the inside track #28

Highlighting CSR Issues of the moment

A further round of reporting changes

Corporate reporting developments seem like the proverbial London bus – they seldom arrive alone!

Currently, there are final versions of statutory instruments for the Strategic Report and the Directors' Report [1], mandatory green house gas (GHG) [2] and remuneration reporting. The former affects all medium and large companies' annual reporting. All are scheduled to take effect for financial years ending on or after 30th September 2013, which means that over 90% of qualifying companies need to submit compliant annual reports for this current year. Non financial reporting requirements for listed companies include information on emissions, gender diversity and human rights.

Mandatory GHG reporting covers all carbon dioxide emissions resulting from energy consumption used in properties or by machinery; as well as energy used by company owned transport; together with any carbon dioxide used in manufacturing processes. Most importantly, the emissions include those generated by leakages, of which the most common relate to gases used in air-conditioning or chiller units. This information will be disclosed in the Directors' Report.

The information on gender diversity requires data broken down by directors, senior managers and for all employees. Also there is the need to comment on a company's human rights approach (to meet the requirements of the Ruggie Frameworks). Both gender and human rights will be disclosed in the Strategic Report.

The EU proposes a new Directive [3] that requires larger corporates in the EU to disclose non-financial and diversity information in annual reports. One purpose is to ensure all EU states report to the standards of the good practices of the few (which include the UK). However, proposed diversity coverage is significantly beyond that anticipated under UK law. The intention is that a company should include within its Corporate Governance report "a description of its diversity policy for its administrative, management and supervisory bodies with regard to aspects such as age, gender, and geographical diversity, educational and professional background". Companies will need to report on diversity policy objectives, their implementation and results.

The (relatively) good news is that the Directive is expected to be set in Members States' legislation by 2016, with the first annual reports meeting these requirements expected from 2017.

Then the International Integrated Reporting <IR> Framework [4], is due for publication in December 2013. This takes annual reporting to another level with a focus on creation of value over time and the company's business model - both of which are set within the context of "capitals" (financial; manufactured; intellectual; human; social and relationship; and natural) that an organisation utilises (and impact upon the business model and creation of value). In some respects, Integrated Reporting reflects some earlier concepts such as Triple Bottom Line (TBL) reporting, but with a greater commercial context for <IR> than TBL.

<IR> is a voluntary framework, but is piloted already by some of the biggest names in the corporate world, including Volvo, Danone, Jones Lang LaSalle, Tata Steel, Coca Cola, Microsoft and SAP. In the UK, ARM, J Sainsbury and Unilever are participants. Whilst voluntary, <IR> is likely to have a big impact on future reporting and be seen as an example of best practice for others to emulate. <IR> is already a legal requirement for all companies listed on the Johannesburg exchange.

Unfortunately, UK listed companies may find challenges if they try to align <IR> reporting with the new UK regulatory approach. Consistent elements between the two lie in a focus on the business model but the extension of <IR> to include the five capitals is a step further than is currently required under UK law .

1 The requirements for the new forms of annual reports are in The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013
2 The requirements for mandatory green house gas reporting are in The Greenhouse Gas emissions (Directors' Reports) Regulations 2013
3 The draft version of the proposed Directive can be found on the EU website http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf
4 The consultation document for the <IR> framework can be found on the IIRC website http://www.theiirc.org/wp-content/uploads/Consultation-Draft/Consultation-Draft-of-the-InternationalIRFramework.pdf

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It would be hardly surprising if boards (and the corporate officers advising them) confess to a certain degree of confusion, especially at a time when their main focus is probably addressing economic and market driven challenges.

However, companies need to consider now how they develop UK annual reporting, in light of the changes anticipated for October 2013.

A first step is to review the approach to the strategic report, especially ensuring the business model and strategy are communicated effectively. Companies continue to face challenges reporting the business model. Many tend towards a limited graphic approach, rather than offering thoughts on the business drivers that deliver the objectives of creating and preserving value. This weakness means those companies are also poor in communicating non financial KPIs, which should relate naturally to key business drivers. Addressing better business model communication also makes communication of the strategy more effective, since it is the basis for delivery of the business model, and should be described with quantitative or qualitative measures, such as key implementation milestones.

Whilst companies will gain most benefit from a considered business model and strategy, there is also a need to address three other additions that come into force with the new reporting regulations. These include human rights, gender diversity and mandatory GHG reporting.

The inclusion of human rights reporting reflects the UK government's acknowledgement of the application of the UN's Ruggie Framework, which focuses on governments' duty to protect against human rights abuses; corporations' responsibility to respect human rights; and the need to offer victims greater access to effective remedy. This is an area where companies have paid limited attention in the past, but will rise in focus from national government and NGO pressure. Companies need to ensure they have adequate policies and practices in place for supply chain arrangements, together with a due-diligence process to identify, prevent, mitigate and account for how the company addresses impacts on human rights, both actual and potential.

Workforce gender diversity measurement will be less arduous for companies based solely in the UK, but may challenge those with multinational locations, especially if there is no unified HR information system. But once measurement is in place, this may be only the tip of the iceberg, and companies need to consider how well gender inclusion policies work in practice.

GHG reporting requires accurate data collation systems, as it is likely that external auditors will have to sign off data included within the directors' report. Again, for companies operating solely in the UK, this may not be very arduous, but with international operations, the challenges of collating data may be very significant. These challenges will increase in scale if companies are heavy users of air-conditioning (e.g. those with office locations or hotels) or chilling systems (e.g. food and drink manufacturers).

Remuneration reporting also requires the attention of corporate officers, not only because it involves a new reporting format, but because of a need to think clearly about the remuneration policy the board proposes to shareholders. The intent is to make the board more accountable to shareholders for delivering balanced and transparent remuneration. Undoubtedly new reports will be a focus for the likes of pension fund advisers. Companies that seek to avoid undue criticism will need to spend time deliberating their approach.

With so much change underway, it is best for companies to address those that affect them immediately, rather than considering all potential changes. However, it is important to watch developments such as the <IR> framework, because it would affect what is considered as good practice reporting.

If you would like to know more about the developments in annual reporting, and would like an objective and impartial view, contact Tony Hoskins or Melissa Kittermaster via thoskins@thevirtuouscircle.co.uk

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