

Simply Put

**Towards an effective UK
regime for environmental and
social reporting by companies**

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Foreword

The extraordinary economic collapse, prompted by an out of control banking system, and the unprecedented Parliamentary expenses scandal, have demonstrated the pressing need for government and business to operate in a transparent, ethical way.

Investors need to know the impact a company's activities are likely to have in order to weigh up risk, as do the communities who are likely to be affected.

The UK has rightly played a leading role in the development of international company law. The introduction of The Business Review provision in the Companies Act 2006 and the Coalition Government's commitment to reinstate the Operating & Financial Review, have added to the lively debate on how to create an effective environmental and social reporting framework for companies, both at home and abroad.

However there is still a long way to go. The UK's existing legal framework for corporate environmental and social reporting has been criticised by a number of independent experts, and indeed the Government's own recent review of the provisions in the Companies Act noted its failings.

The Government recently committed to reform social and environmental reporting requirements in its Plan for Growth. This offers a welcome opportunity to ensure that the legal framework 'UK PLC' depends upon is fit for purpose.

This report *Simply Put* highlights how, with a few road signs for companies, the existing regulatory framework for reporting can be improved quite simply and without the need for excessive bureaucracy.

It could not be more timely.

A handwritten signature in black ink that reads "Lisa".

Lisa Nandy MP
**Chair, The All Party Parliamentary Group
for International Corporate Responsibility**

Executive Summary

Compared to financial reporting, corporate environmental and social reporting ('E&S reporting') is a recent phenomenon. However, in recent years E&S reporting by companies has become, to varying extents, a regulatory requirement in many jurisdictions. There is now wide recognition, by governments, companies and their stakeholders of the value of E&S reporting as:-

- a useful management tool;
- an important mechanism for the communication of risk management information to investors; and
- a vital basis for wider company-stakeholder engagement on environmental and social issues.

Since 2007, all UK companies (except those under the small companies regime) have been subject to narrative reporting requirements in the form of a Business Review. Quoted companies are subject to a more explicit set of reporting obligations set out in section 417(5) of the Companies Act 2006 ('the Act'). These include requirements to report on information about environmental, employee, social and community issues *"to the extent necessary for an understanding of the development, performance or position of the company's business"*.

So far, though, these provisions are failing to deliver the high-quality, forward looking, balanced and insightful analysis on company environmental and social policies and performance that stakeholders need. This report explores why this is, and what changes need to be made to raise standards in E&S reporting and to ensure that underlying processes are more efficient, effective and beneficial to companies and stakeholder groups alike.

The focus of this report is on company reporting of environmental, employee, community, social, supply chain, human rights issues, as well as economic issues (eg. expansion plans, market position and dominance etc.) in recognition of the fact that these can have a significant impact on a company's performance in each of these six areas. For convenience, these issues are collectively referred to in this report as 'environmental and social' (or 'E&S') issues, and 'E&S reporting' refers to reporting on a company's performance in relation to these issues.

Part 1 summarises the importance and benefits of E&S reporting from various viewpoints. Part 2 then considers whether the scope of the UK's detailed disclosure requirements (which currently only apply to 'quoted companies') has been correctly set. It concludes that existing reporting requirements should be expanded to apply to all large and medium sized companies, public and private.

Part 3 looks at what and how much a company should be required to report, including the E&S issues that might pass 'materiality' thresholds. The variable quality of corporate reporting of E&S issues under the Act to date suggests that companies require much more detailed guidance on compliance, particularly on issues such as (a) the types of E&S issues that may be relevant (b) materiality, (c) reporting of risk management and impact mitigation strategies (d) reporting of links between risks and business model (e) reporting on relationships and risk management within corporate groups and (f) use of Key Performance Indicators ('KPIs'). Some additional guidance could be provided by way of extension of the basic statutory obligations, but most of the necessary guidance could be incorporated into new reporting standards. Guidance should also make clear the

need for companies to identify the different ways in which company priorities and objectives *differ* from the priorities and objectives of different stakeholder groups (e.g. consumers, employees, suppliers and communities), and the tensions that could arise as a result.

Part 4 considers the manner in which information should be presented. It acknowledges that there is a balance to be struck between standardisation and flexibility, but it concludes that, at present, the UK's E&S reporting requirements err towards flexibility for companies at the expense of high quality, useful reporting. In the long term this does not do UK businesses any favours, as it may come at the expense of coherence, consistency and comparability, as well as compromising the ability of UK companies to maintain a leadership role in the ongoing development of international and regional standards. In addition, the lack of clarity about what and how to measure, analyse and report may well, in some cases, create difficult dilemmas and inefficiencies for companies. It argues, therefore, that in the interests of efficiency and legal certainty compliance with reporting standards should be mandatory. This Part also notes the growing international interest in 'Integrated Reporting'. This new development only increases the need for standardised E&S reporting frameworks. Part 5 considers briefly the current debate on presentation of on-line information (and the practice of cross-referencing on-line information and other external sources in Business Reviews). It concludes that further guidance is needed on this issue.

Part 6 turns to the issue of assurance and audit. It concludes that the current auditing requirements (and specifically the statements required of auditors under the Act) are too weak. These need tightening up so that the auditor's role properly supports the objectives underlying the Business Review. In addition, the regulator needs to find ways to boost the capacity and skills of the auditing profession in relation to E&S reporting, including through the issue of further guidance.

Part 7 considers the role of the Financial Reporting Review Panel ('FRRP') as corporate reporting regulator. Despite serious questions as to whether many business reviews are compliant with statutory obligations at all, the FRRP has, to date, made little use of its formal powers. While there may be some benefits in this 'softly softly' approach, it does little to reinforce the idea that E&S reporting is a serious compliance issue. The FRRP needs to step up its enforcement efforts in relation to company reporting under section 417(5) of the Act. It also needs to review and strengthen its procedures for receiving and dealing with complaints, and publicise these more widely.

Very simply, the problems with the current legal regime can be summed up as (a) vague corporate obligations (b) insufficient auditor involvement and (c) weak enforcement. However, there are a number of actions that could be taken that could make the reporting framework much more effective, cost efficient and easy to use, and drive up reporting standards over time, without being unduly burdensome for companies. These actions are summarised at Part 8. Suggested amendments to the Act are set out in the Appendix to this report. While there are a number of recommendations regarding enforcement, very few of these suggested actions actually create additional obligations for companies over and above current regulatory requirements. In the main, these suggestions are designed to clarify existing legal requirements, and to simplify, streamline and take the guesswork out of corporate compliance.



1. Why should companies report?

There are several reasons why. First, the process of preparing an external report can be a useful management tool. It can be a driver for programmes to investigate and measure environmental and social impacts, to develop appropriate risk management strategies, and to monitor the success of these strategies over time.¹ In a wider context, E&S reporting potentially plays a vital role in regulatory efforts to encourage greater ‘long termism’ in business and finance by encouraging more thoughtful and future oriented analysis of risks and opportunities.

Secondly, companies report on environmental and social impacts because stakeholders require it. Investors are entitled to the information they need to make fully informed decisions about the likely future performance of their investments. The ‘business case’ for corporate social responsibility is still much discussed, and studies have identified a number of specific business benefits in striving to reduce adverse environmental and social impacts, including improved brand reputation and value, retention and motivation of employees, risk reduction and improvements to operational effectiveness.² On the other hand, and as the current financial crisis demonstrates, corporate failures to understand and properly analyse sources of longer term risk within a business sector can have a dramatic effect on shareholder value. Poor environmental management, and poor performance on human rights and community issues, can also diminish the value of shareholders’ investments. Investors concerned about the longer term performance of their investments want to see that directors are identifying sources of current and future risks (including longer term future risk), and are putting in place the strategies to deal with them. In the context of investment management, it is now common to see investors asking about risks to non-shareholders, as they are increasingly intermingled with risks to the shareholders and the company’s long-term value.

Finally, E&S reporting allows a wider group of stakeholders – e.g. consumers, communities, those involved in the supply chain – to assess the performance of a company in relation to issues that directly affect them and, if necessary, to hold that company to account. This is relevant to all companies, which all, in different ways, have

environmental and social impacts. However, the ability to hold companies to account in this way is particularly important in relation to larger companies, many of which now have considerable economic and political influence. In areas where regulatory oversight is weak, E&S reporting can play a crucial role in helping to close those accountability gaps. Human rights reporting, for instance, is now recognised as a critical part of the responsibilities of all businesses to ‘respect’ human rights.³ As Professor John Ruggie, the Special Representative of the UN Secretary-General (SRSG) on Business and Human Rights, puts it:-

The responsibility [of companies] to respect human rights requires that business enterprises have in place the policies and processes through which they can both know and show that they respect human rights in practice. Showing involves communication, providing a measure of transparency and accountability to individuals or groups who may be impacted and to other relevant shareholders, including investors.⁴

Current UK reporting framework

Since October 2007, all UK companies (except those subject to the small companies regime) have been subject to narrative reporting requirements, under the Companies Act 2006 (the “Act”), in the form of a “Business Review” (see Box 1 below for an extract of the key legislative provisions).⁵ For quoted companies, there are explicit requirements to include information about environmental, employee, social, community and supply chain issues *“to the extent necessary for an understanding of the development, performance or position of the company’s business.”*⁶ However, at present these reporting requirements are too vague, and their enforcement too weak, to meet the needs of stakeholders. So far, the standards of E&S reporting under this regime have been variable at best, and in many cases the quality of information has fallen short of expectations.⁷

The Corporate Responsibility (CORE) Coalition believes that, at a minimum, E&S reporting by companies should be **balanced, relevant and reliable** and presented in such a way that key information is **accessible, understandable and comparable**. This report sets out the changes that need to be made to the current regime to make this happen.

BOX 1

Key provisions of the Companies Act 2006 relating to E&S reporting

417 Contents of directors' report: business review

1. Unless the company is subject to the small companies regime, the directors' report must contain a business review.
2. The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company).
3. The business review must contain—
 - a) a fair review of the company's business, and
 - b) a description of the principal risks and uncertainties facing the company.
4. The review required is a balanced and comprehensive analysis of—
 - a) the development and performance of the company's business during the financial year, and
 - b) the position of the company's business at the end of that year, consistent with the size and complexity of the business.
5. In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—
 - a) the main trends and factors likely to affect the future development, performance and position of the company's business; and
 - b) information about—
 - i) environmental matters (including the impact of the company's business on the environment),
 - ii) the company's employees, and
 - iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and
 - c) subject to subsection 11, information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

If the review does not contain information of each kind mentioned in paragraphs b i), ii) and iii) and c), it must state which of those kinds of information it does not contain.
6. The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—
 - a) analysis using financial key performance indicators, and
 - b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters. 'Key performance indicators' means factors by reference to which the development, performance or position of the company's business can be measured effectively.
7. Where a company qualifies as medium-sized in relation to a financial year (see sections 465 to 467), the directors' report for the year need not comply with the requirements of subsection 6 so far as they relate to non-financial information.
8. The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.
9. In relation to a group directors' report this section has effect as if the references to the company were references to the undertakings included in the consolidation.
10. Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.
11. Nothing in subsection 5 c) requires the disclosure of information about a person if the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.



2. Who should report?

In principle, all companies should report on their environmental and social impacts. As noted above, E&S reporting, properly done, can be beneficial to companies themselves, as well as to different stakeholder groups. At present, the most detailed statutory E&S reporting requirements only apply to 'quoted companies'. This reflects the idea that increased corporate transparency was likely to be of most assistance to investors participating in an open share market, including institutional investors. But this approach fails to give sufficient weight to the benefits to companies that can come from E&S reporting,⁸ it also brushes aside the fact that stakeholders in private companies, particularly large private companies, also have a legitimate interest in corporate E&S performance. As the Company Law Steering Group noted in its 2001 Final Report:-

Others – whether employees, trading partners, or the wider community – also have a legitimate interest in the company's activities, particularly in the case of companies which exercise significant economic power. Our proposals must also satisfy these wider concerns for accountability and transparency.⁹

Whether and how much a company should report should depend, not on the type of company or the way its securities are traded, but on the degree of risks it poses and its likely impacts. The extent of likely impacts does not necessarily bear a direct relationship to the size of company or corporate group. Small companies can still have large environmental and social impacts. However, in many cases requiring small companies to comply with the same detailed narrative reporting requirements that apply to much larger corporations and corporate groups may impose a burden on management and resources that would be disproportionate and unfair. In recognition of this, it is appropriate that 'small' companies¹⁰ should, as a general rule, be exempt from detailed E&S reporting requirements (although the Secretary of State should have the flexibility to require E&S disclosures by smaller companies in appropriate cases). In any case, efforts should continue to be made, e.g. by way of best practice guidance, to encourage smaller companies to measure and report on their E&S impacts voluntarily.

Key recommendation 1

All companies, except for companies subject to the small companies regime, should be required to file a narrative report that includes information about environmental matters, employee issues, social and community issues, human rights issues and supply chain issues (subject to passing a 'materiality' threshold, see p. 11 below). Given that some small companies can potentially have large E&S impacts, the Secretary of State should have the power to require periodic or occasional E&S disclosures from smaller companies in appropriate cases. Small companies, not subject to detailed narrative reporting requirements, should still be encouraged to measure and report on E&S impacts voluntarily.



3. What should companies be required to report?

Problems with the current regime

The question of what companies should report must be informed by a clear idea of what and who the reporting is for. As noted above, shareholders have a legitimate interest in receiving information about the environmental and social impacts of the companies they invest in (and the way management approaches these issues) not least because of the implications that these issues can have for the short and long term value of their investments. However, a company's responsibilities do not begin and end with their shareholders. As social actors, companies have responsibilities to wider society which are defined by social expectations. This set of social conditions (or limitations on behaviour) is sometimes referred to as a company's 'social licence to operate'.¹¹ It is entirely appropriate, therefore, for E&S reporting requirements under company law to attempt to respond to wider concerns about corporate impacts and behaviour.

In E&S reporting, the quality of the narrative is key. If E&S reporting is to be effective – that is, to demonstrate a genuine desire on the part of companies to put in place effective risk management and to engage properly with stakeholders on difficult problems – companies must go beyond reporting on data and methodologies, and include proper interpretation, explaining the relevance of the data in the context of key risks and dilemmas and the implications of these for decision-making. At present, though, the UK's narrative reporting regime – and particularly as it concerns E&S reporting – is not even meeting the needs of the key audience of investors, let alone wider stakeholder groups. As the responses to the recent consultation by the Department of Business Innovation and Skills ('BIS') make clear,¹² there is concern from all stakeholder groups about the patchiness of current practice, including the lack of forward looking information and a lack of proper analysis, particularly in relation to how risks are being managed in line with companies' strategic objectives.¹³

The CORE Coalition's own research into the reporting practices of FTSE companies raises questions as to whether many reports even comply with current statutory requirements.¹⁴ Key information is difficult, if not impossible, to find, and there is a lack of comparability of information

between companies. Few companies make use of KPIs in their reports, despite this being a specific requirement under the Act itself.¹⁵

In short, the Act's narrative reporting requirements are failing to bring about the high quality reporting needed by shareholders to make informed decisions about their investments, and for other stakeholders to be able to hold companies to account. If this regime is to succeed, companies will need much greater clarity as regards:-

- the **issues** to be covered (i.e. how to go about assessing relevance);
- the amount and type of **information** required (i.e. how to go about assessing materiality); and
- the **indicators** by which performance is to be measured ('**KPIs**').

Issues

The E&S issues to be covered in each narrative report will depend on the company, the sectors in which it operates, its activities and future objectives. It is important that companies retain the flexibility to 'tell their own story'. However, this must be consistent with the overriding needs of stakeholders for coherence, consistency and comparability.

As a first step, companies need to identify the broad environmental and social risks or opportunities potentially raised by their activities. The work of organisations like the Global Reporting Initiative (the 'GRI'),¹⁶ the Carbon Disclosure Project,¹⁷ the UK Accounting Standards Board¹⁸ and the International Standards Organisation ('ISO')¹⁹ provide good starting points for this kind of analysis. DEFRA has also published useful guidance on environmental reporting for UK companies.²⁰

A compilation of some of the key issues falling under each of four main themes of section 417 of the Act is set out in Box 2 below.²¹ This is an illustrative rather than exhaustive list.

BOX 2**Risks and opportunities arranged by theme**

See Companies Act 2006, section 417(5)(b) and (c)

Environment

Biodiversity impacts;
 Climate change management;*
 Energy use and efficiency;
 Pollution and emissions;
 Materials and waste, packaging;
 Ozone depleting substances;
 Water use;
 Transport;
 Initiatives to mitigate environmental impacts;
 Pending litigation, legal judgments and any complaints under non-binding initiatives.

Labour

Pay and pensions;
 Diversity and equal opportunity;
 Freedom of association and collective bargaining;
 Recruitment and retention;
 Employee relations;
 Morale and motivation;
 Workplace performance;
 Occupational health and safety;
 Training and education;
 Child and forced labour;
 Pending litigation, legal judgments and any complaints under non-binding initiatives.

Community

Community engagement;
 Impacts on communities (including human rights impacts);**
 Initiatives to reduce human rights impacts;
 Community opposition or support/political risks;
 Local employment and training;
 Payments or donations made to host state authorities/anti-corruption policies and initiatives;
 Political risks/general political climate;
 Pending litigation, legal judgments and any complaints under non-binding initiatives.

Supply chain

Sourcing practices (including screening criteria and procedures);
 Supply chain impacts (including human rights impacts);
 Initiatives to reduce negative human rights impacts;
 Customer health and safety;
 Product labelling, marketing;
 Pending litigation, legal judgments, and any complaints under non-binding initiatives;
 Unfair commercial practices.

Notes

* Would include details of GHG emissions and emissions management. ** Would include, where relevant, issues such as indigenous peoples' rights and relationships, and contracts with military and security personnel.

Selection of issues

Some of the issues identified in Box 2 above will have greater relevance to some companies than others. For instance, ‘materials and packaging’, as an environmental issue, will be of more importance to a manufacturing company than a company providing internet services. Consumer safety and product labelling will be more of a priority issue for companies manufacturing and selling consumer goods, than it will be for a company providing construction services. However, many of them – climate change management, water use, transport, employee health and safety, for instance – will be relevant to most companies, if not all. The first step for a company is to identify the ‘universe of issues’²² that are potentially relevant. As a management exercise, this process can be an extremely valuable one if done properly. A proper understanding of the issues that could be relevant requires detailed internal consideration and evidence gathering. This is the only solid basis for a systematic analysis of what the potential impacts might be (see further the discussion on ‘materiality’ at p.12).

In some cases, the information called for will be relevant for other regulatory purposes, for instance a future regime for mandatory reporting of GHG emissions. Reporting along these lines may also be necessary based on voluntary commitments, such as participation in the UN Global Compact. In these cases, there needs to be coordination between the various initiatives, to avoid duplication of effort and to help streamline, rather than complicate, corporate reporting efforts.

Periodic review

There is also a need for a regular review process to ensure that this overarching framework of issues continues to reflect contemporary environmental and social concerns and priorities. Social and political developments, economic change, new scientific discoveries all have a bearing on corporate risk. New issues come to the fore, and old challenges can alter or fall away. New insights from management science can shed new light on how risks can be assessed and managed. The GRI’s long experience in developing its own Reporting Framework is relevant here. This framework is “continuously improved and expanded, as knowledge of sustainability issues evolve and the needs of report makers and users change.”²³ This development and review process includes (a) actively seeking feedback from reporters and sustainability practitioners through a variety of means, including multi-stakeholder consultation (b) based on feedback, determining a list of priorities which is then fed back into work plans (c) creation of special purpose multi-stakeholder working groups (d) public consultation (e) technical review and (f) final approval for incorporation in the Framework.

Human rights

Impacts on human rights are not explicitly mentioned in the section 417 list of factors potentially underlying performance. They are arguably covered by the reference to “social and community issues” in section 417(5)(b)(iii) of the Act, but there are a number of reasons why human rights impacts deserve special mention. First, it is widely accepted that negative human rights impacts can, and do in some cases, have sufficient impact on corporate performance and prospects to warrant disclosure under corporate reporting rules.²⁴ Explicit mention of human rights impacts in the narrative reporting requirements of the Act would introduce some much needed clarity for companies as to what is expected of them in terms of human rights reporting. Second, an increasing number of international initiatives in this area, including the work of the SRSG, the ISO and the UN Global Compact, have stressed the importance of human rights reporting as part of corporate responsibilities in respect of human rights due diligence. According to the SRSG’s Guiding Principle No. 21:-

In order to account for how they address their human rights impacts, business enterprises should be prepared to communicate this externally, particularly when concerns are raised by or on behalf of affected stakeholders. Business enterprises whose operations or operating contexts pose risks of severe human rights impacts should report formally on how they address them.²⁵

Finally, a distinction is warranted in the Act between human rights issues (which derive from international legal standards) and the other voluntary ‘social’ initiatives which companies may undertake to improve their reputation and standing in the community.

Key recommendation 2

Amend section 417(5)(b) and (c) of the Companies Act 2006 to give greater clarity to companies as to the kinds of issues that may be relevant to report. Explicit reference should be made to the company’s policies and practices and impacts in relation to human rights. Support expanded statutory obligations with further guidance for companies in the form of a mandatory reporting standard (see Key recommendations 3 and 4 below) which should be subject to regular multi-stakeholder review. Ensure that the review process takes account of other government initiatives, policies and proposals relating to corporate disclosures (e.g. mandatory disclosure of GHG emissions).

Information

Materiality

Once the relevant issues have been identified, there is necessarily a filtering process to decide what is 'material' (i.e. necessary to report) and what is not. The present test of 'materiality' under the E&S reporting requirements under the Act is information "*necessary for an understanding of the development, performance or position of the company's business*" (see section 417(5)). This must be read in the context of the stated purpose of the Business Review, which is "*to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)*" (see section 417(2)).

There is growing evidence that environmental and social factors are indeed material to company performance and can affect investment value.²⁶ However, the vagueness of the current reporting obligations means that directors and managers are often unclear as to what they should include and what they should leave out. In some cases, companies are responding with a 'kitchen sink' approach to reporting which means that reports are becoming cluttered with immaterial information, increasing the burden on companies and making important data and information difficult to find.²⁷ The CORE Coalition's own research into the reporting practices of FTSE 100 companies²⁸ suggests that companies are approaching the question of 'materiality' in a way that is neither coherent, nor consistent within sectors. More guidance is needed on the question of materiality to ensure a more systematic and objective approach. Specifically, companies need more guidance on how to keep track

of the issues that are or are likely to be of concern to stakeholders, and to assess their significance as a source of strategic risk (whether reputational, financial, social or organisational). Guidance should also make clear the need for companies to identify the different ways in which company priorities and objectives differ from the priorities and objectives of different stakeholder groups (e.g. consumers, employees, suppliers and communities), and the tensions that could arise as a result.

In practice, the concept of materiality in E&S reporting can be difficult to pin down. But there is already some guidance available. The GRI, for instance, has published guidance on materiality²⁹ that asks companies to take account of a range of internal and external factors including the "*organization's overall mission and competitive strategy, concerns expressed directly by stakeholders, broader social expectations, and the organization's influence on upstream (e.g., supply chain) and downstream (e.g., customers) entities*". The US Securities and Exchange Commission has recently issued interpretative guidance on climate change disclosure obligations, which includes examples of the kinds of climate-related events and developments that could trigger disclosure obligations under US securities laws.³⁰ Drawing on the work of AccountAbility (a UK-based organisation) US researchers Lydenburg, Rogers and Wood have proposed a test based on five 'categories of impact' - (a) financial impacts/risks; (b) legal/regulatory/policy drivers; (c) peer-based norms; (d) stakeholder concerns and societal trends; and (e) 'opportunity for innovation' – to produce a sector-specific set of issues on which to report.³¹ Similarly, any guidance produced for the UK regulatory context will need to be tailored to different businesses and sectors.

BOX 3

Human rights, 'materiality' and the SRSG's Corporate Law Project

A survey of company law in many jurisdictions around the world, carried out as part of the mandate of the SRSG, has found that there is a lack of guidance on how to go about determining which human rights issues will trigger corporate reporting obligations, despite wide acceptance that human rights impacts will indeed meet 'materiality' thresholds in some cases. It was concluded that this is not helpful to companies because it means that companies may be "*at risk of non compliance with reporting obligations, as they may not be reporting material information due to a lack of understanding of its relevance*". The SRSG went on to recommend, in his Guiding Principles on the 'Protect Respect and Remedy Framework', that "*[f]inancial reporting requirements [of states]...clarify that human rights impacts in some instances may be 'material' or 'significant' to the economic performance of the business enterprise*" (see Guiding Principle I.B.3).

Source: Mandate of the Special Representative of the Secretary-General (SRSG) on the Issue of Human Rights and Transnational Corporations and other Business Enterprises, Corporate Law Project: Overarching Trends and Observations, July 2010, copy available at: <http://www.reports-and-materials.org/Ruggie-corporate-law-project-Jul-2010.pdf>

Forward-looking analysis

Under the Act, quoted companies are required to disclose information about “*the main trends and factors likely to affect the future development, performance and position of the company’s business*” (see section 417(5)(a)). As far as environmental, employee and community issues are concerned (see Box 2 above for a list of possible items that fall under each of these categories) they are also required to give information about “*any policies of the company in relation to those matters and the effectiveness of those policies*” (see section 417(5)(b)). But despite these provisions, many companies are still not providing adequate explanations as to how opportunities and risks are identified and managed and their implications for overall company strategy.³² This suggests a need for further guidance on this point. At a minimum, reports should contain information about any pending or ongoing dispute resolution processes relating to E&S issues, including law suits, complaints made against the company to national contact points under the OECD Guidelines for Multinationals, disputes referred to arbitration, or other complaints processes.³³

Control relationships

Under section 415 of the Companies Act, directors of parent companies that are required to prepare group accounts under the Act (i.e. consolidated accounts for the parent company and a group of subsidiary undertakings)³⁴ must prepare a consolidated directors’ report for that whole group. Stakeholders have a legitimate interest in receiving detailed information relating to how such groups are run. Information relating to corporate structures, operating practices and policies, degree of oversight by the parent company of subsidiaries’ activities and operations (including foreign subsidiaries), the extent and substance of group-wide environmental and social policies (and their manner of implementation), environmental and human rights due diligence and mitigation, are all matters on which there should be detailed disclosure. However, there is, at present, little specific guidance on the disclosure requirements that apply to parent companies of corporate groups as regards their relationships with, and management of, their subsidiary undertakings (including foreign subsidiary undertakings). The OECD has estimated that around sixty per cent of global trade takes place within multinational corporate groups. The UK’s E&S reporting requirements need to recognise and take account of the realities of global corporate structures.

Specific regulatory requirements

As noted above, some corporate disclosures will be necessary – regardless of directors’ own assessments as to ‘materiality’ – because they are required for other regulatory purposes (e.g. information about

GHG emissions to assist the government to make the calculations necessary to assess its position in relation to its own targets and commitments on climate change). Guidance to companies must take account of corporate disclosure requirements in other, more specific contexts, to ensure that there is no inconsistency between the two.

KPIs

Quantitative data is crucial for the credibility and comparability of E&S reporting, as well as for the tracking of performance.³⁵ Yet despite the fact that analysis by way of KPIs is a specific requirement under the Act,³⁶ KPIs are not yet widely used.³⁷ Even where quantitative data is provided, “*there is rarely any description or detailed specification of the indicators used*”.³⁸ According to a study of reporting practices of FTSE 100 companies commissioned by the CORE Coalition, the most reported area of environmental information was ‘emissions, effluent and waste’ which includes CO₂ emissions. As the study notes, this information ought to be readily available to companies, as it is often required by other environmental regulation. “*Yet even here, only one third of companies surveyed reported quantitative information, and 18% did not mention the issue at all.*”³⁹

Detailed statutory guidance is needed on the use of KPIs in annual reports. This guidance should include illustrative KPIs for use in different sectors and contexts. In the interests of credibility and consistency, analysis using KPIs should be mandatory for each material E&S issue. This use of KPIs should, as far as is possible, be consistent across industries and within companies from year to year. Multi-stakeholder involvement will also ensure that KPIs remain relevant and credible.

Key recommendation 3

Strengthen current Companies Act 2006 provisions relating to the use of KPIs. Amplify statutory reporting obligations with mandatory reporting standards. Reporting standards should include further or supplementary guidance on matters including (a) assessment of materiality (which should be tailored to different sectors) (b) elements of a proper forward looking analysis, (c) reporting of risk management and impact mitigation strategies (d) reporting on links between risks and opportunities and business model (e) reporting by corporate groups and (f) use of KPIs. Reporting standards should be subject to regular multi-stakeholder review.

4. How should information be presented?

Standardisation vs. flexibility

The balance between standardisation and flexibility can be a difficult one to strike. It is often argued that too much standardisation can lead to too much ‘box-ticking’, ‘boiler-plate’ and ‘clutter’ in company reports, and that better, more meaningful reporting comes about when companies are free to ‘tell their own story’.⁴⁰ On the other hand, too much flexibility in how information is presented can mean that crucial information is difficult to find, compare and analyse, or it may be left out altogether. What is more, a flexible reporting framework is not necessarily a cure for ‘box-ticking’ and ‘boilerplating’.

At present, the UK’s narrative reporting regime errs towards flexibility for companies at the expense of high quality, useful reporting. But in some ways the ‘standardisation vs. flexibility’ debate is premature. What is needed at this stage is more guidance for companies on the way E&S information should be reported. As noted above, this guidance should take the form of clearer statutory obligations and mandatory reporting standards. While some standardisation is likely to emerge from this, guidance should be the primary goal. In time, clearer guidance should make company E&S reporting more straightforward and efficient than it is at present, as well as producing more concise and useful reports for stakeholders.

Key recommendation 4

Mandatory reporting standards (see Key recommendations 2 and 3 above) should provide a standard format for presentation of narrative information, which should be tailored to different sectors. Some flexibility could be introduced by way of a ‘comply or explain’ system, provided that there are sufficient checks to ensure that explanations for non-compliance are adequate.

It is important to recognise, in any discussion about 'standardisation' that some kinds of E&S information are more amenable to standardisation than others. For instance, it would be relatively straightforward to set out standardised requirements regarding the reporting of quantitative information such as GHG emissions, water usage and waste and to prescribe a set of KPIs (see discussion at p.13 above) to enable the company to measure and track its performance. However, guidance in relation to more complex and qualified issues, risks and policies may need to offer companies more flexibility.

If necessary, some flexibility in mandatory reporting standards could be introduced using a system known as 'comply or explain'. However, safeguards would be needed to ensure that explanations for non-compliance were adequate. The level of explanation required would need to be the subject of further guidance. The adequacy or otherwise of explanations of non-compliance should be the subject of complaints processes operated by the FRRP (see further comments at pp.19-20 below). A further check could be provided by allowing shareholders an advisory vote on the Business Review (see further p.20 below).

Integrated reporting

The links between environmental and social risks and a company's long term business strategy and model are still poorly explained in most annual reports. A new method of reporting has recently been proposed which aims to present information about (a) a company's financial performance and (b) its environmental and social performance in an integrated way. This new reporting method, (known as 'Integrated Reporting') is still in the early stages of development. However, its supporters claim that it has the potential to improve the quality of company reporting by better demonstrating "*the linkages between an organisation's strategies, governance and financial performance and the social, environmental and economic context within which it operates*".⁴¹ This should, it is argued, "*help business to take more sustainable decisions and enable investors and other stakeholders to understand how an organisation is really performing*".⁴²

In August 2010, the GRI announced the establishment, in partnership with the Prince's Accounting for Sustainability Project (amongst others) of the International Integrated Reporting Committee ('IIRC'). Members of the Committee are drawn from regulators, large companies, accounting firms, investor groups, academia and civil society from around the world. One of the key aims is development of "*an overarching Integrated Reporting framework, which sets out the scope and key components of Integrated Reporting*".⁴³ A discussion paper is being prepared for consultation in June 2011. This will be followed by a pilot programme during which companies and investors will be able to experiment with, and give feedback on, the new framework.

To the extent that integrated reporting encourages more thoughtful and forward-looking analysis of E&S risks and opportunities, better impact mitigation strategies and more accurate reporting of E&S issues, it is a potentially useful development. However, if it results in even more simplistic analyses of the 'materiality' of E&S issues (e.g. if disclosure of E&S issues was only treated as warranted if the financial impact was immediate and clear), then this would be a backward step. For the time being, much more guidance for companies is needed before this will be a workable option. As the GRI points out "*[i]n order for integrated reporting to be a viable and useful activity for companies, it must be underpinned by standardized financial and ESG [environmental, social and governance] reporting frameworks*".⁴⁴

Key recommendation 5

The UK government and UK regulators should monitor and engage with the work of the International Integrated Reporting Committee.



5. Where should information be published?

Companies are required under the Act to circulate annual accounts and reports to members,⁴⁵ although they often now have the option of circulating summary information instead of the full reports.⁴⁶ In addition, quoted companies must make their accounts and reports generally available, free of charge, via a website.⁴⁷

CORE's research into the reporting practices of FTSE 100 companies uncovered a variety of approaches to the publication of E&S information as part of Business Reviews. For instance, "*some companies referred to more detail on their websites, others referred generally to their CR reports, while yet others made reference to an internet location at which further detail could be found.*"⁴⁸ Legal advice received by The CORE Coalition suggests that this additional information, which is merely cross-referenced in the Business Review itself, cannot be treated as being part of the Business Review.

Interactive web-tools and web-links can be useful ways of displaying and cross-referencing data (e.g. performance data that links directly to relevant policies and targets). However, it is important that, in cross-referencing additional data and information, the relevance of that information to the matters discussed in the Business Review (specifically the "*future development, performance and position of the company's business*") is adequately explained. Companies need to ensure that simply cross-referencing further sources of information is not a substitute for proper analysis.

Companies need to be encouraged to find ways to make the presentation of on-line information as accessible and user-friendly as possible. A common framework for content and presentation would be a good place to start (see Key recommendation 4 above). In addition, the government, through BIS, could provide further guidance to companies from time to time on the kinds of tools and publication methods most likely to enhance accessibility.

Key recommendation 6

Mandatory reporting standards (see Recommendations 2,3 and 4 above) should include guidance on the publication of on-line information. This guidance should aim to ensure that the extent of publication and accessibility of environmental data and information is on a par with that of financial information.



6. Assurance and audit

Virtually all voluntary standards on E&S reporting recognise the importance of an assurance and auditing process to ensure that the information presented by the company is balanced and credible. The GRI identifies six criteria for proper external assurance of E&S reporting by companies. These are set out at Box 4 below.

The present auditing requirements for narrative reports under the Act are very weak. Under the Act, the mandatory audit is limited to a statement as to “whether in his opinion the information given in the directors’ report for the financial year for which the accounts are prepared is consistent with those accounts”.⁴⁹ This is much weaker than the previous OFR framework, under which auditors were required to state whether any matters had come to their attention during the audit which, in their opinion, were inconsistent with the narrative information given in the OFR.⁵⁰ These requirements are also far weaker and far less detailed than the requirements in relation to financial reports,⁵¹ under

which the auditor is required to identify the financial reporting framework that has been applied, describe the scope of the audit and the auditing standards applied, and whether the accounts give a ‘true and fair view’ of the financial position of the company at the end of the relevant financial year.

Proper auditing is a crucial part of an effective reporting process. It provides stakeholders with a second opinion about the accuracy of directors’ statements and analysis. It provides a procedure whereby directors’ judgements, based on all the information before them, can be challenged. However, this is unlikely to be the result of the current regulatory provisions, especially given that narrative reporting is intended to be forward looking, while the financial information with which it is being compared with is historical. As a briefing paper prepared by ClientEarth puts it, “[o]nly a narrow class of the most serious narrative misstatements would be identified by this scope of investigation and assessment”⁵²

BOX 4

The GRI’s ‘six qualities’ for external assurance of sustainability reports

External assurance of reports made under the GRI G3 Guidelines:

- should be conducted by groups or individuals external to the organization who are demonstrably competent in both the subject matter and assurance practices;
- is implemented in a manner that is systematic, documented, evidence-based, and is characterized by defined procedures;
- assesses whether the report provides a reasonable and balanced presentation of performance, taking into consideration the veracity of the data in a report as well as the overall selection of content;
- utilizes groups or individuals to conduct the assurance who are not unduly limited by their relationship with the organization or its stakeholders to reach and publish an independent and impartial conclusion on the report;
- assesses the extent to which the report preparer has applied the GRI Reporting Framework (including the Reporting Principles) in the course of reaching its conclusions; and
- results in an opinion or set of conclusions that is publicly available in written form, and a statement from the assurance provider on their relationship to the report preparer.

Extracted from GRI, GRI and External Assurance, available from <http://www.globalreporting.org/ReportingFramework/ApplicationLevels/ExternalAssurance.htm>.

The auditing provisions in the Act need tightening up so that the auditor's role properly supports the objectives underlying the Business Review. The mandatory audit needs to be expanded so that narrative information is properly scrutinised in light of the information available. This process should include independent discussions with key stakeholders, such as trade unions, local community representatives and relevant civil society actors.

Attention should also be given to capacity building within the auditing profession to ensure that it is properly equipped to carry out this role. The issue of skills in the auditing profession was raised in a 2010 discussion paper by the Financial Services Authority and the Financial Reporting Council, which made the following observations:-

In some cases the FSA has seen concerning valuations, provisions and disclosures, the auditor's approach seems to focus too much on gathering and accepting evidence to support managements' assertions, and whether managements' valuations and disclosures comply with the letter of accounting standards, rather than whether the standards' requirements have been applied in a thoughtful way that would better meet the standards' objectives.⁵³

Key recommendation 7

Expand the scope of the mandatory audit to reflect the approach envisaged under the OFR framework. Consider further guidance to auditors regarding the auditing of narrative information which (a) should be based on the best practice identified by the GRI and other organisations working in the field of environmental, social and human rights reporting and (b) should provide for independent discussions with key stakeholders, such as trade unions, local community representatives and relevant civil society actors.

Key recommendation 8

Investigate ways to boost the capacity and skills of the auditing profession in relation to E&S reporting.



7. Regulatory oversight and enforcement

The Financial Reporting Review Panel ('FRRP'), an operating body of the Financial Reporting Council, is the body with responsibility for ensuring that company accounts and reports comply with the law.⁵⁴ Its powers under the Act include requiring documents, information or explanations from companies (or its officers, employees, or auditors) where it appears that reports may not be compliant⁵⁵ and making applications to court under section 456 of the Act for a declaration of non-compliance and an order to produce revised accounts or a revised report.

E&S reporting issues and problems are only briefly discussed in the FRRP's annual reports. But the little information that is available does not suggest that the FRRP is enforcing companies' narrative reporting obligations particularly vigorously. In 2009/10, according to the FRRP's most recent Annual Report, the FRRP reviewed 308 sets of accounts overall and wrote letters to 146 companies.⁵⁶ It is not clear how many (if any) of these communications related to problems with narrative reporting, and specifically E&S reporting. The main remedy used so far in cases of non-compliance with the reporting requirements under the Act (financial and non-financial) appears to be a press notice and an undertaking from the company to publish a correction in its next annual report.

In 2009/10 the FRRP carried out a 'targeted review' of corporate reporting practices under the business review provisions of the Act, including but not limited to the provisions relating to E&S reporting. According to its Annual Report, the FRRP challenged some companies:

where the risks and uncertainties were not clear or where bullet point lists were provided but without the description needed in order for them to be fully understood. Some companies disclosed a litany of possible risks that they, or indeed any company, might face but without indicating which were the principal risks or saying why they were important to the company...The Panel also asked companies about failure to disclose risks which later events strongly suggested must have been known at the balance sheet date. In these cases, the Panel asked for confirmation of the facts and circumstances known at the date of signing of the accounts and why they had not been considered a principal risk or uncertainty ... **Good descriptions**

which comply with the law say why they [i.e. risks] apply to the company, and why they are important. The Panel is well aware that some companies face serious risks which are inherent in their field of activity and therefore need to be disclosed every year, but does not regard this as an excuse for boilerplate.⁵⁷
(emphasis added)

It is clear, from the comments above, that the FRRP has some concerns about compliance. On the other hand, its approach to enforcement relies heavily on the cooperation of companies and their directors. The last two Annual Reports suggest that formal enforcement powers are rarely, if ever, used. Although a good working relationship between a regulator and regulated companies is in many ways beneficial, the 'softly softly' approach to enforcement apparently adopted by the FRRP does little to reinforce the idea that E&S reporting is a serious compliance issue. On the reporting of environmental, employee, community and social issues under section 417(5)(b) (an area where The CORE Coalition research has identified widespread compliance problems)⁵⁸ the FRRP merely notes that while it had expected to receive referrals and complaints from the public, none were forthcoming. However, the Panel adds that it had "*approached companies of its own volition where it was apparent that there was a question of substantive non-compliance; for example companies were questioned when they did not refer to environmental KPIs despite references elsewhere in their CSR reports suggesting that they were relevant*".⁵⁹ The outcome of these discussions is not recorded in the Annual Report.

The FRRP does not appear to have given wide publicity to the ability of members of the public to complain about the quality of E&S reporting by companies, although information about how to make complaints about accounts or a failure to make disclosures required under the Act is provided, via its website, under the heading 'FAQs'.⁶⁰ Under these procedures, members of the public can complain to the FRRP in writing (including via the FRRP's contacts page on its web-site), following which the FRRP will decide, either that the matter does not fall within its remit, or to seek further information from the company, or to commence a formal enquiry. In July 2010, the environmental law organisation ClientEarth

made a complaint to the FRRP against Rio Tinto plc, alleging that the company's annual reports did not comply with the Act because they did not include "*major environmental, human rights and community concerns*".⁶¹ In a press release dated 15 March 2011, the FRRP announced that the matter had been resolved by an agreement by the company to include additional information in the company's annual report for the year ended 31 December 2010. On this basis, according to the FRRP press release, the FRRP regarded its enquiry into the matter as concluded. However, the FRRP's announcement made no public comment as to whether the earlier reports had complied with the Act or not.⁶² A valuable opportunity to provide some clarity to UK companies as to their E&S reporting obligations under the Act was missed.

One problem likely to be facing the FRRP at present is resource constraints. This problem is likely to be exacerbated further if the recently announced cuts in funding to the Financial Reporting Council result in a reduction in funding and capacity of the FRRP.

Another possible limitation, in relation to the enforcement of E&S reporting requirements specifically, is the current make-up of the FRRP panel. The fact that it is made up almost entirely of City lawyers and accountants is hardly surprising. But while this Panel may be amply qualified to assess corporate financial reporting, the lack of environmental and social management and reporting specialists, and the lack of representatives from wider stakeholder groups raises questions as to whether the FRRP, as currently constituted, has the capacity and expertise to enforce E&S reporting effectively, in line with internationally recognised best practice. The possible lack of independence (or perception of lack of independence) of a group that draws so heavily from the commercial legal and accounting professions is also of concern.

In addition to enforcement, the Financial Reporting Council, through the Accounting Standards Board, has a crucial role to play in the development of new reporting standards and further supplementary guidance on technical issues to do with E&S reporting. The matters that need to be covered by these reporting standards are discussed in Key Recommendations 2, 3 and 4 above. For the reasons discussed above, these reporting standards should be mandatory.

Finally, shareholders should be permitted an advisory vote on the Business Review. Not only would this send a signal to companies that E&S reporting is indeed a serious compliance issue, it also gives shareholders formal opportunities to engage with company reporting of E&S issues, and to challenge this reporting if necessary.

Key recommendation 9

Ensure that the FRRP has the resources and capacity to enforce the sustainability reporting requirements of the Companies Act 2006 effectively and proactively. Make narrative reporting (and specifically reporting of environmental, employee, community, social, supply chain and human rights impacts) a priority enforcement issue. Review current complaints procedures, specifically in relation to communications with the complainant and regarding process and transparency of outcomes. Publicise the substance of E&S reporting requirements. Publicise the availability of the complaints procedures and their applicability to E&S reporting requirements. Ensure better and fuller disclosure of outcomes of investigations of non-compliance (e.g. by way of press releases and in subsequent Annual Reports). Ensure that the membership of the FRRP includes individuals with specialised expertise in E&S reporting issues. Finally, shareholders should be permitted an advisory vote on the Business Review.



8. Summary of recommendations

This section is a summary of all of the key recommendations set out in this report (in blue text boxes above) arranged, for convenience, according to the person or body responsible for implementation. The rationale for each of these recommendations is explained in the body of the report.

1. Using his powers under section 468 of the Companies Act 2006, the **Secretary of State** should amend the reporting provisions of the Companies Act 2006 so that:-
 - present requirements under section 417(5) apply to all companies except for those subject to the small companies regime (not just quoted companies);
 - greater clarity is provided to companies as to the kinds of issues that may be relevant to report;
 - reporting of material human rights impacts is an explicit requirement;
 - reporting is done in conformity with relevant reporting standards; and
 - obligations in respect of the use of KPIs are strengthened.
2. The Companies Act 2006 should be further amended so that
 - auditors are required to state whether anything has come to their attention during the performance of the audit which is inconsistent with the narrative report; and
 - shareholders are permitted an advisory vote on the Business Review.
3. The **Secretary of State** should also:
 - instruct the Accounting Standards Board ('ASB') to prepare new mandatory reporting standards for the purposes of the amended Companies Act 2006 which includes detailed guidance for companies on a range of matters including (a) assessment of materiality, (b) elements of a proper forward looking analysis (c) reporting of risk management and impact mitigation strategies (d) reporting on links between risks and opportunities and business model (e) reporting by corporate groups (f) use of KPIs (g) publication of on-line

information. These mandatory reporting standards should be tailored to different sectors and should provide a standard format for presentation of narrative information. Some flexibility could be introduced by way of a 'comply or explain' system, provided that there are sufficient checks to ensure that explanations for non-compliance are adequate;

- monitor and engage with the work of the International Integrated Reporting Committee;
- ensure that he has the necessary powers (whether under section 468 of the Act or from elsewhere) to require periodic or occasional E&S disclosures from smaller companies in appropriate cases, and to indicate the circumstances in which he will be prepared to use those powers; and
- take steps to encourage companies subject to the small companies regime to measure and report on E&S impacts voluntarily, including through issue of best practice guidance.

4. The **Government** should:

- ensure that the FRRP has the resources and capacity to enforce the environmental, employee, community, social, and human rights reporting requirements of the Act effectively and proactively.

5. The **FRC** should:-

- establish a programme for regular multi-stakeholder review of reporting standards and supplementary guidance;
- ensure that the review process (above) takes account of other government initiatives, policies and proposals relating to corporate disclosures (e.g. mandatory disclosure of GHG emissions);
- monitor and engage with the work of the International Integrated Reporting Committee;
- develop additional guidance for auditors on the auditing of information relating to environmental, employee, community, social, supply chain and human rights issues (which (a) should be based on the best practice identified by the GRI and other organisations

working in the field of environmental, social and human rights reporting and (b) should provide for independent discussions with key stakeholders, such as trade unions, local community representatives and relevant civil society actors);

- investigate ways to boost the capacity and skills of the auditing profession in relation to E&S reporting;
- make narrative reporting, and specifically the reporting of environmental, employee, community, social, supply chain and human rights impacts, a priority enforcement issue;
- review current complaints procedures, specifically in relation to (a) communications with the complainant regarding process and (b) transparency of outcomes. Publicise the substance of E&S reporting requirements. Publicise the availability of the complaints procedures and their applicability to E&S reporting requirements;
- ensure better and fuller disclosure of outcomes of investigations of non-compliance (e.g. by way of press releases and in subsequent Annual Reports); and
- take steps to enhance the capacity and expertise of the FRRP in relation to the evaluation of Business Reviews, including recruiting individuals with specialised expertise in environmental and social risk management and reporting.

Appendix

Draft amendments to the Companies Act 2006

417 Contents of directors' report: business review

1. Unless the company is subject to the small companies' regime, the directors' report must contain a business review.
2. The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company).
3. The business review must contain—
 - a) a fair review of the company's business, and
 - b) a description of the principal risks and uncertainties facing the company.
4. The review required is a balanced and comprehensive analysis of
 - a) the development and performance of the company's business during the financial year, and
 - b) the position of the company's business at the end of that year, consistent with the size and complexity of the business.
5. The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—
 - a) the main trends and factors likely to affect the future development, performance and position of the company's business; and
 - b) information about—
 - i) environmental matters (including the impact of the company's business on the environment),
 - ii) the company's employees (including matters such as employee relations, workplace health and safety, training, recruitment and retention), and
 - iii) social and community issues (including the impact of the company's business on local communities and information regarding community engagement);
 - iv) human rights (including the impact of the company's business on the enjoyment of human rights); and
 - c) subject to subsection 10, information about persons with whom the company has contractual or other arrangements which are essential to the business of the company, including environmental, employee, social, community and human rights criteria relating to—
 - i) the sourcing of goods and services; and
 - ii) the distribution and sale of goods and services to third parties (including end consumers)

In relation to the information mentioned in paragraphs b) i), ii), iii) and iv), and paragraph c) the review must set out in each case any policies of the company in relation to those matters and the effectiveness of those policies.

If the review does not contain information of each kind mentioned in paragraphs b) i), ii) and iii) and c), it must state which of those kinds of information it does not contain.

- 6A)** a) The review must comply with relevant reporting standards.
- b) In this Part, "reporting standards" means statements of standard reporting practice which relate to business reviews and which are issued by a body or bodies specified in an order made by the Secretary of State.
- c) References in this Part to relevant reporting standards, in relation to a company's business review, are to such standards as are, in accordance with their terms, applicable to the company's circumstances and to the review.
- d) Where and to the extent that the directors of a company have complied with a relevant reporting standard, they shall be presumed (unless the contrary is proved) to have complied with the corresponding requirements of this Part relating to the contents of a business review.
6. The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—
- analysis using financial key performance indicators, and
 - analysis using other key performance indicators, including information relating to the matters mentioned in paragraphs 5 b) and c).
- 'Key performance indicators' means factors by reference to which the development, performance or position of the company's business can be measured effectively.
7. The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.
8. In relation to a group directors' report this section has effect as if the references to the company were references to the undertakings included in the consolidation.
9. Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the reasonable opinion of the directors, be seriously prejudicial to the interests of the company.
10. Nothing in subsection 5 c) requires the disclosure of information about a person if the disclosure would, in the reasonable opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.

496 Auditors' report on directors' report

The auditor must state in their report on the company's annual accounts:

- whether in their opinion the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts;
- where the directors' report contains a business review-
 - whether in their opinion the directors have prepared the review after due and careful inquiry; and
 - whether any matters have come to their attention, in the performance of their functions as auditors of the company, which in their opinion are inconsistent with the information given in the review.

Endnotes

1. See *Corporate Social Responsibility Reporting in Denmark: Impact of the legal requirement for reporting on CSR in the Danish Financial Statements Act*, August 2010 ('Danish Reporting Study'). Copy available at http://www.dcca.dk/graphics/publikationer/CSR/CSR_and_Reportin_in_Denmark.pdf. In this recent survey of corporate practices under, and attitudes to, new CSR reporting requirements under the Danish Financial Statements Act, it was concluded that Danish companies were generally positive about the new requirements, and some corporate respondents felt that the new requirements had helped to improve internal systems. The authors report that "*[e]xamples have been found to indicate that the legal requirement has provided businesses with an opportunity to start working with CSR, to increase focus on this area, to better systemise existing work and has given businesses a basic framework for their work with CSR*", at p.14.
2. For a recent study see Business in the Community, *The Business Case for Being a Responsible Business*, March 2011. Copy available at http://www.bitc.org.uk/resources/publications/the_business_case.html.
3. On the need for explicit reference to human rights impacts in the Companies Act 2006, see further p.10 below and Key recommendation 2 at p.11 below.
4. *Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie: Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, UN Doc. A/HRC/17/31, 21 March 2011, ('Ruggie Guiding Principles') General Principle II.B.21 ('Commentary').
5. Note that these provisions are designed to implement in the UK an EU-wide framework for narrative reporting. See the Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (more commonly known as the 'EU Accounts Modernisation Directive'). The DG Internal Market and Services has been consulting on the existing regime on disclosure by companies of non-financial information (including environmental and social information). See DG Internal Market and Services, *Summary Report of the responses received to the public consultation on disclosure of non-financial information by companies*, April 2011, copy available at http://ec.europa.eu/internal_market/consultations/docs/2010/non-financial_reporting/summary_report_en.pdf. In a recent communication from the Commission it was announced that a new legislative proposal is to be put forward on "*the transparency of the social and environmental information provided by companies in all sectors*". See European Commission, COM(2011) 206 final, copy available at http://ec.europa.eu/internal_market/smact/docs/20110413-communication_en.pdf.
6. Companies Act 2006, section 417(5)(b).
7. See A. Henriques, *The Reporting of Non-Financial Information in Annual Reports by the FTSE 100*. A paper prepared for the Corporate Responsibility (CORE) Coalition, 2010 ('Reporting of Non-Financial Information'). Copy available <http://corporate-responsibility.org/wp/wp-content/uploads/2010/04/Reporting-of-Non-Financial-Information-by-the-FTSE1003.pdf>.
8. See Danish Reporting Study, n. 1 above. This study found that, despite the administrative burden and costs associated with CSR reporting, the attitude of Danish companies to the new requirements was generally positive. As well as bringing about improvements to internal systems (see n. 1 above), some respondents to this study noted that the new legal requirement may have indirectly created business opportunities and led to efficiency savings, at p. 14.
9. Company Law Review Steering Group, *Modern Company Law: For a Competitive Economy - Final Report*, Volume I, DTI (June 2001), p. 48.
10. The conditions for qualification for the small companies regime under the Companies Act 2006 are set out at section 382 of the Act. Currently companies that can satisfy two of the following criteria – (i) turnover of not more than £5.6 million, (ii) balance sheet total of not more than £2.8 million and (iii) no more than 50 employees – will qualify as 'small'.
11. Indeed this idea forms the basis of the 'second pillar' of the 'Protect, Respect and Remedy' framework for business and human rights devised by the SRSG: the corporate responsibility to respect human rights. See *Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie*, UN Doc. A/HRC/8/5, 7 April 2008, esp. paras 54 and 55. Copy available at <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf>.
12. See BIS *The Future of Narrative Reporting: A Consultation*, August 2010. Copy of consultation document available at <http://www.bis.gov.uk/assets/biscore/business-law/docs/n/10-1057-future-narrative-reporting-consultation.pdf>. The consultation closed on 19 October 2010. A summary of responses prepared by BIS in December 2010 is available at <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/10-1318-summary-of-responses-future-narrative-reporting-consultation.pdf> ('BIS Summary of Responses').
13. See BIS Summary of Responses. n. 12 above, para. 12.
14. See A. Henriques, 'Reporting of Non-Financial Information', n. 7 above.
15. i.e. "*to the extent necessary for an understanding of the development, performance or position of the company's business*". See Companies Act 2006, section 417(6). On KPIs, see further discussion at p. 14 below.
16. See Global Reporting Initiative, *Sustainability Reporting Guidelines G3.1*. <http://www.globalreporting.org/ReportingFramework/G31Guidelines/>.
17. Carbon Disclosure Project, <https://www.cdproject.net/en-US/Pages/HomePage.aspx>.
18. Accounting Standards Board, *Reporting Statement: Operating and Financial Review*, January 2006. Copy available at <http://www.frc.org.uk/asb/technical/operating.cfm>.

19. See ISO 26000 Guidance on Social Responsibility. See http://www.iso.org/iso/catalogue_detail?csnumber=42546. See also the ISO 14001 Environmental Management Standard. Details available from http://www.iso.org/iso/iso_14000_essentials.
20. See for instance, DEFRA, *Environmental Key Performance Indicators: Reporting Guidelines for UK Business*, 2006, copy available at <http://archive.defra.gov.uk/environment/business/reporting/pdf/envkpi-guidelines.pdf>. See also DEFRA Guidance on the reporting of GHG emissions and transport impacts, available from the DEFRA web-site at <http://www.defra.gov.uk/environment/economy/business-efficiency/reporting/>
21. This ‘four part’ table is inspired by the existing framework for E&S reporting in the Companies Act 2006 (see section 417(5)(b) and (c)). For a more generic framework see S. Lydenberg, J., Rogers and D. Wood, *From Transparency to Performance: Industry-based Sustainability Reporting on Key Issues*, Hauser Centre for Nonprofit Organisations at Harvard University/Initiative for Responsible Investment, Fig 1, p. 19, (‘From Transparency to Performance’). Copy available at http://hausercenter.org/iri/wp-content/uploads/2010/05/IRI_Transparency-to-Performance.pdf.
22. See Lydenberg, Rogers and Wood, ‘From Transparency to Performance’, n. 21 above, p. 19.
23. Global Reporting Initiative, ‘Development Process’, See <http://www.globalreporting.org/ReportingFramework/ReportingFrameworkOverview/DevelopmentProcess/>
24. See further Mandate of the Special Representative of the Secretary-General (SRSG) on the Issue of Human Rights and Transnational Corporations and other Business Enterprises, *Corporate Law Project: Overarching Trends and Observations*, July 2010, copy available at <http://www.reports-and-materials.org/Ruggie-corporate-law-project-Jul-2010.pdf> (‘SRSG’s Corporate Law Project’) at p. 31. The report goes on to note that in most jurisdictions there is still insufficient guidance for companies to be able to tell whether they are complying with regulatory requirements in relation to human rights-related disclosures, or not. See further discussion on ‘materiality’ at pp. 11-12 below.
25. See Ruggie Guiding Principles, n. 4 above, Guiding Principle II.B.21. See also Guiding Principle I.B.3 and comments in Box 3 at p. 13 below.
26. For a review of research on the performance of ‘responsible investment’ portfolios, see UNEP and Mercer, *Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors*, October 2007. Copy available at http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf
27. See Financial Reporting Council, ‘Cutting Clutter: Combating Clutter in Annual Reports’, 2011, copy available at <http://www.frc.org.uk/images/uploaded/documents/Cutting%20clutter%20report%20April%2020112.pdf>
28. See Henriques, ‘Reporting of Non-Financial Information’ n. 7 above.
29. See GRI, *Reporting Guidelines on Defining Content: Materiality*, available at <http://www.globalreporting.org/ReportingFramework/G3Online/DefiningReportContent/LowerBlock/Materiality.htm>
30. These include new legislation and regulations, international agreements, effects of Legal, technological, political and scientific developments on business trends, and physical impacts of climate change. See SEC, ‘Commission Guidance Regarding Disclosure Related to Climate Change’, 8 February 2010, copy available at <http://www.sec.gov/rules/interp/2010/33-9106.pdf>
31. See Lydenberg, Rogers and Wood, ‘From Transparency to Performance’, n. 21 above, p. 21. As the authors note, “*[o]ur definition is broader in scope than the definitions of materiality historically used by financial regulatory parties, but by no means precludes definitions of financial materiality*”.
32. See BIS, ‘Summary of Responses’, n. 12 above, pp.7-8.
33. E.g. The complaints procedures operated by the IFC compliance advisor/ombudsman, see <http://www.icao-ombudsman.org/>
34. For the statutory definition of “parent undertakings” and “subsidiary undertakings” see s. 1162 of the Act. The definition is a flexible one, and refers to criteria that indicate effective control (or a “dominant influence”) by one company over another.
35. See, in relation to human rights performance, Ruggie Guiding Principles, n. 4 above, Guiding Principle II.B.20.
36. i.e. “*to the extent necessary for an understanding of the development, performance or position of the company’s business*”, see section 417(6).
37. See Henriques, ‘Reporting of Non-Financial Information’, n. 7 above.
38. Ibid, p. 6.
39. Ibid, p. 8.
40. Some respondents to the recent BIS consultation on the future of narrative reporting made this point. See BIS ‘Summary of Responses’, n. 12 above.
41. International Integrated Reporting Initiative, <http://www.theiirc.org/the-iirc/>.
42. Ibid.
43. See pp. 11-12 above.
44. GRI, ‘Integrated Reporting’ See <http://www.globalreporting.org/CurrentPriorities/Integrated%20Reporting/>
45. See section 423.
46. See section 426.
47. See section 430(1).
48. Henriques, ‘Reporting of Non-Financial Information’, n. 7 above, at p. 6.
49. Companies Act 2006, section 496.
50. See Companies Act 1985 (Operating and Financial Review and Directors’ Report etc.) Regulations 2005, SI 2005/1011, Regulation 10 (now repealed).
51. See further Companies Act 2006, section 495.

52. ClientEarth, 'Briefing: the Operating and Financial Review and company reporting under UK law', July 2010. p. 15. Copy available at <http://www.clientearth.org/reports/clientearth-briefing-the-operating-and-financial-review-and-company-reporting-under-uk-law.pdf>
53. Financial Services Authority and Financial Reporting Council, 'Enhancing the auditor's contribution to prudential regulation', Discussion Paper 10/3, June 2010, para. 3.9. See <http://www.frc.org.uk/images/uploaded/documents/FSA%20FRC%20Discussion%20paper1.pdf>
54. See Companies (Defective Accounts and Directors' Reports) (Authorised Person) and Supervision of Accounts and Reports (Prescribed Body) Order 2008, SI 2008/623.
55. Companies Act 2006, section 459.
56. Financial Reporting Review Panel, *Annual Report 2010*, August 2010 ('FRRP 2010 Annual Report'). Copy available at <http://www.frc.org.uk/images/uploaded/documents/ANNUAL%20REPORT%202010%20-%20FINAL2.pdf>.
57. Ibid, p. 7.
58. See Henriques, 'Reporting of Non-Financial Information', n. 7 above, at p. 6.
59. FRRP 2010 Annual Report, n. 56 above, p. 8.
60. See the FRRP web-site at <http://www.frc.org.uk/frrp/faqs/>
61. ClientEarth, Press Release: 'First Test of UK's new corporate environmental and social law falls short', 24 March 2011, copy available at <http://www.clientearth.org/first-test-of-uks-new-corporate-environmental-and-social-law-falls-short>
62. See FRRP, 'Statement by the Financial Reporting Review Panel in respect of the report and accounts of Rio Tinto plc, 15 March 2011, copy available at <http://www.frc.org.uk/frrp/press/pub2539.html>



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