March 05

the inside track #04

Highlighting CSR Issues of the moment

The OFR – launching a new requirement for Corporate Reporting.......

The new Operating and Financial Review which comes into force for all listed companies whose financial year commences on or after 1 April 2005, is being trumpeted as a significant improvement on previous corporate reporting information.

Rather than the present situation whereby company reporting is essentially a backward-looking snapshot of results based purely on financial indicators, the new format OFR is designed to provide shareholders with clear and meaningful information about the strategic risks and opportunities that will influence a company's future performance.

As such therefore, the new OFR should present the Directors views on the company's future prospects and their approach to managing and reporting on a range of non-financial factors including :

- Environmental performance
- Employee issues
- Relationships with suppliers, customers and local communities
- Other material factors, such as market position, customer profiles and product development pipeline

It will therefore include those factors seen as crucial to the company's future prospects, reputation and results.

The Accounting Standards Board (ASB) was designated by the Department of Trade and Industry to develop the standards for the OFR and has already published an Exposure Draft of a Reporting Standard on the OFR, with a consultation period which ended on 28 February 2005. This Exposure Draft provides guidelines to Company Secretaries and Finance Directors on how to develop their own OFRs.

In terms of content, the OFR should include information about the company's business strategies and objectives, its past performance and future prospects, and includes indicators of:

- Economic measures demonstrating the ability to create value over time
- Market positioning
- Historical and prospective views of a company's development, performance and positioning
- Resources, risks and relationships that could significantly affect its short and long term value, including relationships with stakeholders relating to its marketplace, its employees, the environment, and its social and community activities
- Receipts from, and returns to, its shareholders

The intention is to complement the usual financial reporting with additional financial and non-financial information about the business using Key Performance Indicators (KPI's) and targets for each significant area of activity. The OFR can also cross-refer to other forms of information (e.g. its company website and other internal reports). Whilst the OFR focuses on material matters relevant to shareholders, Directors also need to consider the extent of reporting on matters relevant to other stakeholders if they too are likely to be significant to investors.

Unlike a CSR report, the OFR requires sign off by the company's auditors to ensure that there are no omissions of information that may reasonably be expected, all disclosures are evidenced, are not misleading, and that the information contained in the OFR is material to the interests of the shareholders. The administrative enforcement of the OFR (in terms of possible omissions or mis-statements) will come under the Financial Reporting Review Panel, who will commence its review of OFR's for financial years beginning on or after 1st April 2006.

TVC comment overleaf >

March 05

the virtuous circle comment: #04

The OFR – an opportunity to improve corporate reputation and drive shareholder value.

Over the past couple of months we have been talking with our strategic partners about the implications of the new OFR, and in addition, talking with many clients regarding their understanding of the possible effects of OFR to them.

A significant conclusion is that many companies are simply looking to comply with the OFR requirements and have not yet appreciated its potential for improving their own company's corporate reputation.

The OFR's inclusion of non financial indicators will have a significant impact and increase the number of companies reporting on social, ethical and environmental matters from around the 200 currently producing CSR reports, to all listed on the London Stock Exchange. This represents a huge increase in information on these matters that will be open for public scrutiny as from 1 April this year.

Through our own research, we have identified that:-

- The OFR will provide a stock source of information for Government and NGO officials who wish to evaluate and benchmark corporate behaviour standards across companies and sectors.
- Non financial information will in future become a critical factor in helping analysts to establish the levels of risk attached to a company's set of accounts, and, as a result, will affect the valuation of the stock in question.

This latter conclusion is supported by PwC's proposition which argues that 'Value Reporting' supplements traditional financial reporting by giving a clear and comprehensive picture of corporate performance – both financial and non financial – that will help drive shareholder value.

The key to driving shareholder value is ensuring the KPI's chosen represent material performance to the shareholders and reflect functional strategies that are aligned to the overall business strategy – easier said than done! Critically, the words supporting the non financial KPI's will become as important as the data itself, so in this regard companies need to look carefully at their key business drivers and develop KPI's which accurately reflect them.

An interesting possible outcome of this approach is that shareholders may start to challenge any CSR-related programmes they regard as immaterial to business performance. For example, there may be a need to demonstrate the business case more effectively in areas such as community giving and diversity.

In developing their new OFR, companies should adopt a five stage process:-

- Identify key OFR issues aligned to the business strategy
- Develop KPI's to ensure materiality
- Develop and review KPI's to ensure auditability
- Map & develop the communications process to ensure consistency between the Directors' Report, the OFR, the CSR report (if available), the Corporate Website - both retrospectively and for the future.
- Review the process throughout the year, and benchmark the approach against the OFR's produced by other FTSE companies.

Most importantly, companies need to develop their procedures in advance of the commencement of the financial year. Developing KPI's at the end of the first financial year of OFR will negate a key criterion – comparability over time.

Those companies that start their OFR process not just looking to comply with the regulations, but to enhance their corporate reputation, will benefit significantly in terms of helping to drive shareholder value.

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