Group of £529 million and fully let, would add further rental income of some £65 million per annum at current market rental values. This does not include 201 Bishopsgate where we have an existing permission but are in the process of seeking a revised planning consent for 77,630 sq m (£85,600 sq ft).

At current market rents, if all these development prospects were completed and let, they would add a further £151 million per annum to rental income.

Describe the principal risks and uncertainties that may affect your company’s long-term value or prospects

A number of companies already try to provide a connection between corporate responsibility issues and their future sustainability. However, in this example, BAA goes considerably further, linking an environmental factor, namely local air quality, to its long-term objective of ensuring that Heathrow “remains the world’s busiest and leading international airport”. One of the strategies to achieve this is to obtain approval from the Government to build a third runway. As set out in the extract below, the Government concluded in its White Paper that “it could not support the building of a third runway at Heathrow without clear evidence that the area will comply with EU air quality standards, due to come into force in 2010”.

Accordingly, by describing how current activities have the potential to impact on future regulatory decisions, BAA provides a clear understanding of the risks associated with these activities and links current non-financial activities with its future financial performance.

BAA plc

Local Air Quality
Air quality management remains a key priority among local and national stakeholders. In its White Paper, the Government concluded that it could not support the building of a third runway at Heathrow without clear evidence that the area will comply with EU air quality standards, due to come into force in 2010.

BAA has worked closely with the Department for Transport on this issue and is a prominent member of the Government-led expert group which is assessing air quality monitoring and modelling methodologies around Heathrow. A report on the findings is due in 2006.

We’ve taken a number of actions to address air particle and NO₂-related emissions, although airport emissions are only one source of local air pollution. Emissions around Heathrow also come from non-airport sources, notably the M25, M4 and A4. One of the key initiatives introduced in the past two years has been an aircraft emissions charging scheme under which airlines pay according to their fleets’ NO₂ emissions. This programme, the first of its kind in the UK, has been in place at Heathrow for a year, and was introduced at Gatwick from 1 April 2005.

Air Quality
Air quality monitoring is required by DEFRA to assess compliance with national air quality objectives and EU limit values. There are a number of fixed monitoring sites at locations close to Heathrow. This year’s figures indicate a non-compliance with future 2010 EU limit for nitrogen dioxide at a number of locations. However, from 1 January 2004, a 30% margin of tolerance, applied to compliance with the limit value, meaning that only the Hounslow and Brentford sites exceeded the limit. Future compliance is the subject of a Department for Transport study on the sustainable development of Heathrow. For more information visit www.dft.gov.uk.

Source: BAA plc Annual Report 2004/05 and used with kind permission.
Clarify the significant relationships with stakeholders that are likely to influence the performance of your company and its value

Engagement with stakeholders is mentioned in many companies’ reports. However, in this example, BT goes into more detail, identifying its customers as a key stakeholder in the company’s business success, as well as providing a business case to explain why investors should consider corporate social responsibility and customers as integral to the future success of the Group’s strategy.

In order to measure progress in managing customers, BT measures and communicates customer satisfaction as one of its 12 key performance indicators (KPIs). For each KPI, BT reports historical trend data, provides a target and discusses those instances where the target has not been met, thereby retaining balance in its reporting.

Further, BT describes the methods it uses to measure customer satisfaction and dissatisfaction, along with the initiatives for improving performance in this area in the future.

Chief Executive’s statement

Relentless customer focus
Our 20 million customers are a wonderful asset and we have to continue to show how much we value every one of them.

A key target for us was driving down customer dissatisfaction – we’ve reduced dissatisfaction levels by 23% on a compound annual basis over the past three years. There is still more to be done and we must continue this focus.

CSR for investors
The key issue for investors is the business case for sustainable development and corporate social responsibility (CSR) and how social, environmental and ethical risks and opportunities are managed to preserve and grow shareholder value.

BT’s approach
We want to present investors with a forward-looking, quantitative business case for CSR and sustainable development. Our business case sets out how good CSR performance is critical to the delivery of BT’s strategy.

We measure our CSR performance through a series of key performance indicators (KPIs) which have been developed in consultation with stakeholders.

Our business case
Our CSR work is integral to the BT strategy, and affects business performance in five key areas:

2. Reputation
When people trust a company they in effect deliver a societal ‘licence to operate’. This is reflected in the company’s reputation which, in BT’s case, we know directly affects customer loyalty.

Through this relationship we have understood how CSR is critical to optimising customer satisfaction. For example, we estimate that BT’s CSR performance accounts for over 25 per cent of the image and reputation element of customer satisfaction. Further statistical analysis shows that a one per cent improvement in the public’s perception of our CSR activities translates to a 0.1 per cent increase in our retail customer satisfaction figures.

Key performance indicators and targets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers</td>
<td>Customer Dissatisfaction — against an objective of reducing the number of dissatisfied customers by 25% per year over three years</td>
<td>23% reduction*</td>
<td>29% reduction*</td>
<td>37% reduction*</td>
<td>To increase the number of extremely and very satisfied customers by 5%</td>
</tr>
</tbody>
</table>

**Satisfaction measures**

To improve levels of customer satisfaction, we need a thorough understanding of what makes customers satisfied and dissatisfied.

To achieve this, we carry out more than 3,000 face-to-face interviews with residential customers every month. We ask them about their overall perception of BT and the quality of service. Customers who use competitors are asked how satisfied they are with our competitors. The interviews also examine image and reputation, price and value, contact and experience, and products and services.

BT Global Services uses three types of survey to measure customer satisfaction:

- Face-to-face interviews, normally with senior decision-makers in the larger organisations
- Tracker surveys, an overall satisfaction survey conducted over the telephone
- An Event Driven Customer Satisfaction Survey, which is a telephone survey conducted immediately after a repair or provision event.

We publish customer-satisfaction and quality-of-service measures every six months.

**Initiatives to improve customer satisfaction**

Our customers have told us that we must:

- Be easy to contact
- Keep them informed (we shouldn’t need to be chased)
- Take ownership of their issues and champion their cause
- Live up to the commitments we make to them.

4 Provide quantified data relating to trends and factors likely to affect your company’s future prospects

While a number of companies are starting to take positive steps in this direction, others already incorporate this information into their annual reports. In this extract from Emap’s 2005 Annual Report, investors are shown market data on both historical and future estimated advertising growth rates. This provides information relating to trends and factors underlying historic performance and likely to affect future performance.

Whilst Emap could have provided its own company metrics relating to growth prospects, it has chosen to use data from an accepted external industry benchmark. A number of companies provide similar external market information. However, Emap balances this data with alternative external views, which in this case are less optimistic about future growth rates.

This forward-looking orientation is useful to investors in assessing the market in which Emap is likely to be operating in the coming years and provides a context for them to assess the potential success of the company’s strategies and future performance.

Macro-economic environment

In the UK, the current advertising growth forecasts from the Advertising Association (AA), set out in the table, indicate some improvement in most of Emap’s markets. These forecasts are updated quarterly.

AA is recognised by the industry as a good benchmark of future growth rates. However, other forecasters have started to reduce their expectations for 2005/06, for example Deutsche Bank reduced their advertising growth forecast from 4.9% to 2.2%, Lehman Brothers have also taken a view that is more pessimistic for the sector than these AA forecasts.

<table>
<thead>
<tr>
<th>UK Advertising growth forecasts</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total advertising</td>
<td>1.6%</td>
<td>3.9%</td>
<td>5.4%</td>
<td>6.3%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Consumer magazines</td>
<td>0.8%</td>
<td>(0.2%)</td>
<td>4.5%</td>
<td>4.2%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Business/professional mags</td>
<td>(9.4%)</td>
<td>(3.6%)</td>
<td>3.2%</td>
<td>3.6%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Radio</td>
<td>1.1%</td>
<td>6.8%</td>
<td>3.4%</td>
<td>5.3%</td>
<td>5.2%</td>
</tr>
<tr>
<td>TV</td>
<td>4.9%</td>
<td>3.4%</td>
<td>5.4%</td>
<td>6.7%</td>
<td>4.6%</td>
</tr>
</tbody>
</table>

Source: Advertising Association
Spell out any uncertainties underpinning forward-looking information

Companies often include a statement within their OFR advising readers to treat forward-looking information with caution. Many incorporate “hold harmless” or “safe harbour” statements, often geared towards the US markets. RS1 recognises that some elements of forward-looking information cannot be objectively verified, but will be made in good faith. In the example below from BAA, the uncertainties relating to future forecast growth in passenger numbers are highlighted and clearly explained.

Furthermore, examples from British Land and Tate & Lyle demonstrate simple statements of caution.

BAA plc, The British Land Company PLC, Tate & Lyle PLC

Drivers of Future Performance
As passenger numbers are set to continue growing for the foreseeable future and our airports become increasingly busy, the Group is focusing ever more on improving the quality of service delivered across the whole range of airport activity – from first impressions on arrival, through check-in and security and on to departure. The move to an airport-led operating model will ensure maximum accountability as close to the customer as possible and a more effective and agile organisation.

Operating and Financial Review
From March 2006 British Land is required to publish an Operating and Financial Review in accordance with new regulations. Although guidance on its preparation is not finalised, this OFR aims to anticipate most of the new requirements.

In preparing this operating and financial review, we are required to advise the reader that by their nature, all forward looking statements made involve uncertainty since future events often cause outcomes and results to differ from those anticipated.

Cautionary statement
This Annual Report and Accounts contains certain forward-looking statements with respect to the financial condition, results, operations and businesses of Tate & Lyle PLC. These statements and forecasts involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. Nothing in this Annual Report and Accounts should be construed as a profit forecast.

Companies often present performance indicators based on traditional financial information. The OFR requires companies to present the KPIs and accompanying targets – both financial and non-financial – used by management to measure progress in delivering against their stated strategies and in managing their business.

In this example, Wells Fargo clearly explains why it chooses to use different measures, giving frank descriptions where common measures such as total customers can be meaningless, and identifies the key measures – financial and non-financial – that it believes matter most, and provides targets for each one.

Wells Fargo goes on to measure progress in achieving those targets, as shown here for cross-selling. Not only does it identify cross-selling “as the most important customer-related measure”, it goes further by providing the rationale for the selection of this measure and its importance to current and future financial performance, namely that “about 80 percent of our revenue growth comes from selling more products to existing customers”. The disclosure is made more readily understandable by good use of graphics.

**Wells Fargo & Company**

We are simply suggesting a new set of value-creation measures for financial services companies so there is an apples-to-apples way to compare companies’ performance across the industry in the measures that really matter. That’s why we say financial services companies measure the wrong things, often based on the traditional measures of the banking industry.

For example:

- Asset size and return on assets — important to banks in the “old days” — do not reflect contributions from such fee-based businesses as mortgage, insurance and money management.
- Total customers can be a meaningless measure — it gives you little or no insight into breadth and depth of relationships. Think of the profit difference between ten customers who entrust you with 100 percent of their business versus 100 who give you just ten percent of it.

**Which Measures Really Matter?**

We measure success differently than our competitors. We believe these measures matter most. They’re the most important long-term indicators of success in the financial services industry.

- Revenue Growth
- Earnings Per Share
- Return On Equity
- Revenue vs. Expense Growth
- Assets Managed, Administered
- Managing Risk
- Retaining Team Members
- Team Member Engagement
- Retaining Customers
- Customer Service
- Customer Access Options
- Cross-Selling
- Product Solutions (Sales) Per Banker Per Day
- Market Share
- Total Stockholder Return

Our 10 Strategic Initiatives guide us toward our vision and help us achieve double-digit revenue and earnings growth. Here’s a brief progress report on each:

Cross-Selling
- Cross-selling: our most important customer-related measure.
- About 80 percent of our revenue growth comes from selling more products to existing customers.

**Goal:** Sell at least eight products to every customer.

2. “Going for Gr-Eight”
Our average banking household has 4.6 products with us (about double the industry average). Our average commercial/corporate customer has 5.3. But both purchase about 16 financial products from someone. We want our consumer and business customers to have at least eight products with us.

Demonstrate the linkage of other content areas within your OFR to your longer-term objectives and the strategies to achieve those objectives

Every company is affected by its external environment and most include some commentary on the markets in which they operate. Pilkington's Operating and Financial Review 2005 does this, but goes further by providing a clear emphasis on future growth opportunities and linkage to Group strategy.

Investors need to know that the Directors’ objectives for the business and the strategies to achieve them are reasonable in the context of the external market. In this example, Pilkington links disclosures about its markets to its strategy. It provides detailed information on the growth prospects of these markets – supported by clear graphics – and their growth drivers. Furthermore, it provides detailed information on each of its three strategic priorities, shown here by the third strategic priority “Invest in profitable growth opportunities”, including the specific actions it will take to implement the strategy and the risks involved in pursuing it.

Source: Pilkington plc Operating and Financial Review 2005 and used with kind permission.
VALUE GROWTH – AUTOMOTIVE

DEMAND

- Complexity
- Curvature & surface tolerance
- Solar control
- Security
- Glazing systems
- Integrated systems
- Acoustic

GROWTH DRIVERS

- Designers see glazing as a crucial element in designs to differentiate vehicles
- Styling demands increase the complexity and depth of curves in vehicle glazing, making surface tolerances critical, e.g. for efficient windscreen wiper operation
- Larger glass areas require tinted and coated glazing to reduce solar heat build-up and air-conditioning load
- Crime and vandalism increase the need for enhanced security, provided by laminated side glazings
- Reduced time to market and lean manufacturing require modularised glazing, including trim and other fittings, in one unit
- Complex antenna arrays and electronics integrated into glazing
- Demand for increased vehicle comfort through noise reduction

VALUE GROWTH – BUILDINGS

DEMAND

- Energy saving (heating)
- Energy saving (cooling)
- Safety
- Security
- Fire protection
- Acoustic
- Self-cleaning

GROWTH DRIVERS

- Energy saving legislation and building regulations; reduction of energy loss from buildings and energy labelling of windows
- Energy saving legislation, reduction of air-conditioning load in buildings. Preventing non air-conditioned buildings from overheating
- Increasing legislative requirement for safety glass in certain applications
- Requirement for transparency combined with security features
- Requirement for good light transmission and compliance with regulations on fire protection
- Increasing noise levels caused by traffic, aircraft etc progressively backed by legislation
- Reduction in use of detergents, safety at heights. Product range now extended to combine self-cleaning with additional features

GLOBAL GLASS GROWTH vs. REAL GDP GROWTH

MOST FUTURE GROWTH OPPORTUNITIES WILL COME FROM EMERGING MARKETS

ACHEIVEMENTS TO DATE

- Pilkington-constructed fourth float line in Brazil for our South American joint venture is in full production.
- Sound base established in China as a platform for future growth. Automotive plants now fully under Pilkington management.
- Float line joint venture in Russia on target to start production in summer 2005.

NEXT STEPS

- Key factor influencing the timing of our transition from Stage 2 to Stage 3 will be progress in building our financial strength.
- China, Russia, India and the Middle East have been identified as top four priority areas for growth.
- Robust systems implemented to assess viability of all growth opportunities.
- Groundwork laid for growth investments during Stage 2, structured to minimise cash outlay until the transition to Stage 3.

RISKS

- Demand growth in mature markets slows in both building and automotive sectors, emphasising the need to grow in emerging markets.
- Risks of operating in new territories minimised through working with joint ventures and local partners where appropriate and by spreading our investments over several markets.

Source: Pilkington plc Operating and Financial Review 2005 and used with kind permission.
Contacts

Specialist support for narrative reporting and their areas of expertise

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

- **OFR strategy**
  - David Phillips
    - david.michael.phillips@uk.pwc.com
    - 0207 804 5055

- **Environmental, social and community issues**
  - Geoff Lane
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    - 0207 213 4378

- **People measurement and reporting**
  - Richard Phelps
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- **OFR process, internal management systems and procedures**
  - David Bishop
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    - 0207 804 2911

- **Assurance of non-financial data**
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    - 0207 213 3789

- **Quality of narrative reporting**
  - Janice Lingwood
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    - 0207 804 6547

- **Mark O’Sullivan**
  - mark.j.osullivan@uk.pwc.com
  - 0207 804 3459

Other narrative reporting publications
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