September 06

the inside track #09

Highlighting CSR Issues of the moment

The Business Review – mist and fog, getting brighter later?

At a recent lunch, attended by representatives from a dozen of the major organisations in the country, guest speaker, David Loweth of the Accounting Standards Board focused on the Business Review (BR) and changes proposed in what was the Company Law Reform Bill but from July 2006 is called the Companies Bill (CB).

The CB is due to be enacted by November 2006 – and the Government cannot afford to delay this. It includes three areas that are likely to challenge listed companies in their corporate governance and reporting. The CB:

- gives the BR an additional rationale with a new definition of the role of directors: "To promote the success of the company…. for the benefit of shareholders as a whole… and having regard for the interests of other stakeholders".
- specifically extends the range of KPI reporting, with specific requirements for non-financial areas – on a "report, or if not, explain" basis. This effectively creates a new version of the BR, which would be similar to the OFR in its reporting scope.
- requires companies to report on policies that underpin KPIs included in the BR – and to comment on their effectiveness (as was required for the OFR).

The changes proposed under the CB take effect for financial years starting on or after 1 October 2007, so there is time to organise. Particularly good news; bearing in mind companies are beginning to come to terms with the scale of BR reporting across all their subsidiaries – one financial services company is facing writing up to 400 BRs (because of the lack of size exemption for finance and insurance companies), whilst a large manufacturing company is envisaging having to write around 60 BRs.

However, companies wishing to be seen as leading edge may wish to incorporate some or all CB changes beforehand. This may be a prudent move, since there may be further changes in the pipeline – the International Accounting Standards Board is still considering whether to take forward its work on the "Management Commentary", which is essentially similar in format to the OFR, and would be regulatory.

In the meantime, the first batch of annual reports to include the BR under the current legislation has been produced. In research to be used in a presentation at the Institute of Chartered Secretaries' international conference in October, we have identified several key themes that emerge from these early reports:

- Uncertainty about KPIs – the BRs use much data as indicators, but few offer clarity about which are **KEY**.
- A dearth of non-financial KPIs – not just the ones favoured by NGOs, like CO2 emissions, but those that directly relate to business performance such as customer or employee retention.
- Poor reporting on risks – these tend to be a list, with no indications that the companies have any actions in place to mitigate the risks.

In summary, the first attempts of BR reporting are shrouded in mist, if not a fog of (mis)interpretation. There seems to be a tendency to add sections to an existing annual report structure rather than to produce an integrated approach that genuinely helps to inform investors and would help to build corporate reputation.

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the virtuous circle comment: #09

The BR, and previously the OFR, has always struck us as offering a significant opportunity to demonstrate the quality of management's strategic thinking and operational implementation. As such, the BR can help companies build corporate reputation and competitive advantage. We understand not all companies may feel they are either able (or want) to take advantage of this opportunity. Yet those that aspire to be leaders in their sector will need to demonstrate leading edge attributes.

At present looking for detailed information in a BR may feel a little like walking through a "pea-souper", but we do think that, with time, things will "brighten up" enabling a clearer view. A sense of best practice will emerge, which is important, given that no prescriptive standards exist for BR reporting.

To help existing and potential clients determine the extent to which they are prepared for the BR (and the changes implicit in the CB) we have identified some key steps to use the BR to gain advantage:

- Develop a multi-functional approach to the BR. The inclusion of non-financial reporting means the BR involves wider accountabilities than those of the company secretary and financial director, who tend to be those responsible for the traditional annual report.

- Identify the key issues facing the company under the current BR approach (and proposed CB changes). Ensure the BR demonstrates alignment between corporate strategy, risks and the choice of KPIs (including anticipating the wider range of non-financial KPIs under the CB).

- Ensure all qualifying subsidiaries are notified of the need for them to produce a BR. Ensure a process exists to secure consistency of approach and content, between subsidiary and group reporting.

- Identify for financial and non-financial areas, the principal risks and uncertainties, together with the appropriate KPIs. As an example, many companies report, "people are their greatest asset", but no value can be assessed due to a lack of evidence in terms of relevant employee-related KPIs.

- Ensure a system to assess policy effectiveness is in place across all companies in the group and, as importantly, there is assessment of the effectiveness of policies.

- Produce a mock up of the BR. In our experience, Directors, especially Non-Executives like to "touch and feel" the proposed report to evaluate whether it meets their needs.

- Make the Board aware of the proposed new role of Directors (which will take effect before changes to the BR). Ensure plans are in place such that Group Non-Executives and directors of subsidiaries are aware of the changes – so they all face the same corporate way!

- Review the range of corporate reporting in the light of the BR. The opportunity to streamline reporting within the annual report (and across the range of corporate reports) will ensure more effective communication to investors and other stakeholders, e.g. why have a separate CSR section within an annual report, when the more appropriate approach might be to incorporate it within the BR?

Brighter spells are forecast, but only if the BR (or the OFR if you prefer) is considered more proactively, as a means of demonstrating how the directors and the management team "promote the success of their company" – informing their investors rather than leaving them in a fog of incomplete reporting.

If you would like more information or practical advice, please contact:
UK: Tony Hoskins +44 (0) 1189 262656
email: thoskins@thevirtuouscircle.co.uk
Brussels: James Wilson
email: jwilson@thevirtuouscircle.co.uk