Response to 'The Future of Narrative Reporting: A New Structure for Narrative Reporting in the UK' – November 2012

Introduction

CORE welcomes the opportunity to engage in this consultation on the draft regulations. CORE is a network of NGOs, academics, trade unions and legal experts which brings together the widest range of experience and expertise on UK corporate accountability in relation to international development, the environment and human rights. Our aim is to reduce business-related human rights and environmental abuses by making sure companies can be held to account for their impacts both at home and abroad, and to guarantee access to justice for people adversely affected by corporate activity.

This response builds on our submission to the original consultation exercise of autumn 2011 and participation in the BIS workshops in Spring 2012. The global reach of UK-linked companies makes public accountability for corporate impacts on people and the environment essential. There is growing international recognition of the need for improvements in corporate reporting in order to deliver accurate, reliable information. We welcome the proposal to include a specific requirement for quoted companies to report on human rights issues. However, we remain convinced that the UK's narrative reporting regime will not be fully effective until further guidance on the content of social, environmental and human rights reporting is provided to companies. The Government has signalled that it is preparing to work with the Financial Reporting Council on new guidance for the strategic report. This is welcome, however, CORE believes that it is important to reconsider current proposals for the guidance to be purely voluntary. Alongside this, serious efforts must now be made to ensure that those companies which are not complying with narrative reporting requirements are identified and publicly sanctioned.

Regulation 3 - A separate strategic report

- **Human Rights Issues**

We welcome the inclusion of human rights issues in reporting requirements for quoted companies and believe that the Financial Reporting Review Council (FRRP) should have the power to request information on human rights issues from all companies. This is of particular importance when those companies are operating in high-risk contexts (for instance, in conflict zones or countries with poor human rights records) and in sectors such as extractives, in which the risks of human rights abuses occurring is known to be high. Therefore in order to meet the UK's public commitment to implement the UN Protect, Respect, Remedy framework and the Guiding Principles on Business and Human Rights, reporting requirements should not be limited only to quoted companies. This requires a broader approach in addition to that currently outlined in the draft regulations. We also propose that the impact of the company is highlighted, in line with the current wording on environmental matters. For instance this could be done easily by rewording section 414C (d) (iii) so that it reads:

"(iii) social, community and human rights issues,

Including information about the impact of the company's business, any policies of the company in relation to these matters and the effectiveness of those policies."

Given that the term 'human rights' encompasses a vast range of issues and is not always properly understood by business, it is vital that clear guidance is provided to directors to enable them to identify which issues are 'material' or constitute a risk. Under the existing regime, the high degree of discretion for companies has tended to lead to generic and poorly evidenced reporting on environmental and social matters. A failure to provide robust guidance to underpin the proposed regulations will risk replicating this problem in reporting on human rights. The proposed regime already retains considerable flexibility for companies and in addition, the current proposals set out a preferred regime of voluntary guidance. CORE believes that it is important for the Government to reconsider this approach and explore options for more robust standards in order to ensure that the legislation is effective in practice.

As stated in our submission to the original narrative reporting consultation, guidance should provide directors with a set of principles which relate to the fulfilment of their duties, and this should be reflected in the form of specific question(s) linked to each duty. For instance, directors should be required to set out the human rights due diligence that their company undertakes, along with a requirement to explain the actions that are taken to prevent or mitigate specific negative human rights impacts which the company has identified. Benchmarks should be developed as part of the guidance to enable companies to give effect to the principles in a way that will encourage consistent and comparable reporting.

Guidance should be consistent with and complemented by a) an improved external audit and b) enforcement of directors' duties and reporting requirements. This is dealt with in more detail below.

Regulations 10 and 11 – simplification

- **Policy and practice of payment to creditors**

We are disappointed that the Government proposes to remove the requirement to disclose this information. As stated in our response to the original consultation, we are aware of some UK retailers paying suppliers 60, 90, or even 120 days late, putting the suppliers' cash flow under great strain. This pressure is frequently passed on to overseas suppliers, resulting in some occasions in employees and temporary workers being paid late. In countries where there is no social security safety net, delayed wages can directly impact on workers' basic nutrition and health. This is unacceptable when developing country suppliers are selling into the well-resourced supply chains of western retailers which maintain lean stock levels and high liquidity. There should be increased disclosure of creditor terms including number of creditors, value owed and creditor days. This information should be disclosed on a month by month basis.

Annex B: Earlier proposals

- **Sign off of the strategic report**

The Strategic Report is where companies' directors demonstrate how they have fulfilled their responsibilities under the Companies Act. Given the importance of this document and its legal status, we believe executive and non-executive directors should be required to sign it off.

- **Increasing the level of audit**

The Accounting Standards Board has found that '…too many Annual Reports do not cover all of the necessary topics sufficiently well to constitute an adequate report on the Board's stewardship of the company.'[1] To raise standards, a form of enhanced audit should become a requirement for narrative reports.

It is disappointing that these proposals on auditing have not been taken forward. As a result the draft legislation risks creating loopholes which could undermine the quality of reporting, especially if guidance for companies is voluntary. We would recommend that the issue of audit is revisited at a later date if standards in narrative reporting do not improve.

Other issues

- **Further comments on the text of the draft regulations**

Annex A: Draft Regulations

414C - Contents of strategic report

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[1] Effective Company Stewardship: Enhancing Corporate Reporting and Audit, p. 8 http://www.frc.org.uk/getattachment/2090009a-91b2-4c89-a48b-27af9c5b78ef/Effective-Company-Stewardship-Enhancing-Corporate.aspx

414C2 states that a strategic report must contain a description of the principal risks and uncertainties facing the company. CORE believes that there would be value in amending the text to highlight the fact this should include environmental, social and human rights risks and uncertainties where appropriate.

414C4d sets out the additional reporting requirements for quoted companies but separates out the need for quoted companies to disclose information on environmental matters, employees and social and community and human rights issues from 414C4 a-to d, which requires a description of the company's strategy, business model and main trends and factors likely to affect future development, performance and position of a company's business. It is equally important that the environmental, social and human rights issues are covered in the strategy, business model and trends and this should be clarified in the regulations.

- **Improving compliance**

Compliance with narrative reporting requirements is patchy, in part due to the absence of monitoring and of sanctions for incomplete and inaccurate reporting. Action is required to effectively enforce directors' duties if a culture change in corporate behaviour is going to become a reality. Failure to sanction companies for incomplete and inaccurate disclosure sends a signal that Government is not concerned about the implementation of its own laws.

To address this, the Government must ensure that Financial Reporting Review Panel (FRRP) is adequately and appropriately resourced to fulfil its wide-ranging responsibilities for ensuring that companies comply with the full range of reporting and accounting requirements.

At present, the FRRP has insufficient capacity and its composition represents a narrow spectrum of experience and interests. It is a major shortcoming that the membership of the body charged with overseeing compliance with reporting on environmental, social and (assuming the Government's proposals enter into force) human rights issues does not include anyone with expertise in these areas. A more diverse membership and improved resourcing would better equip the FRRP to assess complaints more effectively, and foster an increased level of independence and openness.

The visibility of the FRRP must also be addressed. In a context where to date there has been insufficient culture change among business, visible enforcement by the FRRP (or other bodies) would help to ensure that all companies take their responsibility to report seriously, and provide evidence of the actions taken in fulfilling their directors' duties.

ENDS