A MATTER OF PRINCIPLES. THE FUTURE OF CORPORATE REPORTING

FINANCIAL REPORTING COUNCIL DISCUSSION PAPER, OCTOBER 2020

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This response has been prepared by a working party of the Company Law Committee of the City of London Law Society (CLLS). The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. The working party is made up of senior and specialist corporate lawyers from the CLLS who have a particular focus on issues relating to company law and corporate governance.

INTRODUCTION

The Committee welcomes the opportunity to comment on the Discussion Paper (DP) which the Financial Reporting Council (FRC) has issued as a first step in considering the future of corporate reporting.

We support the goals of seeking improvements in the quality and effectiveness of corporate reporting and facilitating innovation towards that end. Corporate reporting is a key enabler of shareholders being able to effectively play their stewardship role and allocate their resources appropriately. We believe that it is now being recognised that the long-term interests of shareholders involve considering the interests of stakeholders. We acknowledge the renewed emphasis on the public interest role of companies and on the importance of stakeholders.

There is much to debate here, in what is a complex and key area. It will take time to arrive at the optimal result. It is vital that full and considered thought is given to the key goals that shareholders and companies in particular, as well as key stakeholders, want to achieve as well as to any specific proposals in order to ensure that they achieve those goals.

While we note that the DP seeks to challenge the status quo and that the development of ideas in it has not been restricted by the laws and standards that underpin the current reporting model, we believe changes to the reporting model should not be made without also considering the legal framework for reporting which we discuss below. We also make a few further introductory points before looking at individual questions.

CURRENT LEGAL FRAMEWORK FOR CORPORATE REPORTING/ANNUAL REPORT

We think that such a major review of corporate reporting needs to be conducted at the same time as a review of the legal framework for reporting and the potential liability of companies and directors for the information provided. This is particularly important as we believe these initial proposals put forward could make very significant changes to the potential liability of companies and directors and we are not sure if this is intentional or not and whether the implications of this have been considered.

In particular, we are not clear about the extent to which the proposals in the DP intend to change the established legal framework for the annual report, particularly in respect of the highly interrelated areas of (i) purpose and primary focus, (ii) to whom directors owe duties and (iii) resulting liability issues. We are concerned that these proposals are likely, perhaps inadvertently, to make significant changes in these areas, in particular by the way that they appear to seek to elevate stakeholders to be on a par with shareholders. Therefore, we consider a fundamental question that needs to be addressed at the outset is whether the established legal framework for reporting and the established liability regime should continue in broadly its current form, with other stakeholder reporting outside of it, or whether the existing legal position is intended to be fundamentally changed by these proposals. We strongly favour retaining the existing legal framework under which reports are prepared primarily for shareholders and (in the case of companies traded on a regulated market) investors, and where the potential liability for information in reports is limited. If the existing legal framework is to be changed, we think this should only happen after very careful and detailed debate.

The current legal framework, as set out in the Companies Act 2006 (2006 Act), the Financial Services and Markets Act 2000 (FSMA) and in case law, comprises a number of highly interconnected elements that are relevant to the subject matter of the DP, and we seek to deal with each in turn below:

Purpose and primary focus

- **Section 414C(1) 2006 Act- purpose of the strategic report.** – Section 414C(1) states that the purpose of the strategic report is to inform **members** of the company and help them assess how the directors have performed their duty under section 172 to promote the success of the company.

  We note that on page 7 of the DP the FRC has defined corporate reporting as "information publicly communicated by a company, about the company, for the purposes of enabling **stakeholders** to: understand the company's performance and how it generates and sustains value; make decisions; and hold the company to account." The DP also talks of a "stakeholder-neutral" business report. Does the DP envisage that the new business report should be aimed at informing all stakeholders equally instead of shareholders primarily and so envisage a change to the section 414C purpose in this regard?

  Without much more debate, we do not at this stage favour a change to the current stated purpose of the strategic report. If the overall initial consensus, having considered the issues as regards current legal framework is for a change to the current stated purpose of the strategic report (or any Business Report replacement), as stated we feel there needs to be a very full and considered debate as to the effects of this. It is a very significant step to suggest that a replacement for the strategic report should move away from having shareholders as its prime focus, and, as we say, one that we do not support at this stage.

  This does not mean that we think stakeholders are not important. Ethical treatment of workers, preservation of the environment and building customer trust can all increase a company's long-term shareholder value. It is therefore important that directors have regard to stakeholder interests in meeting their duties to promote the company's success for the benefit of members and that they are transparent about how they do that in their corporate reporting.

  The 2006 Act has only recently been changed to require additional reporting by companies by way of the section 172 statement (now required by section 414CZA). This requires directors to show how they had regard to the factors set out in section 172(1)(a)- (f) as they pursued their duty to promote the success of the company for the benefit of members in the year being reported on. Similarly, the 2018 UK Corporate Governance Code has only fairly recently been updated to put much more emphasis on stakeholder engagement, company purpose and on contributing to wider society.

  We appreciate that the FRC may have in mind a broader sort of stakeholder reporting in the DP than is covered by the section 172 reporting statement or the 2018 Code stakeholder reporting provisions. That said, it is only in 2019 accounts, seen in 2020, that we have the first evidence of the results of these changes, and we would suggest that more time should be given to see whether these changes have the intended outcomes, and whether they result in achievement of their aims, such as increased volume and quality of stakeholder engagement, increased contribution to wider society and enhanced quality disclosures on these matters. We strongly feel that more than just one reporting round is needed to determine whether the changes can generate the improvements that shareholders, regulators and the Government wish to see. In its most recent review of corporate governance reporting published in November 2020, the FRC states – "*Companies are failing* *to provide sufficient information for investors and broader stakeholders in their s.172 statements*." There is clearly room for improvement here and we wonder if this should be the focus of efforts at this stage.

To whom directors owe their duties

- **Directors duties and section 172 2006 Act**. If the intention is to treat shareholders and stakeholders equally and therefore to change the purpose of the strategic report/business report in section 414C(1), we in turn have a concern as to how this sits vis-à-vis section 172 (duty to promote the success of the company). In particular, we are concerned that this elevation of stakeholders by implication seems to go against section 172 and the fundamental concept of promoting the company's success for the benefit of members.

  Section 172 provides that a director must act in the way he or she considers in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in so doing have regard (amongst other matters) to the section 172(1) (a) to (f) matters. What is important is for directors to consider how having regard to stakeholder interests contributes to making the company successful in the longer term. Section 172 was introduced after long and careful consultation and consideration as to how to balance the interests of shareholders and stakeholders. The wording of the section reflects the consensus and conclusion that was then reached.

  We agree that it is important for shareholders, other stakeholders and also members of the public to understand the way in which the directors have had regard to stakeholder interests in making decisions to promote the company's success. However, this is very different from arguing that the stakeholder interests are to be put on the same level as the interests of shareholders. We strongly feel that section 172 should not be changed without a full and proper debate.

  We also feel that anything that potentially seems to cut across or undermine section 172 should be avoided. These proposals risk giving stakeholders the impression that their interests are to be treated as equal to the interests of shareholders in respect of all reports including the newly proposed Business Report. This could create a further expectation gap in relation to annual reports and accounts.

  There is also a risk that putting too much emphasis on stakeholder interests, rather than the importance of the way in which having regard to stakeholder interests contributes to the company's success in the long term, will itself create problems. There can be differences between the interests of different stakeholder groups and also differences of interests within the same stakeholder group (e.g. where employees at one location are to be made redundant but new people are to be employed at another location).

  Overall we are concerned that these proposals risk re-opening the debate over section 172, and if that is the intention, it needs to be a very full and considered debate, as took place prior to the introduction of the section into the 2006 Act in 2007, and also to an extent subsequently in Government evaluation of the 2006 Act that was reported on in August 2010 (Volume 1 DBIS evaluation of the Companies Act 2006) and the Government response issued in August 2017 to its Green Paper on Corporate Governance.

Liability

- **Section 463 2006 Act.** Section 463 provides that a director of a company is liable to compensate the **company** for any loss suffered by it as a result of any untrue or misleading statement in a report or statement to which this section applies but only if he/she knew the statement to be misleading or was reckless as to whether it was misleading or he/she knew the omission to be a dishonest concealment of a material fact. The reports and statement to which the section applies are: the strategic report; the directors' report; the directors' remuneration report; and any separate corporate governance statement (the protected reports). The section has become known as a "safe harbour", in that it broadly limits liability of directors in respect of the protected reports to cases where the director knows something is untrue or misleading or has not taken the relevant degree of care. Section 463(4) also confirms that it is only the company that is the beneficiary of that liability: neither shareholders, stakeholders or any other persons may claim for losses suffered by reliance on information in a protected report.

- **Section 90A and Schedule 10A FSMA**. Also relevant as regards liability here, albeit applicable to a smaller group of companies than section 463 applies to, is section 90A and Schedule 10A of FSMA. Schedule 10A is broadly relevant to listed or traded companies on UK markets. It provides that such a company is liable to pay compensation to a person acquiring, holding or disposing of securities in reliance on "published information" (which includes annual reports and accounts and any other information published on a recognised information service) where that person suffers loss in respect of those securities as a result of the following:

  - any untrue or misleading statement, but only if the director/person discharging managerial responsibility knew the statement to be untrue or misleading or was reckless as to that; and

  - any omission of a matter required to be included, but only if the director/person discharging managerial responsibility knew the omission to be a dishonest concealment of a material fact.

  Schedule 10A also provides that a person other than the company (eg a director) is not subject to any liability, other than to the company, in respect of such loss as is mentioned above. This mirrors section 463 which also provides that directors are only liable to the company.

  The section 90A/Schedule 10A FSMA liability regime was very carefully crafted after much consideration of this generally acknowledged complex area. Professor Paul Davies QC and HM Treasury issued a number of discussion, final and consultation papers between 2006 and 2008 before arriving at the current form of wording in Schedule 10A. For example, much thought was given to the need for a liability regime that did not incentivise companies to become overly cautious in their disclosures, particularly forward-looking disclosures, to the markets, but which actually contributed to incentivising issuers to make accurate and meaningful disclosures while, at the same time, providing issuers and investors with greater clarity as to the scope of liability. It would be very helpful to review and reconsider the issues referred to in these various reports before it is proposed to change the purpose of, and/or liability regime associated with, corporate reporting.

  Section 463 2006 Act and Schedule 10A FSMA provide much needed certainty regarding to whom directors owe liability for the reports/information in question and in what circumstances. If new reports are to be prepared, the liability regime for them will need to be clearly specified, including to whom liability is owed and whether the test for incurring liability will be the same as for the current reports. (See also Question 3 below for more on difficulties as regards this, where different reports have different purposes, objectives and/or audiences.)

- **Common law - to whom is a duty of care owed**. In addition to section 463 2006 Act and Schedule 10A FSMA, the question as to whom the directors owe a duty of care and hence to whom they may be liable as a result of misstatements in their annual reports and accounts is governed by case law.

  In particular, in Caparo Industries v Dickman 1990, the House of Lords held that harm must be reasonably foreseeable as a result of the defendant's conduct, the parties must be in a relationship of proximity, and it must be fair, just and reasonable to impose liability. The decision was based on the wording in the Companies Act 1985, which made it clear that the purpose of the statutory requirement to prepare accounts was to report to shareholders so they could decide what action to take in a general meeting. It was therefore only in cases where there was a particular relationship between the parties that there would be potential liability to a wider group of people. This is important in considering the size of potential liability. The larger the group of people to whom a duty is owed, the larger the potential liability.

With a new series of reports with their own objectives and audiences such as is suggested, and with the seeming elevation of any number of other stakeholders (who have widely varying different interests between and within different groups of stakeholders) to the level of shareholders, considerable thought needs to be given to the duty of care/liability question for directors and auditors. It would be preferable for the position to be set out clearly in statute, rather than being left for the courts to determine as this would cause considerable uncertainty. There are important public policy issues around the size of any potential liabilities and the cases, if any, in which liability should be imposed. These should be discussed at the same time as any proposals about new requirements for corporate reporting.

BRYDON AND KINGMAN REPORTS AND TIMING

The DP acknowledges in several places the report by Sir Donald Brydon CBE on the quality and effectiveness of audit. For example, it states that since a system for corporate reporting underpins audit, the FRC sees this as the right time to discuss what the future of corporate reporting should look like. It also states that the proposals seek to establish a reporting framework that is consistent with the recommendations made in the independent reviews by Sir John Kingman KCB and Sir Donald Brydon CBE.

We agree that if the consensus is that the future of corporate reporting needs to look different, it should be very carefully considered and be consistent with any of the relevant Brydon and Kingman recommendations that the Government decides to take forward.

The DP notes the possibility of elements of its proposals being brought forward at different time frames (page 2). It would be helpful to explore the timing issues further, to determine whether it is best to have all related reforms introduced at the same time, or whether it would be better to have them spread over time, while recognising that companies will not want to face a state of perpetual reform in this area. It may be appropriate to introduce some aspects first for FTSE 100 companies and then have them cascaded down over time.

On a related point as regards timing, the DP states that its aim is to "create a blueprint for a corporate reporting system of the long term, up to 2030". We are not clear whether this statement envisages that it would take until 2030 to effect all the proposals (as was suggested in an answer to a question at the launch event for the DP) or whether the new regime is being designed to last for the long-term, until 2030? We think that the latter is probably not what the FRC means since even if the proposals result in more modest changes to the corporate reporting regime, but especially if they result in a full scale reworking of the legal framework for corporate reporting, we would hope that any changes should be designed to stand the test of a longer time period.

On timing and priorities, please also see our answer to Question 2.

WHAT ARE THE DESIRED CONSENSUS GOALS FOR ANY CORPORATE REPORTING REFORM, WHAT DOES THE FUTURE OF CORPORATE REPORTING LOOK LIKE BASED ON THESE PROPOSALS AND WILL IT MEET THOSE GOALS?

It is vital that full and considered thought is given to the key goals that shareholders and companies in particular, as well as other key stakeholders, want to achieve from any corporate reporting reform. It would be helpful to try to arrive at a consensus on what those goals are, based on this DP and responses to it and other outreach, and to then articulate those agreed goals clearly at the outset, so that what is proposed can, at each stage of its development, be judged against whether it will achieve those goals or whether the effort involved might be better deployed elsewhere. This also needs to be considered in the context of other priorities for corporate reporting (see our answer to Question 2 for more).

If there is general support for the network reports proposed or an element of them, we suggest that the FRC, perhaps utilising the FRC's Reporting Lab, could take a listed company's existing annual report's narrative elements and prepare illustrative examples of such reports to show what they would look like based on the DP's proposals. For example, if the emerging consensus seemed to favour a separate Public Interest Report, taking some information out of the strategic report and directors' report and leaving a more streamlined annual report, this exercise could be done on a few sets of annual reports (perhaps one FTSE 100 and one FTSE 250) to see the result. This would enable companies, shareholders, other stakeholders, regulators and the Government to: see what the resulting reports look like; assess what issues arise; and, most importantly, judge whether the resulting reports achieve their purposes and meet the consensus goals that companies, shareholders and others would like to see achieved from reforms in this area (or whether they perhaps only achieve the marginal gains that we mention in Question 3 and so need to be re-thought).

CONSULTATION QUESTIONS

1. **What are your views on our proposals as a whole? Are there elements that you prefer over others?**

   As mentioned in our introduction, we think that such a major review of corporate reporting needs to be conducted at the same time as a review of the legal framework for reporting and the potential liability of companies and directors for the information provided. This is particularly important as we believe these initial proposals put forward could make very significant changes to that legal framework and to the potential liability of companies and directors and we are not sure if this is intentional or not and whether the implications of this have been considered.

   We consider that aspects of the principles-based elements of the proposals could usefully be debated, and once agreed, brought in sooner. For example, whether or not one has a new set of network corporate reports as proposed or keeps the existing annual report but with an additional Public Interest Statement within it or some other solution, a set of content communication principles would be useful and should help improve the quality of disclosures both in mandatory and voluntary reports. See our comments in Question 4 for more.

   Implementation

2. **What do you see as the key practical challenges of implementing our proposals? Do you have any suggestions on how these could be overcome? What do you see as the costs and benefits of the new model?**

   We appreciate that these proposals will take some time to come to fruition. That said, companies will need to engage with these proposals at each stage from this point onwards to ensure their voices are heard and that they contribute to achieving the desired outcomes. We are mindful that businesses have a great deal on their plates at the current time and that the effects of COVID-19 and Brexit are unparalleled challenges for our times and for businesses. With finite time and resources, we think careful consideration should be given to the burden on business and the need to prioritise at this time. We also mention below some additional, key new reporting related developments that companies are also grappling with at the moment.

   We consider that whilst there may be a few FTSE 100 companies with secretariats of a size that can deal with the changes proposed and maintain and perhaps enhance the quality of their disclosure, many companies, in particular smaller FTSE 250 companies and companies outside the FTSE 350, will struggle to have the internal resource in terms of either time and/or money for third party assistance that they will need to implement the proposals.

The DP says that the proposals have been developed with public interest entities (PIEs) in mind but that some of the ideas could apply beyond this group and that the ideas would need to be adapted to be proportionate for companies of different sizes. We think the challenges for large private companies, depending on the approach adopted, could be significant. We also note, as we know the FRC is aware, that the Sir John Kingman Review suggested broadening the definition of a PIE, and this should be borne in mind when determining which companies will be in scope in relation to the proposals.

We consider that the issue of proportionality should be further explored, so as not to put undue burdens on smaller listed, AIM and large private companies.

We also feel that the timing, together with goals, of any corporate reporting reform should be carefully considered in the context of other priorities. We are concerned that embarking on such far-reaching changes now, at a time when the FRC is still seeking to improve the quality of reporting by some listed companies on several fronts, particularly smaller ones, runs the risk that limited resources will be diverted to the structural elements of the reforms at the expense of, for example, the goal of better quality, more granular and evidence-based disclosures, with less boilerplate and box-ticking.

We also consider that the recently introduced Listing Rule requiring climate-related disclosures consistent with the Taskforce on Climate-related Financial Disclosures (to feature in 2021 annual reports of premium listed commercial companies to be published in 2022) will require a great deal of preparation, time and management and director resource if it is to be done well, and needs to be the priority reporting focus of relevant companies. We also note the Government's intention to consult on extending the requirement for Taskforce on Climate-related Financial Disclosures reporting to a wider group of companies.

We also still await, the White Paper response of Government to all of the three recent major reviews on audit and the future of the FRC. Careful thought needs to be given to the burden on companies and how to help them best achieve what the consensus view sees as the priority reporting challenges.

Objective-driven

3. **Should corporate reporting focus on a wider group of stakeholders through multiple objective-driven reports, instead of a primary user focused approach?**[1]

We do not consider, as the question perhaps suggests, that a report with a primary user focussed approach means that it cannot also focus adequately on other stakeholder issues and how actions as regards stakeholder issues contribute to long-term, sustainable success.

We consider that it is appropriate to have a primary user in mind to act as a single lens through which to prepare and consider a report. This is because having many competing users/stakeholders in mind risks the reports having to be everything to everyone (or something different for each group to which a report is directed) and so having more of the traits that shareholders and the FRC have issue with such as undue length and loss of key messages, consistency and cohesion. We also think it runs the risk of imposing more burden on the preparer of the reports.

[1] Business Report (para 3.7) - To provide information that enables users to understand how the company creates long-term value in accordance with is stated purpose

Public Interest Report (para 3.16) – to provide information that enables users to understand how the company views its obligations in respect of the public interest, how it has measures its performance against those obligations and to provide information on future prospects in this area

We feel strongly that the primary user focus for a company's Business Report should be shareholders, as the providers of financial capital, in order to support both their stewardship role and their financial capital allocation assessments.

As we have said in our introduction, in relation to both the purpose of the annual report and section 172, there is also a risk that putting too much emphasis on stakeholder interests, rather than the importance of the way in which having regard to stakeholder interests contributes to the company's success in the long term, will itself create problems.

A number of statements in the DP give rise to questions that we think merit further discussion. For example:

The DP says (Para 2.3) that in many cases the information needs of different user groups significantly overlap. We wonder therefore whether the proposed changes, resulting in a network of different reports, are going to be really beneficial (or will they just provide marginal gains)?

The DP says (Para 2.6) that an objective-driven approach would result in dialogue between companies and their stakeholders which will provide better understanding between a company and its stakeholders of the purposes for which users seek information and to determine the relevant content. We are not clear how this would be the case.

We also have a concern that there is a real risk that stakeholders will want information for their own purposes, rather than understanding that the directors' role is to consider how the stakeholders' interests (as referred to in section 172) are relevant to creating a sustainable business in the long-term. If the directors have to consider the information needs of the stakeholders separately from how directors take account of those interests in terms of how they make the company successful in the long term, companies could be required to provide very different information.

The DP also says (Para 2.3) that it is unhelpful to establish bright lines between different types of stakeholders. We agree with this and also consider that this links into the difficulties (already mentioned in our answer to this Question) that directors will face with objective driven reports without a primary user focus.

One set of principles

4. **Do you consider the set of principles (system level attributes, report level attributes and content communication principles) in section 2 would be helpful in improving the quality of corporate reporting today and in the future?**

System level attributes (SLA) – page 11 DP

Whilst the overall headings used on pg 11 of the DP seem to cover sensible areas and aims – Accessibility, Consistency, Connectivity and Transparency especially in the context of an annual report with a primary user focus, we consider that there are a number of questions on the SLAs that merit further discussion and we list the main ones here:

Accessibility. We agree that accessibility is important and think more guidance should be given on what this means in practice. We are concerned, however, by the suggestion that the information must be "*presented and communicated in a way that is meaningful and understandable **to users***". Questions this raises if we move away from the primary user model include: how does the company determine who these users are and what their information needs are? Could this potentially be very burdensome to companies and result in a proliferation of information?

Consistency. We agree that consistency of information is important, but could there be a conflict if a company has to take account of different users' needs, for example where a different performance measure may be relevant for one group of users but not for another? Should consistency trump user needs? Also, there could be different levels of sophistication amongst different users eg users of investor presentations compared to employees. How is this to be factored in?

Connectivity. One of the FRC's regular pleas to annual report writers has been for greater inter-connectivity and cohesion – that the annual report should be a cohesive whole, with helpful cross-references from one part of a report to another to give a unified picture of a company's activities. The proposals for a series of different network reports risk exacerbating problems of silo drafting and lack of overall cohesion.

Report level attributes – page 12 DP

Fair, balanced and understandable. We are not sure how the "fair, balanced and understandable" requirement would apply to the new proposals. Do you have to judge this based on all the network reports together, or will it be judged on just those that are part of the statutory accounts filed at Companies House per the 2006 Act or on a report by report basis?

True and fair. Will the "true and fair" requirement only apply to the statutory accounts (as at present)? Will there be changes to the way in which the "true and fair" requirement is treated as applying in the light of the proposed changes?

Role of regulators. If as the DP states (Para 2.8), regulators are to set report level attributes in future, it would be helpful if the proposals could address how they would propose to do this and the process for consulting on them.

Content communication principles

Brevity. The detailed principle here (pg 12 DP) talks of "clear and concise", using the formulation that companies have become used to from the FRC Guidance on the Strategic Report. We would suggest that phrase should be used instead of "brevity".

Comparability. On comparability, how will a company know if the information it provides is capable of comparison with information produced by other companies?

All attributes

Further questions/suggestions we have:

Where is it proposed that such principles/attributes would feature?

We find the two attribute titles to be rather unclear and wonder whether the titles can, like the title - communication principles - be improved to better explain what they are and what they do?

Reporting network (pg 13 onwards)

5. **Do you agree with our proposals to improve the relevance and accessibility of information, involving concise reports distributed across a reporting network?**

We have a concern that distributing information across three reports, rather than in one annual report could mean that information is harder to locate. It could also mean that overall the volume of corporate reporting increases. We do not see anything concrete in the DP that addresses the issue of how to make reports more concise and corporate reporting overall less voluminous. If disaggregated information in a series of reports is the consensus goal, rather than one annual report, these issues will need to be carefully considered.

We are not clear as to what the timing would be for each of the network reports. We are assuming that the Business Report, Financial Statements and Public Interest Report would all be done at the same time. However, on page 3 of the DP, it talks of "an additional periodic report provided at a **different timeframe**" and we are not clear to what this refers. The timing of these reports will need to be clarified.

We also think that companies and shareholders see benefits in having all key information in one annual document prepared at one point in time and dated the same date, so as to help companies present themselves to, and engage with, shareholders both generally and in advance of Annual General Meetings at which annual reports are voted on (although an advisory vote only and not required under the 2006 Act, which only requires the annual report to be laid before the meeting).

We agree that the Business Report should enable shareholders to understand how the business generates and sustains value creation over the longer term (Para 3.7 DP).]

We also agree that, as in the Strategic Report, companies should consider the key resources and relationships that support the generation and preservation of all relevant aspects of value, as part of communicating the company's business model, that key resources can be financial and non-financial and key relationships means considering important stakeholders as well as shareholders (Paras 3.8 and 3.9). We also agree with what is said in 3.11.

Forward-looking orientation. Providing an overall forward-looking orientation as a general principle rather than in limited situations is a much more onerous proposal than the current position. It merits close attention and debate before proceeding.

If there is to be a forward looking element as an overarching principle for the Business Report, we assume that directors would have the same protection as is afforded by section 463 2006 Act (see Introduction for more), ie the Business Report would be a protected report under section 463. If there is any debate on this, it should be raised and discussed now.

It would also be useful to explore the following as regards forward-looking orientation/statements:

- Should there be a need for auditors to play a role in these, either in the way they currently do as regards the viability and going concern statement (LR 9.8.10) or some other way; and how would this work if forward-looking is a general principle rather than attached to a requirement for specific statements to be forward looking?

- How would an overarching principle for forward-looking orientation fit with legal regimes in other countries?

- Should there be any other assurance that surrounds forward-looking statements?

Additional network reports. On the network reports, we can see potential benefits of providing additional detail on information contained in the Business Report and for reporting information that does not change from year to year (eg policies). Thought should be given to what would happen if standing information has changed eg a change of policy? Should this have to be highlighted e.g. in the Business Report and/or the relevant network report?

Paragraph 3.13 seems to suggest that each additional network report should have its own objective, so it provides information which is more targeted to a particular information need. This raises the question of how a user of the reports will know what additional reports (if any) the company has prepared or will prepare and how to find it or them. It seems to suggest that investor presentations will be included as an additional report. We are not clear if this means that different requirements will apply to them that do not apply at present and, if so, what these would be. Similarly, it is suggested that half year reports and ad hoc announcements would be additional reports. Again, would this mean they would be subject to different requirements from those that apply at present? If so, in what way?

Public interest report. We agree that the activities of companies have wider impacts such as on stakeholders (including shareholders) and the environment and that a Public Interest Report or Statement may be helpful in showing how a company views its obligations in respect of what it sees as its public interest role.

We strongly oppose the idea in paras 1.5 and 3.16 of the DP that one of the purposes of the Public Interest Report should be to enable **stakeholders** to "hold a company to account". There is a real risk that if the FRC starts to talk about stakeholders' interests in these terms, stakeholders will think this means their immediate short term interests and that the company or directors have a duty to prioritise these or put them on the same level as the shareholders' interests. This could be a real source of problems not only for companies, directors and shareholders but also for stakeholders, who may well have different interests between themselves or even within the same group.

If a public interest statement/report is to be proceeded with, we consider that it should be for directors to say what public interest means to their company and how it affects what the company does.

Materiality

6. **We are proposing that there should no longer be a single test for materiality that is based on accounting standards but instead materiality will be dependent on the objective of a report. Do you agree with this approach, please explain why?**

We have serious concerns over, and questions on, the proposal for several tests for materiality referenced to different reports with different objectives. The question of judging materiality by reference to the objective of a particular report means that defining the objective of any report is very important. As set out above, we consider the objective should continue to be judged from the perspective of a shareholder who is interested in the long-term sustainability of the company's business. If materiality were to be judged for example by reference to the interests of stakeholders, how would the company know what these are and how would it deal with a case where they differ between groups of stakeholders or within a group of stakeholders?

We are not clear whether the proposal is for the company to determine what is material or for this to be determined objectively or by reference to particular criteria. If a company were to be required to determine materiality by reference to the interests of stakeholders, those interests might change from one year to another. If there are significant differences from one year to another, would the company have to explain what those differences are?

Although we agree that there is a greater need for disclosing the basis on which materiality judgments have been made (para 4.5 DP), we have concerns about the proposals on materiality which we think need significant debate.

For example, there seems to be an element of "double materiality" - materiality at the network as a whole level and then at the individual report level (para 4.1 DP). We are not clear how this will work in practice.

We note that there is an acknowledgment (para 4.7 DP) that the time horizon for materiality decisions can range from short term through to the whole of the business planning cycle, and that there is a suggestion that the time frame for materiality decisions should be communicated. We agree with this, but consider that it needs more debate and guidance to assist directors in this area.

We note that the DP acknowledges (para 4.8) that a focus on individual reports and individual objectives risks missing consideration of whether the reporting network as a whole is complete. This ties into the questions we raise at Question 4 above of how to decide if a report is fair and balanced, as part of the fair, balanced and understandable test. The DP goes on to state that it is therefore important that companies consider information at both levels. As we have already mentioned (see our answer to Question 4), we have concerns that cohesion is already a challenge for some companies as regards the annual report, since in practice different parts of the annual report are written by different people (as the FRC itself identifies in its 2019/2020 annual review of corporate reporting) and these proposals for a network of more individual reports risk exacerbating this problem.

We support proposals (in 5.8) for a minimum content for the Business Report. However, we think it would be better for this to include information on capital allocation strategy which should focus on what the company believes to be the optimal balance between the interests of its key stakeholders, address all main uses of capital that are relevant for the business, and set out the governance and decision-making process around major capital decisions. This would be instead of talking about how value is distributed to other stakeholders to sustain value creation. (See ICGN Viewpoint Capital Allocation July 2019 for more.)

We agree that it would be helpful for the Business Report to set out how consideration of the key stakeholder interests contributes to sustaining value creation.

Non-financial reporting

7. **Do you believe that there is a need for regulatory standards for non-financial reporting? If so, what do you consider the scope of the information that should be covered by these standards?**

We support regulatory standards for non-financial reporting. They will assist shareholders , and other stakeholders, in comparing such disclosures across companies.

We note that the IFRS Foundation is consulting on whether it should play a role in developing sustainability reporting standards and any proposals should take account of developments there. We also note the IFRS Foundation February 2021 announcement that, given the growing and urgent demand for global sustainability standards, the intention would be for it to produce a definitive proposal (including a road map with timeline) by the end of September 2021 and possibly leading to an announcement on the establishment of a sustainability standards board at the meeting of the United Nations Climate Change Conference COP26 in November 2021. We believe international regulatory standards are likely to be welcomed in particular by dual listed companies and companies incorporated in one country and listed in another (which would then avoid the need for such companies to need to report against different domestic regimes) as well as by users of annual reports.

That said, we would also urge those responsible for proposing, consulting on and setting such standards to take account of the need for standards to be sufficiently flexible to allow companies to tell their own story, not stifle good narrative reporting and not encourage boilerplate reporting.

8. **Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest?**

Yes. See our answers in Q 5 on the Public Interest Report.

9. **Do you agree with the introduction of a Public Interest Report and the suggested content as set out in Section 6?**

We consider that it should be for directors to say what public interest means to their company and how it affects what the company does.

If directors are to be required to identify those "who are affected, or at risk of being affected, by the company's operations", this could generate a very long list of people and raises many challenging questions which need very careful thought and debate, not least what materiality test should a company apply. Would something only be material if it would affect the company's business or is materiality to be judged from the perspective of the person affected (as the DP states at para 6.21) or on the basis of what a reasonable person would think the effect would be on the person affected?

Directors will need guidance on these and other matters even if it is made clear that directors take the ultimate decision here (and explain that decision). If those "who are affected, or at risk of being affected, by the company's operations", is to be determined from the perspective of the person affected or objectively, there will need to be very clear guidance as to the steps a company will need to take to determine who falls within this category. One can see there may easily be disagreement between a company and those who see themselves as affected by the company (eg if there is a difference of opinion as to whether the company is the entity responsible for the matter giving rise to the effect or if there is disagreement as to whether a particular issue is material or not). An individual may believe they are materially affected by the company, looking at it from their own perspective, but the company may not realise this. Also, something may have a severe impact on one subset of stakeholders in a group, whilst having a minor impact on another subset of stakeholders in the same group and be minor in relation to the company's business. How is this to be dealt with?

If the report has to include "what [the company] hopes to achieve in the future" (see 6.19), we consider this raises a number of questions including: what is the time period over which this must be determined? Must the company state the period? Can it vary from one company to another depending eg on its business cycle? As this will be forward-looking information, what protection will companies and directors have, given the uncertainty attaching to what they say?

We think it would be helpful for the FRC to issue more detailed examples, or lists, of what the Public Interest Report might contain. As we mention in the Introduction, it might be useful for the FRC Reporting Lab to prepare a mock-up of a set of network reports, including the Public Interest Report.

The DP notes (para 6.20) that there may be some overlap between the content of the Public Interest Report and Business Report. This raises questions such as - if a matter is dealt with in the Public Interest Report, might it also need to be dealt with in the Business Report if seen by the directors as sufficiently strategic. It also raises the question of how to try and ensure that there is not excessive duplication which increases overall reporting length and the disadvantages associated with that.

Technology

10. **Do you see any other ways that current and new technology could be used to facilitate the proposed model and support the system level attributes of corporate reporting identified in section 2?**

We are not responding to this question**.**

Proportionality

11. **Do you agree that the model we propose will achieve a proportionate reporting regime for companies of different sizes and complexity?**

We support the idea that the Public Interest Report should only apply to the very largest companies in the first instance (para 8.7) This could perhaps be for at least two years to allow initial issues to be ironed out and to allow time to judge whether it is useful to apply it to the next tier of companies at a later stage.

See our answer to Question 2 as regards Public Interest Reports and PIEs.

Other

12. **What other areas do you see being necessary or relevant to the development of a model for corporate reporting that is fit for the future?**

Information on website. We note that in the conclusions from the online survey of FRC stakeholders, there is mention in comments (see page 27) that some respondents would like to see more information on a corporate portal or website and less in the annual report. We think this should be explored more as there are potential benefits for companies and users but also not inconsequential issues to be decided.

One issue would be what liability would attach to directors for disclosures on the website that used to be in one of the protected reports? This might in part depend on the nature of the disclosures. If purely factual, eg describing policies, directors might be happy to rely on usual website disclaimers. If more material, extension of the section 463 safe harbour should be considered.

There would inevitably also be a tricky debate, both initially and on an on-going basis, about what elements could go on the website and what should remain in the annual report/network reports. There should be clear guidance on this, as otherwise companies could take different approaches, which would not assist users to find the information they are looking for and could also hinder assessments of comparability of information across companies.

Whilst website information should be dated, we do not however consider that it is practical for this information to be real-time, and thought would have to be given to how often it might be useful, but not overly burdensome, for this to be updated. This might depend on the nature of the information that is to go on the website, and it may be that once a year is enough, although companies could voluntarily do more frequent updating (although that might in itself give rise to an expectation of regular/real-time updating).

Advantages of moving some information onto for example the website would be that the annual report could reduce in length and this would allow companies and users to focus on key messages and disclosures. Companies would have more opportunity to work on website disclosures over the year rather than just once a year, although should have no obligation to do so.

Disadvantages include that annual reports and accounts are voted on by companies as part of the business of the shareholder meeting thereby affording shareholders a say on all matters within them. That said, there is no reason why a Q&A session on the report and accounts should not extend also to material on the website. There may be a tendency by companies, shareholders and others to see website disclosures as less important. There is also a risk that fragmented reporting can result in a lack of consistency and lack of a holistic view.

Annual financial report under DTRs. On a different point, we are assuming the Business Report should serve as the Annual Financial Report for the purposes of the Disclosure Guidance and Transparency Rules. This would need to be more fully assessed as part of any reform.

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