

Company Workforce Practices

A guide to assessing corporate reporting on
employment practices

**Best Practice Guidelines of the
Local Authority Pension Fund Forum
April 2005**

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FORUM BEST PRACTICE GUIDELINES: REPORTING ON EMPLOYMENT PRACTICES

Issue No. CWP/1

April 2005

Purpose: To assist Trustees of Local Authority Pension Funds in assessing the quality and effectiveness of investee companies' reporting of employment policies and practice.

Method: To engage with investee companies on the following three-pronged basis involving:

- A common core of performance indicators (to ensure a minimum standard of reporting);
- A risk assessment of industry specific factors;
- A strategic evaluation of the materiality of employment factors in the statutory Operating and Financial Review (OFR).

Outcomes: To encourage each Fund to identify the criteria by which the effectiveness of its engagement with investee companies, either by the Fund itself or through the Forum, is to be judged in the short and long-term against its subsequent activities.

Application:

1. The Forum is pioneering a distinctive method of engagement which draws on the best from the Accounting for People Task Force (Kingsmill) report¹ and the Forum's approach is also informed by its submission to, and the report of, the OFR Working Group² and the Exposure Draft of the Accounting Standards Board (ASB) setting out for comment the proposed OFR Reporting Standard.³
2. These guidelines outline the approach to best practice, which the Forum has evolved, applied by way of illustration to two industry sectors.
3. The guidelines have been written with due attention to the resource and time constraints that every Fund faces. Trustees' or Officers' feedback on how the guidelines might be improved will be carefully considered by the Forum and taken into account in any future revision that may be made.

¹ . Accounting for People: Report of the Task Force on Human Capital Management (DTI, October 2003).

² . The Operating and Financial Review: Practical Guidance for Directors (Department of Trade and Industry, May 2004). The LAPFF submission is available from PIRC.

³ . Accounting Standards Board, Reporting Standard 1: Operating and Financial Review, Reporting Exposure Draft (ASB, November 2004).

Introduction

The Kingsmill report concluded that ‘there is no single set of HCM [human capital management] practices widely accepted as “best practice” applicable to all organisations, nor agreement on a set of universally relevant indicators.’⁴ This conclusion reflects the state of knowledge at the time (end 2003) and failed to recognise the work being undertaken by the Forum. In fact progress towards a broad consensus is now possible on the basis of the Forum’s own discussions. The Forum has achieved a consensus amongst its members on what core indicators FTSE 100 companies (with 500 or more employees) ought to be reporting against. This is the basis of its recommendations on best practice.

Moreover, the development of reporting capability in this area, as the Kingsmill report noted, will be partly dependent on the demand for high-quality information on HCM from investors and other stakeholders. The Task Force wishes to ‘encourage institutional investors to work with leading employers on the development of key indicators and definitions.’⁵

These guidelines take forward that proposal following extensive testing and consultation within the LAPFF membership and amongst other stakeholders.

⁴ . Accounting for People, p. 13.

⁵ . Accounting for People, p. 26.

A. A Minimum Reporting Standard

Background

One of the LAPFF members, the West Midlands Pension Fund (WMPF), commissioned PIRC to identify those FTSE 100 companies that are leaders in promoting good employment practices and also those companies that are doing less well, with the long term aim of seeking improvements to protect shareholder value. This survey was carried out in early 2003 and the report was produced in June and made available at the September LAPFF business meeting that year.⁶

The WMPF report contains a template for evaluating how thoroughly companies report on employment issues which worked well to reveal the differences especially within industry sectors. However, after considering the Kingsmill Report which takes account of a wide range of investor and stakeholder views the Forum produced a new template of core indicators, qualitative and quantitative, on which all publicly quoted companies should be required to report, especially those with 500 or more employees. This template is contained in Appendix 1.

The Forum recognises that specific issues may arise, such as the outsourcing of particular services to developing countries, that require more in-depth research than its template currently allows for. Consequently, in those cases, LAPFF will undertake supplementary studies to ensure such additional critical issues are given due weight.

Application of New Template

The Forum's business meeting on 19 September 2003 agreed the sectors and FTSE 100 companies for engagement on the basis of company under-performers, as identified in the WMPF study. The sectors covered were:

- Banks (five companies)
- Food Producers & Processors (two companies)
- Leisure, Entertainment & Hotels (four companies)
- Chemicals (two companies)

Consultation followed in early 2004 with LAPFF members, concerning the template and proposed engagement strategy, and also with those companies having the best reporting on employment practices in the sectors chosen for engagement, as well with the CBI, TUC and other non-governmental organisations. The template was then applied to each of the above sectors in turn during the remainder of 2004.

⁶ . Reporting on Employment Practices: PIRC Report to West Midlands Pension Fund (PIRC Ltd, June 2003).

Findings

The considerable improvement in the quality of the *five Banks' reporting on employment issues*, since the WMPF project was carried out in early 2003, was reported to the July 2004 business meeting. The meeting agreed this could form the basis for a possible seminar with the above companies in the banking sector. There would be an opportunity to discuss questions relating to industry-specific employment risks and the final Operating and Financial Review regulations and associated Accounting Standards Board's Reporting Standard.

In the *Food Producers sector* one company appeared to have made sufficient progress since the original WMPF project as to not require a specific engagement programme. However, the standard of employment reporting of another company was deemed to remain weak beyond the policy area – where there were still a few significant gaps or ambiguities – so that the Forum would be justified in seeking specific improvements. The LAPFF Executive Committee approved the commencement of an engagement programme with this company at its meeting on 17 November 2004.

In the *Chemicals* sector one company had improved, and the other had greatly improved, its standard of employment reporting since early 2003 so that no further action seemed necessary now.

However, the *four companies in the Leisure sector* – a very labour-intensive business – appeared to have made comparatively limited progress in the last two years though some more than others. Hence this sector is an appropriate one to engage with using the LAPFF best practice guidelines as an initial benchmark, as agreed in principle by the Executive Committee on 17 January 2005.

The Forum recognises that each industry sector has its own characteristics that may make certain employment policies and practices more or less important. To appreciate this sectoral impact necessitates investor awareness of specific employment risks and opportunities relating to individual companies. The purpose of the LAPFF engagement will be to ask company managements to explain their comparatively poor disclosure on employment issues in relation to:

- (i) the template of core indicators (best practice guidelines in Appendix 1); and/or
- (ii) the material employment risks and opportunities in their industry sectors.

Naturally this would be done by comparison with their industry peers, bearing in mind investors tend to prefer like-for-like comparisons across each sector. Where a reasoned case for variation, even on the core indicators, is made then this would be reported back to the Forum and the wider investment community.

B. Risk Assessment of Industry-Specific Factors

At present most companies, even those whose employment reporting was otherwise judged to be good, disclose little on the employment risks and opportunities faced in their industry sectors. The ASB's Reporting Exposure Draft, which sets out the proposed reporting standard on the OFR, now offers an authoritative way forward to ensure that investors can conduct corporate risk assessment on employment (and other CSR) issues in a more rigorous way.

The Exposure Draft outlines a framework for the disclosures to be provided by directors in an OFR which takes into account the industry or industries in which a company operates. The objective is:

The OFR shall provide information to assist investors to assess the strategies adopted by the entity and the potential for those strategies to succeed. The key elements of the disclosure framework necessary to achieve this are:

...

c. the resources, risks and uncertainties and relationships that may affect the entity's long-term value;...⁷

The Forum's submission to the ASB commended the comprehensiveness of the disclosure framework but suggested how the forward-looking orientation of the OFR could be expanded for the benefit of investors in particular.

With respect to employment issues in a given industry sector, to the extent that they are material, the Forum expects that:

- * Any assumptions underlying the main trends and factors that directors consider likely to impact future prospects of the company shall be disclosed;⁸
- * Prominence should therefore be given to potential future issues, as the Forum considers that they may be particularly relevant to employment policy and practice, whose long term significance has previously tended to be ignored or underplayed;⁹ consequently
- * The methods used to identify potential future issues should be disclosed in the OFR whether or not the directors have identified any such issues.¹⁰

Otherwise, the Forum follows the draft Reporting Standard on disclosing risks (as replicated in our Appendix 2).

⁷ . ASB, Reporting Standard 1: OFR, paragraph 26.

⁸ . See ASB, Reporting Standard 1: OFR, paragraphs 45-6.

⁹ . See ASB, Reporting Standard 1: OFR, paragraph 47.

¹⁰ . The Forum has proposed to the ASB a revised paragraph 47 to include this requirement.

The draft Implementation Guidance, which accompanies but is not part of the draft Reporting Standard, is helpful but the Forum's submission to the ASB emphasised the need for a more developed approach to reporting CSR issues, particularly company workforce practices. The worked examples in the Implementation Guidance are useful but a copy of the Forum's template of core indicators was sent in confidence to the ASB to illustrate a more comprehensive approach.

The Forum recommended that:

- * The ASB should emphasise in its Implementation Guidance that the proposed Key Performance Indicators (KPIs), relating to the content to be covered in the OFR, are not only selective and illustrative but that a range of KPIs is likely to be needed to adequately cover certain employee management issues. There is a danger that some listed companies might think that a single KPI could achieve the company's objectives when, on too narrow a basis, the results could prove misleading even if supplemented with other measures.
- * The ASB consider citing qualitative measures in its Implementation Guidance. It currently offers only quantified KPIs even when the company objective is expressed in qualitative terms, e.g. with respect to a common set of values for all parts of the business including suppliers. In this case, when the KPI proposed is the number of factories subject to ratings by independent accredited monitors there is a risk that the company becomes focused on these numbers and ratings rather than the standards which are being applied.¹¹ One useful qualitative measure of these standards, the Forum has found, is the International Labour Organisation's core Conventions which are subject to authoritative interpretations by ILO bodies as well as being used as a basis for developing a common set of values by companies, trade unions and non-governmental organisations.

The distinction made in the draft Reporting Standard between KPIs and 'other measures' and evidence (paragraphs 73 to 75) is one that the Forum will be seeking to adopt and integrate into its best practice guidelines in due course.

The Forum is content to accept a developmental approach to KPIs that companies should disclose in the OFR such that the draft Reporting Standard need not specify any particular requirements now. However, when the time comes for the ASB to review its OFR Reporting Standard the Forum anticipates that it may be practical to specify certain KPIs for employment and other CSR matters particularly on a sector basis and in certain respects more generally. If some companies take advantage of the more flexible approach the Board has adopted to take an unhelpful attitude to disclosure of KPIs then the Forum might well be expected to take a more robust line, at the time of the review, than would otherwise be the case.

¹¹ . See ASB, Reporting Standard 1: OFR, [Draft] IG Example 16, p. 60.

C. Strategic Evaluation of the Company OFR

The statutory OFR Regulations passed by Parliament will take effect for listed companies with financial years beginning on or after 1 April 2005. Consequently the first OFRs would not be available for analysis until well into 2006. There is still time for listed companies to put in place the systems and procedures to ensure that relevant KPIs and other quantitative and qualitative measures can be used by directors to evaluate progress in their management of employees.

The Forum will be undertaking work during 2005/06 to develop its approach to analysing statutory OFRs, once the ASB's Reporting Standard has been finalised, and will use its experience of engaging with companies in the Leisure and Food Producer sectors to inform that process. Once the Forum's members have discussed, and decided on, the right approach to take these best practice guidelines will be updated and published widely.

The Forum remains committed to improving the quality of employment reporting by listed companies as part of its support for developing good practice in corporate reporting more generally. It regards the OFR as an opportunity to be grasped in achieving this objective but without neglecting the broader foundation of CSR, and especially employment, reporting on which it must be based.

Appendix 1

Reporting on Employment Practices: Outline Best Practice Guidelines

Core indicators for FTSE companies (especially those with 500+ employees)

A. Principles, policies and business strategy

1. The company has a group-wide employment policy including objectives covering (in so far as local laws allow):
 - i. Health & safety
 - ii. Diversity/equal opportunities
 - iii. Freedom of association
 - iv. Information, consultation and participation
 - v. Training and development
 - vi. Remuneration
 - vii. Social responsibility
2. The company discloses what the links are between its employment strategy and its business strategy.

B. Responsibility and Accountability

1. Board level responsibility is identified for human resource issues
2. A human resource or equivalent function exists with senior management reporting to the main board
3. Group programmes with targets for improvement are disclosed on:
 - i. Health & safety
 - ii. Diversity/equal opportunities
 - iii. Training and development
 - iv. Remuneration

C. Engagement with Employees

1. The company explains how it promotes the benefits of human rights at the workplace (in so far as local laws allow)
2. The company demonstrates that it has mechanisms for:
 - i. Communication on strategic and operational matters
 - ii. Two-way communication or consultation at group, regional and divisional/business unit levels
 - iii. Participation in management decision-making and/or collective bargaining arrangements

3. The company has regular employee satisfaction surveys or other means of ascertaining employee views on relevant subjects

D. Performance and Key Data

1. The annual size and composition of the workforce in the company's main areas of operation:
 - i. Age, gender and ethnic profile
 - ii. Full-time and part-time
 - iii. Management and non-management
 - iv. Direct and indirect (where significant)
2. Retention and motivation of employees annually in the company's main areas of operation:
 - i. Staff turnover overall and by significant groups
3. Health & safety data annually in the company's main areas of operation including any fatalities, fines and prosecutions.

E. Standards, reporting and audit

1. Monitoring and evaluation of employment practices is accredited against at least one recognised and relevant general management standard in the company's main areas of operation
2. Reporting of the Board's assessment of the links between the company's approach to employment strategy, its business strategy and its performance covers at least one of these areas:
 - i. Size and composition of the workforce
 - ii. Retention and motivation of employees
 - iii. Skills and competencies necessary for business success, and training to achieve them
 - iv. Remuneration and fair employment practices
 - v. Leadership and succession planning
3. Auditing by an independent, external reviewer of the information on which the Board's employment reporting is based.

Appendix 2

Reporting Exposure Draft 1: Operating and Financial review (Accounting Standards Board, November 2004)

Risks and Uncertainties

- 50. The OFR shall include a description of the principal risks and uncertainties facing the entity, together with a commentary on the directors' approach to them.**
51. While different industries and entities use different risk models or approaches for identifying and managing risk, all entities face and shall disclose strategic, operational and financial risks where these may significantly affect the entity's strategies and developments of the entity's value.
52. The risks and uncertainties facing entities will vary according to the nature of the business, although it is expected that some risks, such as reputational risk, will be common to all.
53. The description of the risks and uncertainties shall cover both the exposure to negative consequences as well as potential opportunities. The directors' policy for managing risks shall be disclosed.
54. The OFR shall cover risks and uncertainties necessary for an understanding of the objectives and strategies of the business, both where they constitute a significant external risk to the entity, and where the entity's impact on other parties through its activities, products or services, affects its performance. Directors will need to consider the full range of business risks.