

Overview:

This paper represents the CORE coalition's response to the ASB exposure draft of the **Reporting Standard 1: The Operating and Financial Review**.

In general, there are 3 key problems with the Exposure Draft, including:

1. The draft as it stands has taken a very narrow interpretation of the government regulation and as such, fails to articulate the government's specific intent, which is to lead to more disclosure on, amongst other things, social and environmental reporting in the interests of users and members alike. The Radcliffe Report provided a stronger framework for companies that would be more likely to result in such an outcome. Furthermore, the ASB explicitly redefines the regulation in such a way as to further reinforce a reporting regime that will fail to see companies take into account how their wider responsibilities can affect their own performance for investors.
2. We believe that by failing to place a suggested list of indicators for companies to report on vis-à-vis non-financial matters, companies will rely on loose statements that will easily meet the standard, but will fail to improve the measurability of social and environmental matters and thus the quality of reports. CORE believes that by relegating the approach on the use of KPIs to "implementation guidance" only, the ASB inadvertently steers companies away from seeking to understand how their impacts affect both the business and the wider community. The ASB should use the implementation guidance for process-based suggestions, rather than the calculation of KPIs.
3. Finally, CORE believes that the ASB has made an assumption that investors will be solely concerned with making decisions that relate to the financial outcome of a company, whereas investors often make decisions based on other factors, namely ethical, social, economic or environmental matters. Investors must be provided with the range of information on all aspects of the company to enable them to make such an informed decision.

CORE believes that the ASB should immediately seek to recruit at least two professionals with expertise in social and environmental reporting onto its Board, both with experience from a business and stakeholder perspective, if we are to see a more progressive reporting regime to emerge from the introduction of the mandatory OFR.

Q1. CORE disagrees with the principles identified in paragraphs 5 to 24. The coalition believes that they are too narrowly defined to meet the overall intent of the OFR as stated by the regulation and the government. In particular, principles

5, 7 and 14 steer those preparing the OFR to only take into account the needs of investors.

Following the consultation on the draft regulation, the government explicitly issued a statement (November 25, 2004) stating that: Having met the needs of the schedule, “Directors will then need to consider and include information relating to their environmental, employment, and social and community policies to the extent necessary for shareholders to understand how these are **impacting the business and wider community.**” Thus, the government has supported CORE’s position that shareholders must be provided with an understanding of businesses wider impacts, even where there may be no immediate financial risk to the company. Reporting must address stakeholders, not just shareholders.

The principles and approach suggested by the ASB, however, will fail to lead to improved disclosure in the interests of stakeholders and, in fact, may reduce current levels of reporting in this area. We urge the ASB to strengthen and enhance principles to include a consideration of the needs of stakeholders in the preparation of the report along these lines of those found in the Materiality Working Group report which preceded the ASB draft standard.

Q2. CORE disagrees with the approach of using a disclosure framework without providing stronger mandatory indicators for companies to use in preparing the OFR. We believe that it is the duty of the ASB to start to define indicators in order to steer companies towards better and more transparent reporting. This would not only help companies, it will help investors to make better-informed decisions about the prospects of the company itself. The current approach will lead to a chaotic and vague reporting regime that will see reports vary in terms of both quality and comparability.

Q3. The Framework must include explicit reference to the needs of stakeholders and the impacts a business has on the wider community with a proposed list of

mandatory social, environmental and employee matters. The draft framework fails to embed stakeholder concerns into the standard and leads reporters to consider their business impacts simply as an afterthought, for example, as stated in paragraph 32. Paragraph 35 additionally narrowly implies that the only judgment investors will make will ultimately be based on pure financial decisions alone.

Q4. CORE believes that it is outside of the remit of the ASB to redefine the government's regulation as worded in paragraph 27 and should only outline the actual wording of the OFR as defined by the government. By adding 3 additional elements in front of other particular matters, the ASB inadvertently relegates social and environmental matters to a tertiary position. This is not acceptable. Points a, b, and c are all elements of social and environmental matters in themselves, and it is possible to provide KPIs that would lead to relevant reporting in these areas that meet the objectives of the OFR.

Q5. CORE believes KPIs should be specified especially vis-à-vis employee, environmental matters and community issues in order to avoid vague statements from companies that fail to inform investors of the companies' key impacts, their relevant risks and opportunities. CORE provided a proposed approach to defining such indicators in response to the consultation on the draft OFR regulation. These are included here, as Annex 1.

Q6. CORE supports the provision of methodology behind any KPIs provided, however would not want this to lead to reduced reporting of social and environmental KPIs that may be qualitative in nature.

Furthermore, paragraph 73 should restate the position in the regulation that KPIs should be considered in each of the main areas, in order to meet the needs of the OFR (eg not explicit to financial indicators only). CORE does not support

placing a discussion of which KPIs companies should use, in the Implementation Guidance, rather than the body of the Standard itself.

Q7. We support the proposal that the Reporting Standard should encourage other measures and evidence, both quantitative and qualitative, in addition to KPIs but argue that this should be part of the OFR, rather than simply acting as supportive information, as suggested by the question. Investors will be better informed with explicit information provided on such things as the values of companies, relations with stakeholders and other indicators that measure social and environmental performance. The ASB should not assume that investors only make decisions about which company to invest in based simply on the profitability of that business over time. Other factors may influence an investor's decision, especially as it relates to ethical elements such as social and environmental factors.

Q8. CORE supports further movement by the ASB to help bring non-financial indicators to the same status as financial indicators and would prefer that a similar approach on developing and including indicators be given to all indicators that companies choose to report on. The body of the OFR, however, need not include a detailed description of the methodology used to develop indicators and CORE would be amenable to seeing the detailed methodology in other formats, as long as these are made available to users and their location referenced in the OFR.

Q9. While examples are useful, the ASB should provide a more thorough list of possible indicators from which companies can draw (see Annex 1) in the body of the standard itself, based on already accepted practice, such as the Global Reporting Initiative. Only then, should examples be teased out in implementation guidance. By simply providing limited suggestions in the way that the draft currently does, CORE believes that business will limit rather than widen their

understanding of their responsibilities, impacts and risks beyond pure profit-based information.

Q10. The draft implementation guidance provides some useful signposting of possible employee, social and environmental matters but finds that these will unlikely lead to more reporting of these elements by business. In the first instance, CORE believes that the sign-posted items should be included in a table format in the body of the standard itself. The guidance, however, should focus primarily on process: how to calculate information; how to determine exactly what to include, and so on. The Materiality Working Group paper provided a more useful approach on process and articulating the duty of Directors that should be embedded into an implementation guidance document.

Furthermore, the draft guidance focuses primarily on financial operating information examples and thus implicitly fails to meet the objective of the OFR as defined in the regulation itself, which says that the objective of the OFR is to provide an analysis of “*the main trends and factors underlying the development, performance and position of the business*”...as well as “*the main trends and factors which are likely to affect their future development, performance and position*”. If reporting were to meet this objective, the standard must provide further explicit direction in the areas of non-financial reporting.

Annex 1

CORE Response to the DTI Draft Regulations on the Operating and Financial Review and Directors' Report Consultative Document.

Question	Summary Response
Q 1. Implementation – ASB Standards	As drafted, the OFR will not achieve the Government's stated objective of creating a 'reporting standard to have similar authority to that which has been achieved for accounting standards' (3.21) for two reasons. Firstly, like financial reporting, non-financial reporting needs to be mandatory if it is to be effective. Second, like financial reports, the data provided must be rigorous, consistent and comparable. The wide discretion to be given to directors to report "to the extent necessary" will not respond to public interests. Moreover, the Government's proposal to give the task of developing standards to the ASB fails to reference several existing non-financial reporting tools (e.g. the Global Reporting Initiative Guidelines) that are already being widely used internationally and have wide stakeholder support. To ensure that indicators developed by the ASB are consistent with and build on international best-practice, representatives of the major stakeholder constituencies, who are aware of companies' impacts, should be included in the ASB's work, not only in the initial development of the standard, but as the OFR matures over time.
Q 2. Scope – quoted companies only?	The CLR recommendation (that both public and private large companies should be required to prepare an OFR) was correct. If sustainable development is to be achieved, all companies need to engage. The fact that a large company has a private legal status cannot be used as a device to exempt it from internal and public scrutiny. As drafted, the OFR will create a double standard and exempt a number of unlisted companies (including public corporations) whose sustainability impacts could be significant.
Q 3. Scope – financial	No comment
Q 4. Directors' statements	The OFR's proposal to rely on directors' assessments of what is material is too subjective and unacceptable. While CORE agrees broadly with the list of topics which must be considered

	<p>(see Annex 2), leaving it to directors' discretion on how to report these invites non-disclosure of key data. As the Government notes, an increasing number of companies already report such information routinely on a voluntary basis.</p> <p>CORE supports the proposal (3.51) that an explicit statement should be made where directors consider that nothing is to be reported under paragraphs 4 to 7.</p>
Q 5. Disclosure of key performance indicators	<p>CORE agrees with the proposal that "directors should include all key performance indicators that are relevant to their business" (3.53). While this is directors' fiduciary duty, history has demonstrated that directors do not always identify or disclose all relevant KPIs. For this reason, CORE considers that the OFR should include generally-accepted KPIs, as well as mandatory stakeholder consultation mechanisms (see Annex 2) which would help identify the relevant KPIs in their interest.</p>
Q 6. Role of Auditors	<p>If they are to be of any value, the content of company reports needs to be clear, accurate and reliable. In this regard, auditing has a key role. External auditors can play a valuable assurance role, as can employees and unions, as well as external stakeholders, such as consumer organisations and NGOs. CORE recommends that reference be made to existing multi-stakeholder based processes. The AccountAbility AA1000 AS standard, which is already being used by major UK and foreign companies, might be a point of reference.</p>
Q 7. Audit costs	<p>CORE looks forward to discussing the responses to this question. CORE assumes that audit costs will be fully tax deductible. In any consideration of the costs of reporting and auditing, CORE would like to see consideration being given to the various benefits (including in terms of public goods) which derive from an enhanced disclosure regime. (See also responses to Q 16 & Q 17.) There is evidence that reporting can actually add value to a company (e.g. by identifying areas of waste and reducing risk).</p>
Q 8. Enforcement	<p>If they are to be effective, laws must be</p>

	<p>implemented in spirit and practice. CORE supports the need for enforcement, however believes that the proposed approach does not have the necessary safeguards. Two measures are proposed. First, the position of OFR Ombudsman should be created, with the authority to review and challenge reports. Second, legal standing should be given to all persons affected by a company's activities to challenge its accounts.</p>
Q 9. SME exemptions	<p>CORE's position is that all companies should be required to measure and report their sustainability performance. As a practical first step, it accepts that this should begin with large companies, both public and private, and that medium and small companies should be included as experience develops. CORE notes, however, that SMEs play an important part in the supply chain. In this context, many large or multi-national clients already require non-financial reporting on or conformance with certain OFR-related standards.</p>
Q 10. Enforcement (bis) & entry into force	<p>See comments above on content, enforcement and the role of auditors. The OFR should be brought into effect as soon as possible. Given the time already spent on this process, entry into force by January 2005 is appropriate.</p>
Q 11. Other comments on draft regulations	<p>No comment.</p>
Q 12. Distribution of reports	<p>There is a risk that if the concept of a 'light' OFR is endorsed, the credibility and effectiveness of reporting will be undermined. For this reason, CORE agrees with the principle of universality: all shareholders should receive all OFR information. While shareholders are an important group of stakeholders, they are not the only ones. Employees, unions, consumers and NGOs may also have interests in OFRs. For this reason, CORE demands that OFRs be made available in full to the general public, with a requirement to make the OFR available both in print and electronically, easily accessible via a website.</p>
Q13. Exemptions - Corporate Governance	<p>Issues of corporate governance have assumed increased importance in recent years. In the interests of transparency and efficiency, CORE recommends that OFRs should repeat information required under the FSA Listing Rules,</p>

	<p>or, at a minimum, cross-reference it (4.6). In the longer term, CORE believes there is scope for better integrating financial and non-financial reporting requirements, and ensuring that key corporate governance information is disclosed.</p>
<p>Q14. Exclusions – Confidentiality</p>	<p>Company operations considered to be ‘confidential’ need to be construed narrowly, both to protect shareholders from the risk of inappropriate dealings, and to ensure confidentiality is not used as a cloak to cover transactions that may be contrary to the public good. CORE supports the Government’s proposal not to include a provision for confidentiality in the OFR.</p>
<p>Q15. “Safe Harbour” provisions</p>	<p>Companies should be encouraged to think about the future, and to set challenging targets to improve their economic, social and environmental performance. Full and frank disclosure of these targets is in the interests of all stakeholders. CORE agrees with the Government’s proposal to omit any “safe harbour” provisions.</p>
<p>Q 16. Costs and Benefits</p>	<p>As noted (5.2), there are costs and benefits associated with expanded reporting requirements. In many cases, it will be difficult or even impossible to calculate the impact of the OFR. Companies differ widely in their internal practices of data collection and disclosure. Many companies already report their sustainability performance using recognised international tools, such as the Global Reporting Initiative (GRI). To improve policy implementation in the longer term, CORE recommends that the Government fund multi-stakeholder research into the issue of costs and benefits, and seek recommendations as to ways of increasing disclosure and keeping costs to the minimum.</p>
<p>Q 17. Additional Costs and Benefits</p>	<p>As recent corporate failures and continuing reports of bad practices indicate, the costs to society and the environment of poor corporate behaviour can be huge (e.g. job losses, collapse of pension funds, increased operating costs). It is the Government’s responsibility to ensure that stakeholders are able to assess and respond to these risks, both through market mechanisms and recourse to the law.</p>