SPEECHLY BIRCHAM

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Recent developments in public company law

Farewell to the OFR

The requirement for companies listed on the London Stock Exchange's main market to produce an operating and financial review (OFR) was originally introduced into UK law by the Companies Act 1985 (Operating & Financial Review and Directors' Report etc) Regulations ('Regulations'). These came into force in March 2005 and applied to financial reporting years commencing on or after 1 April 2005.

However, on 15 December 2005, the Government announced that it was to abandon the requirement for an OFR by repealing the relevant provisions of the Regulations. These were repealed with effect from 12 January 2006 by the Companies Act 1985 (Operating & Financial Review (Repeal) Regulations 2005). In addition, the provisions regarding the OFR in the proposed Company Law Reform Bill have also been removed.

The OFR was intended to be a 'balanced and comprehensive analysis' of:

- a group's development and performance during the financial year and its position at the year end
- the main trends and factors underlying these
- any trends and factors likely to affect the group's future development.

The OFR was intended to assist shareholders in assessing the strategies adopted by a company and the potential for those strategies to succeed. Companies were also required to address non-financial matters such as environmental, employee and community interests. The OFR was to be included within a company's yearly financial statements.

Business review lives on

Although the provisions regarding the OFR were repealed, the provisions of the Regulations requiring **all** companies - except small companies which are defined below - to produce a 'business review' remain in force and are now contained in section 234ZZB of the Companies Act 1985.

The business review must be a fair review of the company's business indicating the principal risks and uncertainties facing the company. It should be contained in the directors' report section of the accounts.

In summary, the business review must be a balanced and comprehensive analysis of the company's performance and development during the year and its position at the year end and:

- be consistent with the company's size and complexity
- include an analysis of financial key performance indicators (KPIs) if necessary to understand the development, performance or position of the company, and
- if appropriate, and for large companies only, use other non-financial KPIs including information about environmental and employee matters.

A small company is one which satisfies two of the following criteria: turnover not more than £5.6m, balance sheet total not more than £2.8m, not more than 50 employees. However, a small company cannot take advantage of the exemption from producing a business review if it is a public company, or if it has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on one or more regulated activities, or if it carries on an insurance market activity.

Companies that meet the statutory definition of a medium-sized company (turnover not more than £22.8m, balance sheet total not more than £11.4m, not more than 250 employees) have to prepare the business review, but are not required to include information about key non-financial performance indicators. Nevertheless, they are strongly encouraged to report voluntarily on these issues, where appropriate, in recognition of the benefits such disclosure brings to the operation of the business.

The business review differs from the OFR in the following respects:

- no requirement to describe the business, objectives and strategies of the company or the resources available to the company

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- no requirement to address the trends and factors underlying the company's existing position that are likely to affect its future performance and development
- narrower scope of issues to be addressed, eg. no requirement to address social and community issues, business relationships and financial relationships with owners
- no requirement to address the capital structure, treasury policy and liquidity of the company.

Although this change has removed the risk to directors associated with being obliged to publish forward-looking information in the OFR, the business review is potentially broader and more subjective than the OFR which was more prescriptive. This may place an additional burden on the directors who have to determine what is included in the review.

In addition, the EU's Transparency Directive, to be implemented in January 2007, will introduce a requirement for directors to give a responsibility statement in relation to annual and half yearly reports which could add to concerns about directors' liabilities.

Despite all the changes to reporting requirements, many listed companies are likely to produce the equivalent of an OFR in any event as it is considered best practice by regulatory organisations such as the Accounting Standards Board.

Institutional shareholder voting disclosure

Clause 876 of the Company Law Reform Bill has been the subject of much parliamentary debate. The clause is designed to give the Treasury and the Secretary of State the power to make regulations compelling institutional shareholders to disclose details of how they exercised their voting rights at general meetings of listed companies.

The intention is to improve retail investors' confidence in the governance exercised by institutional investors and to increase the accountability of institutional investors for their voting decisions. Institutional shareholders affected include unit trusts, OEICs, investment trust companies, pension schemes, long-term insurance businesses and authorised overseas collective investment schemes.

The regulations may require disclosure to be made to the ultimate beneficiaries of the shares or to the public at large, or both. The court will have power to order disclosure where it is not made in accordance with the regulations and the Financial Services Authority will be able to take any breaches into account in considering whether an institutional investor is a 'fit and proper' person to conduct business under the Financial Services and Markets Act.

Disclosure is currently voluntary although there are various non-legislative guidelines which encourage institutional shareholders to disclose voting information, eg. the Combined Code, ABI, NAPF and IMA guidance.

Although the House of Lords removed the clause in their reading of the Bill on 26 May, it is likely that the Government will seek to reintroduce the clause at a later date. As there has been much opposition to the clause, it is likely that the current wording of the clause will be watered down. Furthermore, the Government has suggested that it would not seek to make any regulations under this clause unless the current pace of voluntary disclosure drops.

Proposed changes to the AIM Rules

Third party platforms

The London Stock Exchange (LSE) Notice of 6 April 2006 proposed changes to the AIM Rules in respect of AIM companies with securities traded on a third party trading platform (examples of these being Ofex and Euroclear). The following changes are proposed:

AIM Rule 10: a provision is to be included to ensure that there is no delay in the disclosure of information which is required under the AIM Rules as a result of a company's discussions or obligations owed to a third party trading platform.

AIM Rule 37: an AIM company whose securities are admitted to a third party trading platform must inform the LSE of this admission immediately and of any subsequent changes to that status. The company will also be required to provide the LSE without delay with a written summary of all regulatory communications with a platform operator in relation to the trading in the company's securities on that platform.

AIM Rule 39: a nominated adviser will be required to inform the LSE without delay of any unusual trading activity on a third party platform of which it becomes aware.

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EEA companies: Use of International Accounting Standards

London Stock Exchange Notice of 21 December 2005 confirmed the proposed changes to the AIM Rules in relation to the use of International Accounting Standards (IAS) by AIM companies incorporated in the EEA. The revised rules will apply to financial years starting on or after 1 January 2007 and:

- require EEA companies that prepare consolidated financial statements to use IAS in preparing these for the purposes of the AIM Rules
- allow EEA companies that do **not** prepare consolidated financial statements to use IAS or their applicable national accounting and company legislation regulations.

Finance director fined for market abuse

In December 2005, the FSA fined the finance director of Cambrian Mining Plc, an AIM company, £25,000 for market abuse.

The director concerned had acquired 50,000 ordinary shares a few hours before the company announced a share placing. The shares were placed at a premium to the share price. The director knew the announcement had not yet been made, that the company was in a close period and knew the likely content of the company's interim results. He then bought a further 20,000 ordinary shares ahead of the interim results announcement. The director did not sell any shares, but had he done so, he would have made a profit.

The FSA found the director's actions constituted market abuse as they involved the misuse of information which was not publicly available but which would, had it been available, been considered relevant information to a regular user of the market (under S118 of FSMA). The fact that the director concerned did not profit from his transactions was no defence.

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