THE DTI's DRAFT REGULATIONS ON THE OPERATING AND FINANCIAL REVIEW AND DIRECTORS’ REPORT

THE Acas RESPONSE

Introduction

1. The basis for this response is Acas’ general statutory duty, which is to promote the improvement of employment relations. The comments set out below are therefore principally confined to Questions 5\(^1\) and 11\(^2\) and their reference to the inclusion of information about employees in the proposed Operating and Financial Review (OFR) Regulations. The overall Acas position is:

- we are very much in favour of the greater transparency of human capital reporting that will be afforded by including a narrative OFR in the year-end accounts;
- we believe that there is a need to encourage the development of guidance for reporting on human capital;
- we stand ready to use our good offices to help bring this about.

Improving reporting standards

2. Acas fully supports the premise that organisations should report on their management of human resources in an open and transparent way. Acas’ own extensive and in-depth experience in workplaces confirms the research evidence that the Accounting for People Task Force summarised establishing the link between effective management of human resources (the DTI’s ‘high performance workplace’) and a more productive and profitable business. People, and the way they are managed, are indeed the key to success though few organizations systematically collect information about this. One of the main reasons is the immense problem of evaluating intangibles such as training, innovation in people management and so on. The debate around human capital management (HCM) is therefore central to this Government’s key aim of improving productivity and enhancing the country’s competitive edge. Effective human capital management should be seen as an essential component of corporate governance. Listing it will help to raise its status and also standards.

\(^1\) Q5: Do you agree with the approach taken in, and the drafting of, Schedule 7ZA?

\(^2\) Q11: Do you have any general comments or specific suggestions on the drafting of the Regulations at Annex A?
3. As the Accounting for People Task Force emphasised, it is not just investors who are interested in the long-term strength and sustainability of a company’s performance and need information on how that company manages its human resources. Potential employees also need information as future stakeholders to make better and more informed choices about the organisations they might work for, thereby reducing the likelihood of early labour turnover and its attendant high costs. Society in general, and local communities in particular, needs information to help ensure that companies fulfill their corporate social responsibilities. Especially important also is that management itself needs such information as reporting is an extremely valuable management tool. As the DTI itself recognises, information enables management to benchmark their organisation’s performance against the best in the sector and the “best in class” as the basis for continuous improvement.

4. Acas is aware that good people management practices cannot easily be reflected on a balance sheet – or indeed in a narrative commentary. The consistent and open reporting of human capital is nonetheless a vital step in evaluating the contribution that a company’s workforce can make to overall corporate performance. A significant number of organisations are leading the field in their recognition that their human assets may be the one differentiating factor for competitive advantage, given the rise in the number of service organisations and the increased difficulties in standing out from the crowd in terms on technological grounds. Denise Kingsmill’s final report highlighted a number of these organisations and the frameworks they have adopted to evaluate their human capital and the crucial link to organisational performance and productivity.

**The case for developing guidance on human capital reporting**

5. Acas appreciates why the Task Force felt unable to recommend more detailed suggestions, preferring instead to allow for an evolutionary approach to develop. It nonetheless believes that it is sensible to start to build on the work of the Task Force and develop guidance on human capital reporting for the following reasons:

- Acas’ own experience – confirmed most recently by its active engagement with organisations wanting to introduce an appropriate framework in the light of the impending Information and Consultation of Employees Regulations – is that many companies will welcome the clarity and support that common approaches would provide. Even the largest companies will not necessarily have the specialist resource to develop and implement from scratch a relevant framework for reporting on their human capital.
• Common approaches will reduce the significant resources involved in setting up robust reporting. It would also facilitate the pooling of the already existing – and in some cases extensive – body of knowledge that those companies at the leading edge of human capital management possess, thereby providing a gentler learning curve for those companies just starting off on the HCM road.

• In the absence of common approaches, it will be difficult for companies to undertake meaningful benchmarking. There is the danger that some will not therefore take the management and reporting of human capital seriously. Others will be worried about the legitimacy of the results – that they will lay themselves open to the accusation of simply engaging in a PR exercise. The more benchmarking and comparison there are, the greater the pressure will be to produce information that is trusted.

• There is a range of headings under which organisations could usefully present narratives dealing with approach and policy in key areas. There are also some already widely used indicators, such as absence and labour turnover, that might feature. Together these provide enough flexibility in reporting to take account of a company’s “uniqueness” and the need to customise its own approach to human capital management.

• While it is acknowledged that relatively few companies currently report externally on the management of their human capital, many of the larger companies (and indeed some of the smaller ones) already collect human capital data on areas such as training spend, employee turnover and absence and workforce diversity, to name but a few. The Workplace Employee Relations Survey confirms this point, with the majority of organisations with more than 25 employees already routinely collecting data on the most obvious human capital areas. Reporting should not therefore present a significant technical burden. It could be argued that one of the main barriers to effective human capital management and reporting is that there is no guidance available to support their work in this area or a common understanding of what indicators could be the most useful.

• Having common approaches does not prevent organisations from stressing their unique strengths. Without guidance, however, there is the inevitable danger that they may treat it as a PR exercise and report only on their
strengths. This would run counter to the Government's overarching aim of transparency in company reporting standards.

6. One of the main objections put forward to common approaches, namely that indicators such as absenteeism would not have the same meaning between sectors, does not stand up to close scrutiny. In reality, any serious comparative analysis will compare companies within the same industry sector and not necessarily across sectors. It is expected, as in the case of the CBI’s highly regarded annual survey, that absenteeism will be higher in, say, the hospitality and retail sectors than in information technology or manufacturing. Managers and analysts will be primarily concerned with closed sector comparisons.

7. Any guidance for HCM reporting that is developed, however, would also need to allow companies the room to provide human capital information and analysis that could not be reflected in a quantitative measure. It is vital that such guidance affords companies the flexibility and innovation to reflect their own unique approach to managing people. There would be distinct difficulties associated with any attempted metrication of certain human capital areas, such as employee involvement.

8. The components of common approaches do already exist for some areas of HCM. A closer inspection also suggests that there is a greater consensus than is sometimes imagined. For example, there are close parallels in the narrative frameworks of the Investors in People Standard and, indeed, Acas’ own 'Effective workplace’ model, which the Task Force quoted in full in its final report. Also the DTI itself already promotes two high-profile and well regarded benchmarking initiatives that are based on a standardised measurement framework: the “Sunday Times Top 100 Companies to Work For” annual awards programme and its own diagnostic tool for Business Support funding. Additionally, there are the measures associated with the EU’s employment strategy and the Lisbon agenda, which the UK Government promoted and the Council of Ministers endorsed.

9. Perhaps most immediately relevant, however, is the framework that the Accounting for People Taskforce left on the table in proposing that an HCM report should:
   - have a strategic focus:
     communicating clearly, fairly and unambiguously the Board’s current understanding of the links between the HCM policies and practices, its business strategy and its performance; and
including information on:
- the size and composition of the workforce;
- retention and motivation of employees;
- the skills and competencies necessary for business success, and training to achieve these;
- remuneration and fair employment practices;
- leadership and succession planning
  - be balanced and objective, following a process that is susceptible to review by auditors.
  - provide information in a form that enables comparison over time and uses commonly accepted definitions where available and appropriate.

Acas believes that this provides a valuable starting point for the further development work that is necessary to make progress.

Clarifying the next steps

10. The Task Force recommended that a new Standards Board should play the key role in inviting “leading employers, co-operating as appropriate with investors, professional organisations and other relevant stakeholders to develop guidelines on key indicators and definitions.” In its OFR consultation document, the DTI states that: “The Government was initially inclined to support this idea but has reconsidered in the light of subsequent events, such as the use from 2005 of International Accounting Standards and the reorganisation of the Financial Reporting Council and its subsidiary bodies. The Government does not now intend to pursue the Standards Board proposal. Instead it intends to ask the ASB to prepare standards for the OFR, building on its existing statement.”

11. It is unclear what the Consultation Document intends so far as human capital reporting is concerned. We know that many companies are not yet adequately prepared for any detailed reporting requirements that would befall them in the area. The only practical way therefore in which they are likely to increase their capability and confidence is if further work is carried out by those leading in the field, as the Task Force appears to have intended.

12. In the circumstances, Acas stands ready to play its full part in undertaking this further development work. It could, for example, draw up guidelines for discussion with the other major players. Alternatively, it could work with the Accountancy Standards Board to do this.
Annex The Acas "Effective workplace"

Acas believes that putting policies, practices and procedures in place, although a good start, is not sufficient on its own to improve people management. The same goes for improvements in skills. It is behaviour, the way things are done, that is fundamentally important. It is also the all-round contribution that employees can make that must be developed and not just their formal qualifications.

In response to many requests, therefore, Acas has drawn on its unrivalled workplace experience to define the characteristic features of an "Effective Workplace". Although the degree of formality and complexity will inevitably differ from organisation to organisation, depending on size and whether they have access to HR expertise, effective workplaces are typically associated with the following:

- Ambitions, goals and plans that employees know about and understand
- Managers who genuinely listen to and consider their employees’ views so everyone is actively involved in making important decisions.
- People to feel valued so they can talk confidently about their work and learn from both successes and mistakes
- Everyone to be treated fairly and valued for their differences as part of everyday life
- Work organisation that encourages initiative, innovation and people working together
- An understanding that people have responsibilities outside work so they can openly discuss ways of working that suit personal needs and the needs of the business
- A pay and reward system that is clear, fair and consistent
- A safe and healthy place to work
- As much employment security as possible
- A culture where everyone is encouraged to learn new skills so that they can look forward to further employment either in their present organisation or elsewhere
- A good working relationship between management and employee representatives that in turn helps build trust throughout the business
- Formal procedures for dealing with disciplinary matters, grievances and disputes that managers and employees know about and use fairly.