

A photograph of two men in business attire (light blue shirts and ties) looking down at documents they are holding. The man on the left is slightly behind the man on the right, and both appear to be in a professional setting.

The Impact of the Companies Act 2006 on Corporate Responsibility Reporting

ADVISORY

Debate on narrative reporting and its perceived value has never been greater than in recent years mirroring the increasing profile of Corporate Responsibility (CR), namely the environmental and social impacts of companies. The EU has pushed for greater shareholder engagement by enhancing the Directors' Report requirements to compel boards to include a Business Review.

Firstly, the Companies Act 1985 has been amended to include **mandatory narrative reporting** requirements for all companies, other than those who qualify for the small companies' exemption, in the form of a Business Review in their Directors' Report. The Business Review must include a fair review of the company's business, and a description of the principal risks and uncertainties facing the company. It requires a balanced and comprehensive analysis of the development and performance of the company's business during the financial year; and the position of the

company's business at the end of that year, consistent with the size and complexity of the business.

In addition, to the extent necessary for an understanding of the development, performance or position of the company's business, the review must include analysis using financial key performance indicators (KPIs), and where appropriate, other key performance indicators, including information relating to environmental matters and employee matters.

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Directors are personally liable to a fine, should they fail to comply. Although fines may be modest, there are potentially huge implications in terms of reputational damage and shareholder trust.



These requirements first apply to accounting periods beginning on or after the 1st April 2005 (i.e., **31st March 2006 year ends and later**).

Whilst there are no specific requirements on how KPIs should be presented, the Accounting Standard Board's Reporting Statement (RS) – voluntary guidance for the Operating and Financial Review – is widely acknowledged as a good starting point. It recommends that KPIs relating to environmental and employee matters are **extended to cover social and community issues**.

In the case of failure to comply with these requirements, every director who failed to take all reasonable steps for securing compliance is guilty of an offence under the 1985 and 2006 Acts and is **personally liable** to a fine. The Act provides that directors can be found liable to the company for statements made in, or omissions from,

directors' reports to the extent that those statements are false or misleading or have been made recklessly. Although such fines may, in effect, be modest, there are potentially huge implications in terms of reputational damage and shareholder trust.

Furthermore, the 2006 Act changes the Financial Services and Markets Act 2000 such that quoted companies can be liable to pay compensation to an investor or other third party for statements made if they are untrue, misleading or made in bad faith, or there is deliberate and dishonest concealment of material facts, but, in either case, only if the investor or third party had reasonably relied on the statement (or omission) and suffered loss as a result. The upshot is that investors do not have a direct right of action against directors but they may be able to claim against a company which may, in turn, seek to claim against a director for any loss it has suffered.

In addition to the above Business Review requirements, the Companies Act 2006, expected to take effect during 2008, adds significantly to Director's obligations with regard to environmental, social, community and employee matters. In the case of quoted companies the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

- information about environmental matters;
- the company's employees; and
- social and community issues.

This includes information about any policies of the company in relation to those matters and the effectiveness of those policies.

When the 2006 Act becomes effective, in the case of quoted companies, the business review must include information about environmental matters; the company's employees; and social and community issues, including information about any policies of the company in relation to those matters and their effectiveness



Key considerations:

- Does the board have a transparent process for determining what should be included in the Business Review and has it had board approval?
- How well does the board understand investors' and other key stakeholders' concerns / requirements and how will these be reflected in the Business Review?
- How confident are you that your existing risk management processes enable you to identify and disclose forward-looking risks and opportunities and the way they are managed?
- How does the board get comfort over the quality of information contained within the Business Review?
- How will the Business Review be aligned with other information published by the company?

How KPMG can help

KPMG's Risk and Sustainability practice can help you answer the questions posed above through:

- Helping you identify the social and environmental risks and opportunities for your business through a process of both internal and external stakeholder consultation;
- Facilitating the development of a transparent company-wide process to analyse and prioritise what should be elevated to the Business Review;
- Helping you define a strategy for managing your key risks and opportunities and how to practically implement this throughout your business; or
- Providing assurance to the Board on the quality of the elevated non-financial information and the effectiveness of the company's CR policies.

Helping you identify
the risks and
opportunities for
your business



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