



the inside track #19

Highlighting CSR Issues of the moment

So, has the dust settled?

The previous Inside Track discussed “Sadly, regulations don't stop for a recession - or even an election!” We covered four sets of impending legislation and regulations - the implementation of the Carbon Reduction Commitment Energy Efficiency Scheme (CRC), royal assent for the Bribery and Equality Acts, and the introduction of the UK Corporate Governance Code.

Now the question is “will the new Coalition Government have any impact on regulations affecting Corporate Responsibility, Reporting or Governance?”

As far as those regulations discussed are concerned, it is clear a change of government will not derail legislation, although it may delay implementation.

It is no surprise the government wants the **CRC** to continue, given the coalition makeup. The CRC steams ahead unabated, although clearly some organisations have still to come to terms with its implications. Registration is scheduled to be completed by 30th September, and organisations are expected to have the basis for their Evidence Packs in place by then.

The Bribery Act was a contentious issue for Conservatives before the election. It appears the government is modifying the guidance procedures for companies, causing delay. Consultation about guidance offered to companies commences in September 2010 (originally scheduled for July). The likelihood is that the final guidance will be published in January 2011 and the Act goes live in April 2011 (previously scheduled for October 2010).

The Equality Act was definitely contentious. The government has adopted a selective approach. Existing legislation harmonisation takes effect from 1st October 2010, whilst “equality duty”, relevant to certain public bodies, is due for consultation, possibly implementing in April 2011. Other, more contentious, areas remain up in the air, with the government “considering how best to implement them” - if at all. These include disclosing gender pay gap information.

The UK Corporate Governance Code took effect for financial years commencing after 29th June 2010. However, it is guidance, based on “comply or explain”, and the role of the Financial Reporting Council is to “encourage” Premium Listed companies to adopt its principles.

What is interesting is the way government is using the new Code as one of its inputs into potential new areas of legislation.

One example is that, as part of the Coalition Agreement, the government committed to reinstate “*the Operating and Financial Review to ensure that social and environmental duties have to be covered in company reporting and to investigate further ways of improving corporate accountability...*” and “*transparency is central to achieving these aims*”. Consultation on this OFR commitment is currently ongoing. It includes questions relating to companies' effectiveness in reporting business strategy and the extent to which directors' remuneration includes non financial performance criteria relating to strategic objectives. Both echo comments under the new Code relating to the business model and non financial metrics as criteria for incentive schemes. The reintroduction of the OFR may be reflected internationally, although on a voluntary basis. The International Accounting Standards Board is setting out guidance on introducing the Management Commentary (akin to the Business Review) as the basis for annual reporting by listed companies worldwide.

In the UK context, it is interesting to see the government's environmental commitments. The government is required under the Climate Change Act both to:

- review by December 2010 the contribution emissions reporting is making to achieving its climate change objectives;
- introduce regulations by April 2012 requiring mandatory reporting of GHG emissions information under the Companies Act 2006 - or explain why not!

Given the level of continued support for carbon management under the CRC, it seems that mandatory reporting will come to pass - as will more rigorous corporate reporting!

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What is surprising is not that the regulations are moving forward, but that even more are being considered for introduction.

It is clear that narrative reporting continues to evolve, with possibly some mandatory features. This evolution may be reinforced by international developments. An EU consultation on the review of the Transparency Directive includes questions about integrating all narrative reporting rules into this Directive. Also, the International Integrated Reporting Committee aims to create an accepted global framework for accounting for sustainability - and, supported by the Big 4 accounting practices, this may have a major impact on the scope of future annual reports.

From the perspective of a company secretary or CSR specialist based in the UK, the key issues to be considered are:

- The new Code's emphasis on the business model and non financial metrics for incentive schemes will generate changes in the way annual reports are written over time, but the implications need to be considered now. Better description of the business model requires better description of the business drivers, to which non financial metrics chosen as criteria for incentives need to be aligned.
- Non financial metrics need to be carefully reviewed - it will no longer be satisfactory to have a long list of CSR metrics. Instead meaningful metrics related to the business strategy will be required.
- Similarly, if the OFR is reintroduced, the focus will be on the quality of integrated reporting. Ensuring the description of the business model and the business strategy in financial and non financial terms will be essential.
- The focus on GHG emissions continues unabated, even for companies with relatively low direct impacts. Whether a trading scheme, such as CRC, or mandatory reporting, companies will have to be more transparent about their emissions. Some companies have made great strides in this area, but others continue to rely on the board's opt out to avoid detailed performance data. They will need to ramp up their reporting, including setting targets. Depending on the scope of reporting, GHG reporting may be particularly onerous.

What this means for those involved with CSR is that there will be even greater need to ensure that it is part of business processes. The priority is those areas of CSR representing either the company's biggest risks, or its greatest opportunities. The quality of narrative reporting will come under greater scrutiny. In this respect, the Financial Reporting Review Panel's 2010 Annual Report commented that narrative reporting is claiming an increasing proportion of its attention. Furthermore the report stated companies had been questioned when they did not refer to environmental KPIs despite environmental references elsewhere in their CSR reports that suggest they were relevant to the organisation.

The implication for CSR practitioners and others with responsibility for corporate reporting is that they should have extended dialogues with their Company Secretary or Investor Relations counterparts to discuss how narrative reporting may develop over the next few years, and how the CSR element may play a relevant part in content development. This does not imply the CSR section of an annual report should become of greater importance. Rather there should be consideration of how it can be better integrated into the overall story. The need is to ensure the relevance of CSR elements to the business model and the business strategy become more evident - ensuring their relevance better appreciated. This also means the role of CSR should be better integrated into overall business functions.

So, whilst some dust may have settled, change in CSR and corporate reporting looks likely to continue.

If you would like an objective and impartial view on the new requirements described in the is newsletter, contact **Tony Hoskins** - thoskins@thevirtuouscircle.co.uk or **Ian Redington** - iredington@thevirtuouscircle.co.uk