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**UKSIF submission:
August 6, 2004**

Response of the UK Social Investment Forum (UKSIF) to the consultation on the Operating and Financial Review (OFR) and Directors' Report

To: Kate Marshall, DTI

UKSIF is grateful for the opportunity to respond to this DTI consultation. Our response is informed by discussions with SRI specialists from across UKSIF's diverse membership base, and, in particular, by the discussions at a roundtable member meeting held last year.

We strongly support the objective, principles and approach of the OFR. The OFR should generate reporting that will enable investors to gain an understanding of companies' strategy and the way it is implemented that is not reliably provided by current annual reports, and provide a valuable platform for dialogue between investors and companies. We particularly welcome the Regulations' recognition that factors such as the environment, employee issues and community relations can be important for a company's ability to achieve its strategic objectives, and strongly support the use of key performance indicators. We also welcome the Guidance document published at the same time as this consultation document and believe that companies should be regularly made aware of its existence.

Question 2:

Do you agree that quoted companies comprise the appropriate class of companies to be required to prepare an OFR?

We strongly support the proposed requirement that all quoted companies be required to prepare an OFR. However, there are two areas in which we would welcome an extension of the scope of the Regulations.

Firstly, UKSIF members also invest in non-UK companies whose shares are quoted on the London Stock Exchange but which will not be covered by the OFR regulations. There will therefore be lower levels of disclosure by these companies on potentially important issues. We encourage the government to discuss with the Listing Authority the extension of OFR requirements to include these companies.

Secondly, our members are also significant holders of the bonds of UK private companies that will not be covered by the regulations as currently framed. Strategy information of the kind to be provided by the OFR would be of great benefit to bond investors, who are clearly just as interested in the likelihood of a company achieving its strategic objectives as are equity investors. We therefore urge the government to extend the scope of the regulations to include large private companies.

Question 3:

Do you agree that the draft Regulations should include a specific requirement to include a description of the capital structure, treasury policies and objectives and liquidity of

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the company?

Yes.

Question 4:

Do you agree that directors should be required to state the fact where they have concluded that there is nothing relevant to report in respect of the items covered by paragraphs 4 to 7 of Schedule 7ZA?

We consider this proposal to be extremely important. The absence of a reference to an issue in an OFR – e.g. the environment or employee matters – will not in itself indicate to investors that a company board has duly considered whether that issue merits inclusion and reached an informed decision that it does not. It may simply indicate a failure to consider an issue at all, or to consider it appropriately. An affirmative statement that an issue has been considered for inclusion and rejected would provide considerably greater assurance to investors, and a more helpful starting point for discussion between the company and its shareholders.

Question 5:

Do you agree with the approach taken in, and the drafting of, Schedule 7ZA?

As noted, we strongly support in particular a requirement to report on employee matters, the environment and social and community issues where they are necessary for an understanding of the company's strategy. We note the explanation in the consultation document that 'directors should include all key performance indicators that are relevant to their particular business', not just those relating to employees and the environment. Nonetheless, we are concerned that the wording of the regulations themselves may not be sufficiently clear in this regard, and that companies may confine the use of KPIs to employees and the environment. We therefore suggest that the wording of the regulations be amended to make it absolutely clear that KPIs should be used for all appropriate issues.

Given the crucial importance of human capital for business success, we find it hard to imagine many situations in which companies will conclude that it is not appropriate to report on employee matters in their OFR.

We note that the OFR will complement for company reporting the obligation on pension fund trustees to make a policy statement on 'social, environmental and ethical' matters. The OFR will make it significantly easier for investors to obtain information on companies' approaches to these areas, in order to ensure that trustees' policies are being implemented. The proposed regulations do not refer explicitly to 'ethical' matters – though we note and support the statement in the Guidance drafted by the working group chaired by Rosemary Radcliffe that the company's purpose, values and ethical stance form a good starting point for the OFR (*The Operating and Financial Review – Practical Guidance for Directors* – p.10). Ethical issues have lain at the heart of many recent corporate scandals – such as those at Enron, Tyco and Ahold. We therefore believe it would be valuable to add an explicit reference to the company's approach to business ethics, with associated key performance indicators, to paragraph 4 of Schedule 7ZA (perhaps by adding '(d) matters relating to business ethics').

Question 6:

Do you agree with the proposed role of the auditors as set out in regulation 8, including whether 'due and careful enquiry' is a reasonable and practicable standard to require of directors?

Over time it will be extremely important that appropriate assurance on the content

of the OFR is provided to investors and other users of the OFR. However, care needs to be taken to ensure that 'boiler plate' statements are avoided, particularly in the early years of mandatory OFR reporting. An appropriate assurance framework could be built up over time, and the initial framework made subject to review after 3 years.

The need for appropriate assurance applies at two levels. Firstly, that data lending themselves to verification – predominantly quantitative data provided by means of KPIs – are accurate. This might apply, for example, to figures on greenhouse gas emissions or health and safety performance. Secondly, that the process the board has gone through in determining which issues should be covered in the OFR is appropriate and has identified all relevant issues. We would welcome a specific requirement for the actual information in the OFR, not just the process by which it has been prepared, to be subject to audit.

Question 9:

Do you agree with the Government's proposal to implement the Member State option in the Modernisation Directive by providing an exemption for medium-sized companies from the requirement to include non-financial information?

We believe that this should be reviewed, perhaps in 3 years time.

Question 10:

Do you agree with the Government's proposal to bring OFR Regulations into effect for years beginning 1 January 2005? We would welcome suggestions on how the government can best implement the Regulations.

Yes, we agree that the OFR Regulations should be brought into effect for years beginning 1 January 2005. Nonetheless, we recognise the challenges inherent in this aim, particularly for the ASB. We would encourage the ASB to set out as soon as possible a broad framework, going beyond the overall standard on which it is currently working, indicating the general direction of its future work in setting more detailed standards for the OFR.

Question 12:

Do you agree that all shareholders should receive the OFR? Do you agree that it is not appropriate to legislate to permit companies to send a summary OFR in place of the full version?

Yes, and yes. On the first question, it is an important principle that all shareholders should be treated equally. On the second, we find it hard to envisage what a 'summary of the OFR' would contain, given that the OFR is not intended to include all possible information on the various aspects of the company's strategy and how it goes about implementing it. Allowing the OFR to be summarised could deprive it of precisely the content that makes it so potentially useful to investors.

Question 13:

Do you believe that the draft Regulations should omit any requirement on directors to include information on corporate governance in their OFR, or do you think that such information is sufficiently key to company performance that repetition is justified?

Given the way in which requirements covering reporting in different parts of the Annual Report have evolved (OFR, corporate governance, remuneration report, etc), there is clearly a practical challenge in achieving genuinely coherent reporting on all the dimensions of strategy and its execution. In principle such a

rounded picture would include corporate governance information – as well as information on remuneration right across the company, not just at the director level. We see the OFR as the first step towards such genuinely integrated reporting. For the purposes of the current regulations, however, we recognise the need to allow the OFR to provide as complete a picture as possible while avoiding unhelpful duplication with other parts of the Annual Report. We therefore suggest a requirement for particularly relevant corporate governance information to be included in the OFR – such as details of board structures and processes for dealing with employee, environmental and community issues – and for other corporate governance information to be cross-referenced to other parts of the Annual Report. We would also expect a discussion in the OFR of how the company's approach to remuneration across the organisation – as well as other human resource management issues – contributes to strategy. This would go considerably beyond what is currently required in the Directors' Remuneration Report.

Questions 14 and 15:

Do you agree with the Government's proposal that a provision for confidentiality should not be included for the OFR?

Do you agree with the omission of "safe harbour" provisions? If you think a "safe harbour" is necessary how should this be framed?

Yes and Yes.

If you have any questions about any of the above, please do not hesitate to contact me.

Helen Wildsmith
Executive Director
UK Social Investment Forum

About UKSIF & Just Pensions

The UK Social Investment Forum (UKSIF) is the UK's membership network for socially responsible investment (SRI). UKSIF's 250+ members include institutional investors, pension funds, investment consultants, trade unions, NGOs and individuals interested in SRI. For a full list of UKSIF members, please see www.uksif.org. *Just Pensions* (JP), UKSIF's main programme, was established in September 2000 by Traidcraft and War on Want. Since October 2002, JP has been managed by UKSIF and is part-funded by the Department for International Development (DFID). JP aims to promote the development and awareness of SRI amongst pension trustees and fund managers to advance international development. JP was formed in response to the amendment to the 1995 Pensions Act, which came into force in July 2000, requiring all occupational pension funds to disclose in their statement of investment principles (SIPs) the extent to which pension fund trustees take into account social, environmental and ethical (SEE) considerations. In addition to [UKSIF's three programmes](#), the Forum also provides the secretariat to the [All-Party Parliamentary Group on SRI](#). For further information, please visit www.uksif.org and www.justpensions.org.

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[Materiality: Consultation Document \(Sept 2003\)](#)

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