

A missed opportunity?

The UK's long-awaited Company Law Review promises to embed social responsibility at the heart of company reporting. **Chris Knight** asks whether this a blueprint for other countries to follow, or a damp squib

The three-year Company Law Review drew to an end this summer with the presentation to government of the review steering group's final report. As the first comprehensive review of UK company law in 40 years, this has been eagerly followed by many observers as a rare and vital opportunity for government to make businesses more accountable for their impacts on society and the environment.

But what will the results mean for the corporate social responsibility (CSR) agenda?

Many of the group's recommended amendments to the law will focus on improving governance – both through directors' duties and company reporting and audit. For the former, the review steering group proposes a statutory statement of directors' duties, which makes clear that directors must take account of:

- short- and long-term consequences of their operations and decisions;
- relationships with stakeholders;
- the need to maintain a reputation for high standards of business conduct; and
- the impact of their actions on the community and the environment.

On the latter – company reporting and audit – the newly-proposed disclosure requirements recommend that most public and large private companies (those that meet certain requirements on turnover, balance sheet and number of employees) include a mandatory operating and financial review (OFR) within their annual reports and accounts. The OFR would supersede much of the information in the current directors' report; in fact the review recommends the directors' report be abandoned.

The OFR will provide a review of the business, its performance, plans and prospects. It should also contain that information which the directors, "in good faith ... judge necessary" for an understanding of the business, such as:

- relationships with employees, suppliers and customers;
- environmental and community impact; and
- corporate governance and risk management.

In addition, the report recommends two



Material to a company's operating and financial review?

further forms of statutory OFR content – matters always to be included, and those to be included whenever the directors regard them as "material to achieving the objective of the OFR".

Matters falling into the former category include factors which may affect future performance – such as the risks and opportunities associated with health and safety, environmental liabilities, and training programmes (disclosure on these issues is for the most part already recommended by the Turnbull Report on corporate governance, released earlier this year).

Those in the second category, required to be disclosed "to the extent material", include policies and practices on:

- employment, disability and non-discrimination policies;
- compliance with international labour conventions and anti-discrimination laws;
- social and community programmes;
- ethical and environmental issues and their impact on the business;

- international trade and human rights issues; and
- political and charitable donations.

Those companies that already report on these issues, for example in separate stand-alone environmental reports, will not be able to simply cross-reference to the separate document. The review recommends that such reports become integral parts of the annual report. This will be welcomed by those groups who believe that for ethical considerations to be taken seriously by directors, they must be reported alongside those elements required under statutory financial reporting rules.

These proposed revisions to company law would appear to mark a significant advance in mandatory non-financial disclosure requirements for the UK.

However, the review has attracted criticism from those who believe the OFR's actual implementation will stifle any potential advances. The main justification for this view is that some of the most important reporting areas – certainly in the overwhelming view of the many organisations contributing to the lengthy consultation process – will be left to the directors' discretion.

The idea that many of these issues should only be reported "to the extent material" will disappoint those who believe there is already a strong business case for companies to be managing and reporting on issues of concern. One saving grace may be the recommendation that all OFR's be reviewed by the company's auditors, though a lack of consensus regarding the level at which financial and environmental issues are judged material may complicate matters.

For example, financial costs for a large company may be considered material if in excess of £5 million. Therefore, a major pollution incident attracting costs of £150,000 would not be considered material, although the costs to the company's reputation are likely to be far higher. While auditors' views on this subject may or may not influence levels of disclosure, their review provides a good opportunity for them to raise social and environmental performance for discussion at board level.

Ministers will be considering the review steering group's recommendations for some months. Draft legislation may be issued in 2002 for comment, with the exact timing of putting legislation before parliament yet to be decided.

Many companies who have already recognised the compelling business case for CSR will already be making this information publicly available and compiling the new OFR should raise little concern for them.

What the results of the review will mean for the CSR agenda and UK business generally will become evident from the degree of 'material' disclosure by companies yet to report on this area. An absence of increased disclosure will signal an opportunity missed. **■**

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** Details of the Company Law Review, including the full final report of the review steering group, can be found at www.dti.gov.uk/cld/review.htm*