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Background

By way of background, Hermes is a leading fund manager in the City of London. As part of our Equity Ownership Service (EOS), we also respond to consultations on behalf of many long-term institutional investor clients from around the world. In all, EOS advises clients with regard to assets worth a total of US \$195 billion (as at 31 March 2013).

Introduction

As a representative of long-term asset owners we seek to maximise the long-term value of our clients' shareholdings by taking an enlightened shareholder approach. Our firm view is that by taking account of all significant stakeholders' needs, companies are better able to prosper over the long-term. As a result, we welcomed the publication of the UN Guiding Principles on Business and Human Rights and supported their development, participating in the consultation process on them. We have an active programme of dialogue with many of the world's largest public companies, and, where we perceive these companies to have significant risks in relation to human rights, we engage on these issues with them.

We have also actively supported, and continue to encourage, improvements in corporate reporting through a variety of means. These include dialogue with individual companies, engagement with regulators and standard setters as well as participation in a number of initiatives such as Integrated Reporting, the Global Reporting Initiative, the Sustainability Accounting Standards Board and our active involvement in and sponsorship of the ICSA/Hermes Transparency in Governance Awards.

We continue to believe that company reporting, particularly the annual report, must be aimed at shareholders above all. There is a growing tendency for stakeholders to argue that companies should be expected to report on a myriad of different issues. However, we believe that we need to encourage better reporting, not more reporting; if something is not material it should not be reported. Intelligent readers are able to challenge judgments and draw conclusions about the quality of management if what they consider material is not reported (and vice versa). The proposed standards and assurance regime should very clearly encourage this approach from companies, and encourage understanding from stakeholders. Choosing not to take this approach will encourage more boilerplate, lowest common denominator reporting and indeed risks spilling over into behaviour and culture as companies increasingly measure success not by what is important but by meeting reporting requirements.



Our recent thought piece, “Procrustean beds: ensuring reporting standards for companies are appropriately flexible”, which we attach, summarises our views on corporate reporting and the dangers inherent in the proliferation of best practice and mandatory reporting requirements. A tendency towards more requirements, comparability and assurance runs a variety of risks. These include: compliance with rules rather than the true voice of the board emerging from the reporting, false comparisons being encouraged and misleading conclusions about them being drawn, and a tendency for companies to manage to the reporting requirements rather than what is most important for the business and its stakeholders. We believe that good reporting can be both reflective of good practice and can encourage better practice. However, sadly the converse can also be true: compliant reporting can actually mask problems at companies and be a tool of management to deflect attention from genuine concerns that might exist.

We encourage better reporting by companies, including on relevant human rights risks to which they are exposed and how they manage those risks. However, we have to be mindful that there are a plethora of reporting initiatives, sometimes with assurance requirements attached, all vying for companies’ attention. There is a danger of creating an industry around reporting and assurance which runs the unintended risk of drowning out the true voice of companies, which is the one that shareholders want to hear and make judgments about.

It is with these concerns in mind that we have considered the consultation. We encourage Shift and Mazars to demonstrate how they will overcome these concerns as they develop their proposals. Without resolving these concerns, we remain worried that the intended benefits from this initiative will actually result in another layer to the already too complex web of company reporting best practice and requirements.

Views would be welcomed regarding both the proposed elements for inclusion in the Reporting and Assurance Standards, set out in Annex B, and on the possibility that companies may limit a Statement to certain aspects of their operations.

We believe that companies should have the ability to limit the statement to certain aspects of their operations. However, if a company chooses to limit its statement in this way, it should explain its reasons and, if applicable, the timeframe for including all of the company’s operations in the Statement.

Our view is that reporting standards should not be overly prescriptive as rules can encourage compliance rather than good behaviour. Giving companies the ability not to report on aspects of their operations enables them to report on the journey as it progresses. Stakeholders are able to interpret the omissions as well as what is included in reports and draw conclusions.

Views on the proposal to include information about salient human rights risks, as well as general human rights policies and processes, in the Statement would be welcomed.

Views on the degree of disclosure about how the company addresses potential or actual severe impacts in the Statement would be welcomed.

We question the use of the word “salient”. “Material” is the standard term usually adopted in relation to other corporate reporting and a term that is broadly understood. We are concerned that having a subtly different standard will only serve to confuse

and lead to sterile debate on the differences between “material” and “salient”. We would therefore strongly suggest that “material” is adopted.

To discuss the policies and processes without discussion on the most important risks is vacuous: one cannot judge the policies and processes without a view of the risks, nor can one judge how effectively the risks are being managed without understanding the policies and processes, amongst other things. However, we note that human rights risks are often amongst the most important risks to a company and therefore should be reported elsewhere in the company’s reporting. However, to avoid duplication, there should be judicious cross-referring.

Views on the inclusion of additional matters in the Human Rights Statement, beyond the baseline requirements proposed in sections 2.1, 2.2 and 2.3 would be welcomed.

Views would be welcome on whether this is an appropriate approach for assessing Scoping Materiality and any other general factors that should be considered.

It should be clear that companies can voluntarily report additional matters. However, we believe that this needs to be a matter of judgment for companies. We expect companies to report in such a way as to enable the reader to make a balanced assessment of what the board views its material human rights risks to be, how it identifies them and how it manages them both through prevention (including by avoiding the most acute risks), mitigation and remediation.

We note that much of the consultation concerns itself with remediation and mitigation. However, avoiding risks that are outside a company’s risk appetite is also an important tool to manage risk. In our engagement with companies, we often learn of decisions not to operate in particular countries, decisions often arising from human rights risks. Companies should be encouraged to discuss their human rights risk appetite and the outcomes arising from measuring risks against it. Reporting on how risks are avoided as well as mitigated is vital to understand companies in a balanced way.

Views would be welcome on these proposed definitions of ‘Material Weakness’ and ‘Material Misstatement or Omission’.

The definitions seem appropriate.

Views would be welcome on the nature and amount of evidence that assurance providers should examine in order to provide the Assurance report.

Views regarding the handling of relevant information not included in the public Assurance report would be welcomed.

Views would be welcome regarding whether the reasonable assurance level is appropriate for this Assurance review.

Views regarding the competencies of human rights assurance providers would be welcomed, and whether and to what extent they can or should be assessed and/or certified.

We need convincing that assurance is necessary and will add value. We are conscious of the risks of assurance processes making reporting seem a compliance not a communication exercise and that assurance must thus deliver significant value to overcome this cost. We note that under the IAASB’s new ISA 720 the external

auditor will continue to have an obligation to read all the disclosures for consistency with their knowledge. We believe that the evidence examined would vary in accordance with the size, nature and complexity of a company's operations but should be sufficient, both in quantity and quality, to enable the assurance provider to provide an accurate and professional assessment of the company's human rights risk management policy, procedures and outcomes.

We believe that the approach in relation to information described in the consultation is appropriate.

We believe that the reasonable assurance standard as described is appropriate.

The consultation provides a good description of the types of skills needed by assurance providers. We are concerned in particular by a lack of expertise and a lack of independence. We also note that professional judgment is needed at least as much by human rights assurance providers than by providers of some other types of assurance because of the subjective nature of the work. This is particularly the case if the focus of the work is assessing outcomes.

The readers of the human rights Statement and Assurance report will be relying significantly on them. We believe that some of the recent reforms to the auditor's report in the UK would provide significant reassurance to the readers. For example, the Assurance Statement should include a statement that none of the provider's findings during its work were contrary to anything in the Statement or elsewhere in the company's reporting or it should provide details of the lack of congruence.

The assurer's work should focus on outcomes of the policies and processes. It is relatively easy to develop a good policy and process and also to train the policy reasonably effectively. However, a crucial determinant of success in risk management is the actual culture and behaviour of the company. In this context, this refers to how the culture and behaviour upholds the UN Guiding Principles on Business and Human Rights. The assurers should be assessed on their success in judging how the company has implemented the Principles, not on whether it has developed an excellent policy that is reflective of the Principles and has identified the human rights risks it faces accurately – it is therefore on sections 3 onwards, in the annex to the consultation, that are the most important (we would include risk avoidance as well as mitigation as appropriate in these sections) on which to base the assessment.