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Article

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REAPING THE VALUE OF REPORTING – Michael Hutchinson explains how more stringent environment, social and governance reporting to meet updated regulations in the uk can offer new opportunities for mining companies.

by Michael Hutchinson

New Regulations Drive Governance Agenda in Mining Sector

New regulations extending the scope of mandatory non-financial reporting obligations in the UK and introducing a new reporting format have sent environmental, social and governance (**"ESG"**) to the top of the board agenda for mining companies. Whilst voluntary reporting on these issues may have been widespread, not only will the scope and form of these reports need to be reconsidered but companies must also now navigate the risks and liabilities that come with these new responsibilities.

The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the "**SR Regulations**") which came into force on 1 October 2013, abolish the requirement on companies[1] to publish a Business Review and replace it with an obligation to produce a Strategic Report. They also introduce changes to the content of Directors' Reports. The requirements take effect for companies whose financial year ends on or after 30 September 2013.

In addition, it is crucial for mining companies to understand how to avoid the new criminal and civil sanctions and possible reputational damage caused by deflective ESG reporting.

Yet while the SR Regulations create new risks for businesses and their directors, they also present new opportunities. Those mining companies already engaged in voluntary reporting have seen an increase in the value of their business and attractiveness to shareholders.

The Reporting Requirements

Quoted, large and medium sized companies all have differentiated requirements as summarised in the table below.

The Strategic Report's scope differs from that of the Business Review in the following ways. Quoted companies must provide *"to the extent necessary for an understanding of the development, performance or position of the company's business"*:

- information about human rights issues alongside social and community issues;
- a gender breakdown at the end of the financial year of the company's directors, senior managers and employees.

Any reports not containing this information, must explicitly say so.

Under the SR Regulations, quoted companies must also state the annual quantity of emissions expressed in terms of tonnes of carbon dioxide equivalent arising from activities the company (and its consolidated undertakings) is responsible for (for example, from direct emissions to the atmosphere) and arising from the purchase of energy for heating or cooling.

Taking these changes together with existing reporting requirements, the UK's mandatory ESG provisions can be summarised as follows.

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Legal & Reputational Risk

Getting these ESG reporting requirements wrong can have serious ramifications. Directors of companies failing to comply with mandatory reporting obligations can face fines. Regulators may also require companies to amend defective or inadequate sustainability reports. Indeed, the Financial Reporting Council has previously taken such action following a complaint about a mining company's sustainability reporting.

Problems can also arise for businesses because of the multiplicity of standards for reporting on sustainability issues, especially as companies move from voluntary to mandatory reporting. Carbon emissions reporting, for instance, frequently falls under a number of different schemes, often with differing requirements, conversion factors and boundaries. This can cause confusion, sometimes leading to accusations (often unfair) of a lack of consistency and truthfulness.

Inconsistency can again arise as sustainability information is often disseminated by a range of people within a business. Therefore, the key elements of any risk mitigation strategy must be:

- **balance**: this requirement is set out in SR Regulations and unremittingly positive ESG reports are, in practice, a prime target for activist NGOs;
- **transparency**: sources of information and supporting materials should be clearly signposted in the Strategic Report;
- **consistency**: internal control and reporting lines should be established to mitigate the risk of contradictory messages being disseminated to stakeholders.

Lawyers can assist in mitigating ESG risk by ensuring companies understand how to manage disclosures relating to actual or potential litigation, preserve legal privilege relating to draft ESG reports and assure compliance with legal requirements on reporting.

Type of disclosure	Quoted companies	Large companies	Medium-sized companies
Proncipal business risks and uncertainties	✓	✓	✓
Analysis of Key Peformance Indicators (“**KPI’s**”) for non-financial matters	✓	✓	✗
Business strategy and model	✓	✗	✗
Environment employees, Social Community and Human Rights Diversity	✓	✗	✗

Strengthening businesses through ESG

SR Regulations may mean that mining companies may have to change their approach to ESG reporting but they should not be seen as series of hurdles. In fact, they present opportunities for companies willing to maximise the benefits of the new requirements.

The mining industry is particularly vulnerable to ESG issues owing to environmental risks, the particular dangers of the work performed and the infrastructure, or lack of it, present in countries where operations are based. These added considerations make meeting ESG standards more important not just to secure operations' safety and success but to minimise the chance of high profile breaches, which create adverse publicity and immediately register on investors' radar.

Establishing structures suitable for mitigating ESG risks can help strengthen long-term business plans and limit short-term financial and reputational damage arising from incidents. Fostering positive community relations has in particular influenced mining companies' financial valuations as investors' often believe a strong social licence to operate indicates that projects will succeed.

REAPING THE VALUE OF REPORTING

Those companies with strong ESG performance are also more likely to have increased analyst coverage and improved forecast accuracy, boosting their efficiency and making shareholders more likely to invest. Conversely, companies with poor ESG performances are less likely to maintain profitability due to regulatory, customer, and investor pressure.

The importance of ESG only seems likely to grow. Investors are becoming increasingly sensitive to ESG reporting, particularly when defects in a company's policy can be easily communicated and comparative data on companies within the same sector accessed.

The United Nations Environment Programme Roundtable in 2011 found that investor interest in corporate ESG performance has become so high that a tipping point had been reached where it is beginning to affect company valuations. Certainly, ESG indexes such as FTSE4Good ESG Ratings are becoming commonplace on stock exchanges, highlighting that companies' non-financial obligations are integral to decision making.

So while SR Regulations will help bring many companies up to speed with ESG reporting, legislation in this area will only become more rigorous. The mining sector may have traditionally thought that ESG reporting only presented challenges but companies receiving tailored advice will start to see how it can benefit their businesses and with it bring them greater investment.

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