



Comments to the Financial Reporting Council in response to the FRC's Exposure Draft: Guidance on the Strategic Report

Submission from Amnesty International UK

Amnesty International is a global movement of more than 3 million supporters, members and activists who campaign for internationally recognised human rights to be respected and protected. Our vision is for every person to enjoy all of the human rights enshrined in the Universal Declaration of Human Rights and other international human rights standards. Our mission is to conduct research and take action to prevent and end grave abuses of all rights – civil, political, social, cultural and economic.

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Amnesty International's comments to the Financial Reporting Council in response to the FRC's Exposure Draft: Guidance on the Strategic Report (August 2013)

Introduction

Amnesty International welcomes publication of the new regulations contained in the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013¹, which came into force on 1st October 2013.

These require all listed companies and others that are not part of the 'small companies regime' to prepare as part of their annual reports a Strategic Report, to include specific reporting with regard to human rights, subject to certain caveats.

While the FRC Guidance on the Strategic Report will not be mandatory, it will send important signals to companies and shareholders as to what is good practice with regard to 'high quality corporate governance and reporting'.

Amnesty International has far-reaching concerns with regard to the August 2013 Exposure Draft: Guidance on the Strategic Report (hereafter referred to as "the Draft FRC Guidance"). These can be summarised as follows:

1. The Draft FRC Guidance does not reflect the current reality that some companies have not provided shareholders with information relating to social, community and environmental matters in their Business Review, as required under the provisions of the Companies Act 2006, under circumstances where such information could be relevant to an understanding of the principal risks and uncertainties facing the company, and the performance or position of the company's business.²
2. The restrictive concept of materiality set out in the Draft FRC Guidance predisposes companies to filter the contents of their strategic report in a way that:
 - will not actually meet the requirements of the underlying legislation.
 - will fail to meet UK Government expectations concerning human rights reporting.
 - will deny shareholders information that is significant with regard to their long term interests and to the company's strategy and business model.
3. The Draft FRC Guidance, by omitting any reference to the UN Guiding Principles on Business and Human Rights (hereafter referred to as the Guiding Principles), ignores a key strategic development in standard-setting for companies that has been endorsed by the UN Human

¹ The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, http://www.legislation.gov.uk/ukxi/2013/1970/pdfs/ukxi_20131970_en.pdf

² A. Henriques, "The Reporting of Non-Financial Information in Annual Reports by the FTSE100", a paper prepared for the Corporate Responsibility (CORE) Coalition, 2010, <http://corporate-responsibility.org/wp-content/uploads/2010/04/Reporting-of-Non-Financial-Information-by-the-FTSE1003.pdf>

Rights Council, many governments including the UK, international business associations and civil society organisations.

Overall, Amnesty International views the Draft FRC Guidance in its current form as a missed opportunity to improve the transparency of companies with regard to their impacts on human rights, especially in cases when these are relevant to business performance and prospects. It is also at odds with the Coalition Agreement's commitment to improve corporate accountability and transparency on these issues, and it is inconsistent with the Government's intention when the Companies Act 2006 was introduced to bring about "a radical departure in articulating the connection between what is good for a company and what is good for society at large".³ We would urge the FRC to incorporate our comments into their final Guidance.

Executive Summary / key points

Summary and Section 1 - Objectives and how to use this guidance

With regard to appropriate reporting of human rights issues, the new requirement embodied in the amended Companies Act (2006) should be considered by FRC in the context of the UN Guiding Principles on Business and Human Rights and UK Government expectations of human rights reporting within the Strategic Report.

The Government's expectations are set out in guidance issued in September 2013 entitled "Good Business – Implementing the UN Guiding Principles on Business and Human Rights"⁴ (hereafter referred to as the "UK's Implementation Plan"). The UK's Implementation Plan makes clear that the UN Guiding Principles "should be at the heart of a company's core operations" and that "from 1 October 2013 a clarification of the Companies Act 2006 means that company directors will include human rights issues in their annual reports" (para 15 ii). This provides clear direction on the part of the Government to include human rights within a company's Strategic Report, and as such should inform appropriate revision of the Draft FRC Guidance.

Section 1 currently sets out a very narrow view of the purpose of the Draft FRC Guidance on the Strategic Report. Amnesty International believes it should be clarified and expanded to explain the actual requirements of the legislation, which appear to be significantly broader than simply meeting the needs of shareholders within a narrowly defined focus based solely on economic decision making.

Section 5 Materiality

Amnesty International has a fundamental concern with the adoption in the Draft FRC Guidance of the concept of materiality based on the IFRS definition, and its overarching use as the main filter to determine the inclusion or exclusion of information in the Strategic Report. Amnesty International believes that this will have the following consequences:

³ Duties of Company Directors, DTI, June 2007, 'Introduction and Statement of the Rt Hon Margaret Hodge', copy available at <http://www.dti.gov.uk/files/file40139.pdf>

⁴ H M Government: Good Business - Implementing the UN Principles on Business and Human Rights September 2013 see: <http://www.official-documents.gov.uk/document/cm86/8695/8695.pdf>

1. The contents of a strategic report may not actually meet the requirements of the underlying legislation.
2. The contents of a strategic report may fail to meet UK Government expectations concerning human rights reporting.
3. Information that could be of significant importance to shareholders (and other users) may be omitted.

The concept and application of an overarching “materiality” qualification has been introduced into the Draft FRC Guidance, despite this not being a term that can be found or derived from the underlying legislation.⁵

Section 6 – the content elements of the strategic report

Amnesty International’s comments on this section reflect a concern that the guidance on content is overly narrow to the point that it fails to meet the requirements of the amended Companies Act or stated UK Government expectations concerning the reporting of human rights issues. Revised FRC Guidance must reflect this and therefore also provide guidance on appropriate human rights related content. This should encompass whether the company has a human rights policy, whether this applies to its supply chain and business relationships, whether it has a due diligence procedure reflecting the UN Guidelines, and whether it has a grievance procedure that is rights-compatible.

The strategic report need not contain extensive details of the above content, but would need to provide a reference/URL to the document which does contain this information.

Taking together the proposed use of a materiality screen as currently defined, and the very limited guidance with regard to human rights content, there is little prospect that the FRC Guidance, as drafted, would have the effect of meeting either the requirements of the underlying legislation or the expectations of the UK Government with regard to human rights reporting.

Detailed comments and proposed amendments

Summary to the Draft FRC Guidance

The Summary to the Draft FRC Guidance in paragraph ix (p6) refers to the content of the guidance being derived from the relevant Companies Act 2006 amendments. This should be referenced in the context of the UK Government’s expectations that human rights reporting will be included within the Strategic Report, which is expressed in paragraph 15 of “Good Business: Implementing the UN Guiding Principles on Business and Human Rights”, a document launched by the Secretaries of State for Business and Foreign Affairs on 4 September 2013. In view of the fact that the launch of this plan postdates the Draft FRC Guidance, it would be appropriate now for the revised FRC Guidance to reflect this.

⁵ The Companies Act 2006 (Strategic Report and Directors’ Report) Regulations 2013 414A & 414C requires directors to prepare a strategic report for the purpose of informing members of the company and helping them assess how the directors have performed their duty under section 172 of the Act.

Section 1

1.1. (a) states a key objective of the guidance is to “ensure that relevant information that meets the needs of shareholders is presented in the strategic report”.

Section 1 sets the tone for the whole guidance. Amnesty International believes that section 1.1 (a) should be clarified and expanded to explain that the objectives are to meet the needs of shareholders, *in keeping with* the expectations of the UK Government and actual requirements of the underlying legislation itself, both of the last two being broader than simply meeting the needs of shareholders (particularly in the context of the “materiality” screen – see comments on Section 5 below).

The UK Government has made it clear that it expects companies to report on human rights in their Strategic Report, with regard to the responsibility of UK companies to respect human rights as embodied in the UN Guiding Principles. This responsibility to respect human rights is independent of a company’s responsibility to its shareholders. This implies that if FRC Guidance is framed solely in terms of relevance to shareholders it is unlikely to reflect the Government’s expectation on the need for the Strategic Report to reflect a company’s responsibility to respect human rights.

In terms of the underlying legislation itself, section 414 of the Companies Act 2006 (the “Act”), details the requirement to prepare a strategic report, and in particular s414c explains that the purpose of the strategic report is to inform members of the company and help them assess how directors have performed their duty under s 172 of the Act. The latter details the duty of directors to promote the success of their company for the benefit of its members, but crucially qualifies this by the requirement that directors “have regard to” a number of other matters, which themselves do not fit into a narrow framework of information that could be solely useful for shareholders.

Section 2, 3 and 4 No comment

Section 5 Strategic reports and materiality

Section 5 of this draft guidance addresses the application of the concept of materiality to the strategic report, remaining as faithful as possible to the definition of materiality used in International Financial Reporting Standards (IFRSs).

Question 4 - Do you agree with this approach? Is the level of guidance provided on the subject of materiality appropriate?

Amnesty International believes that there is a lack of coherence in the adoption of the concept of materiality based on the IFRS definition, and its overarching use as the main filter to determine the inclusion or exclusion of information in the Strategic Report. Amnesty International believes that this is likely to mean that:

1. The contents of a strategic report may not actually meet the requirements of the underlying legislation
2. The contents of a strategic report may fail to meet UK Government expectations concerning human rights reporting.

3. Information that could be of significant importance to shareholders (and other users) may be omitted

“Materiality” is not a term that can be found or derived from the underlying legislation, as embodied in the Companies Act 2006 s 414. Its suggested use in the Draft FRC Guidance as an overarching screen to determine whether information should be included or excluded from a company’s strategic report could potentially result in the scope and detail of information provided in a Strategic Report not meeting the requirements of the underlying legislation. The latter requires information be disclosed “to the extent necessary for an understanding of the development, performance or position of the company’s business”, relating to the underlying purpose of the strategic report which is to inform members regarding directors performance under s 172 of the Act.

The FRC-introduced concept of “materiality” adopts the International Financial Reporting Standards’ (IFRS) definition, which focuses solely on information that could influence the “economic decisions” of users. However the purpose of the strategic report is to enable scrutiny of the performance of directors under s 172 of the Act, with regard to their duty to promote the success of the company. Crucially, s172 makes it clear that this duty is subject to having regard to a number of other matters, which by their very nature should be considered in a broader context than those that may solely influence economic decisions. For example matters concerning the interests of the company’s employees (s 172 1 a), the impact of the company’s operation on the community and the environment (s 172 1 d), or the need to act fairly between members of the company (s 172 1 f) cannot adequately be considered solely in relation to information which might impact the economic decisions of shareholders.

Following endorsement by the UN Human Rights Council of the UN Guiding Principles, companies are now expected to act on their responsibility to respect human rights. By definition this responsibility is towards rights holders⁶, which means that action to meet this responsibility cannot be framed only in terms of issues that may or may not affect shareholders. The UK Government has endorsed the UN Guiding Principles and in September 2013 issued guidance on their implementation, including a corporate reporting expectation that “from 1 October a clarification of the Companies Act 2006, means that company directors will include human rights issues, in their annual reports” (para 15 ii). The use of a narrow definition of materiality as the main information filter is therefore incompatible with the UK Government’s stated reporting expectations with regard to UK companies meeting their human rights responsibilities.

Quite apart from the legislative requirements and UK Government expectations, the introduction and use of the current narrowly defined materiality qualification within the Draft FRC Guidance may result in directors excluding specific information of significant relevance to shareholders concerning human rights issues. This reflects the situation where the directors’ view of what is material may itself be flawed as historic instances have shown. This is another reason why FRC’s Guidance should require directors to report certain key, selective elements of information on the company’s approach to human rights irrespective of any view on materiality. Such an approach would provide

⁶ All human beings are rights holders in so far as they are entitled in international law to have their rights respected and protected.

an important warning signal to investors as illustrated in the case of Vedanta Resources PLC cited in Section 6 below.

Section 6 The strategic report

The responsibility of companies to respect human rights across all aspects of their operations, and address any negative impacts, is formally codified through the UN Guiding Principles. These have been endorsed by the UK Government which expects them to be applied by UK companies wherever they operate, through due diligence policies, consultation of affected people, grievance mechanisms, transparency about policies, activities and impacts, and reporting. The Draft FRC Guidance on the purpose and content of the Strategic Report needs to be clarified and expanded if it is to provide appropriate guidance that reflects the underlying legislative requirements and UK Government expectations concerning the reporting of human rights issues.

Suggest amendment to Box 6.1

6.1 Amnesty International recommends that for the sake of completeness, Box 6.1 needs to add “having due regard for the additional matters (a) – (f) detailed in 6.4 below “. Excluding this may otherwise provide incomplete guidance as to the required purpose and scope of the strategic report in relation to enabling an assessment of the full scope of directors’ duties under s 172 of the Act.

Question 5

Do you agree with the proposed ‘communication principles’, set out in paragraphs 6.5 to 6.27 of the draft guidance, which describe the desired qualitative characteristics of information presented in the strategic report? Do you think that any other principles should be included?

6.11 The Boxed principle that “ the strategic report should be concise” does not appear to be sufficiently qualified or explained elsewhere and so not reflective of the relevant legislation, and in particular not reflective of its stated requirement that information should be provided “to the extent necessary” for understanding the information in question.

6.12 Guidance that the strategic report should contain only information that is relevant to the performance of directors’ duty in relation to promoting “the success of the company for the benefit of its shareholders” fails to recognise that this duty is also qualified with regard to a number of matters, on which information should also be provided to enable a full assessment of the directors’ performance of their duty.

6.13 As commented on under question 4 above, the application of materiality as directed in the existing Draft FRC Guidance may well result in strategic reports failing to meet legislative requirements, UK Government guidance and expectations, or shareholder requirements with respect to human rights reporting.

Question 6 No comment

Question 7

The ‘content elements’ in bold type described in paragraphs 6.28 to 6.73 do not go beyond the requirements set out in the Act, although the precise wording may have been expanded to make them more understandable. Do you think this is appropriate? If not, what other ‘content elements’ should be included in this draft guidance?

An overall comment would be that the Draft FRC Guidance on content is overly narrow to the point that it fails to meet the requirements of the Act (or stated UK Government expectations). This is reflected in our detailed comments below.

6.52 This states that directors should consider the full range of business risk, but omits to include non-financial risks, such as social, environmental and human rights related risks. This is despite non-financial KPIs being referenced in 6.55.

6.61 / 6.64 6.61 refers to the inclusion of analysis to supplement the financial statements, and reference is made to an aim of answering “questions that are commonly asked by shareholders at an Annual General Meeting”. Questions are increasingly asked at AGMs in relation to matters such as impact on the environment or human rights, and guidance in relation to 6.64 should be expanded to encompass these.

6.64 to 6.67 6.64 includes, inter alia, the legislative requirement for the strategic report to include information on human rights issues. However, no specific guidance is then given regarding what companies might be expected to report on human rights, other than that such information should only be in the strategic report where its influence or potential influence is of a nature or magnitude “relevant to shareholders” (6.65), and where it is “material” i.e. might influence shareholders’ economic decisions (6.66). As it stands the Draft FRC Guidance will, if followed, be likely to significantly narrow the scope of human rights reporting within the strategic report. This is directly at odds with the UK Government’s own expectations in relation to UK companies reporting on implementation of their responsibility to respect human rights in line with the UN Guiding Principles. The Draft FRC Guidance was published before the UK Government’s Implementation Plan for the UN Guiding Principles, and needs now to be updated accordingly. In particular the FRC should consider the following excerpts from “Good Business – Implementing the UN Guiding Principles on Business and Human Rights”:

- in the Ministerial Forward the Rt Hon William Hague MP Secretary of State for Foreign Affairs and the Rt Hon Dr Vince Cable MP Secretary of State for Business, Innovation and Skills and President of the Board of Trade state that it “sends a clear message of our expectation about business behaviour”

- the Introduction specifically refers to UK businesses’ “responsibility to respect human rights throughout their operations” (para 2).

- “The UN Guiding Principles guide the approach UK companies should take to respect human rights wherever they operate” (para 13). The stated key principles in the UK’s Implementation Plan include (para 13):

 - “adopt appropriate due diligence policies to identify, prevent and mitigate human rights risks, and commit to monitoring and evaluating implementation;”

 - “be transparent about policies, activities and impacts, and **report on human rights issues and risks as appropriate as part of their annual reports.**” [our emphasis in bold]

- the Government states in paragraph 15 (ii) “from 1 October 2013 a clarification of the Companies Act 2006 means that **company directors will include human rights issues in their annual reports.**” [our emphasis in bold]

Although the strategic report is not specifically referenced, it is clear that the Government’s expectation is that human right issues will be reported on in the strategic report section of the annual report framework.

Given that there has been little historic guidance for companies with regard to human rights reporting, the Draft FRC Guidance should include appropriate references and summary guidance for companies. At minimum reporting within a company’s strategic report should cover relevant aspects of a company’s responsibility to respect human rights, and the requirement to action this via:

- i) informed policies agreed at the most senior level
- ii) human rights due diligence processes to cover all relevant operations, supply chains and business relationships
- iii) processes to enable remediation of any negative impacts
- iv) appropriate tracking and accountability and reporting mechanisms.

One reason why such information should be a requirement within the Strategic Report is that a consequence of companies not getting this right might be significant underperformance. The provision of such information to shareholders may provide “early warning” signals of problems to come and of liabilities that the company might be carrying through not having proper human rights due diligence procedures in place.

Amnesty International has produced several reports on the UK FTSE-listed company Vedanta Resources, including briefings on the company specifically for shareholders. In response to such briefings among others, one major UK investor, Aviva, was able to identify significant underperformance of the company with regard to their handling of human rights issues. This is reflected in a statement made by Aviva at Vedanta’s AGM in August 2013 attributing share price underperformance to mismanagement of sustainability issues.⁷

6.67 S 414C (7) of the Act states clearly that provision of information concerning human rights issues, inter alia, is expected to include information about any policies and their effectiveness. The necessity for inclusion of policies and their effectiveness should be specifically included in box 6.64 to emphasise their integral importance, rather than separated into 6.67.

6.67 Following from 6.67 there is no reference in the main text of the Draft FRC Guidance to anything that reflects the final legislative requirement of 414C (7). This states that if the strategic report does not include any information covering the matters referenced in 414C (7) b i ii iii

⁷ <http://www.theguardian.com/business/2013/aug/01/top-investor-attacks-vedanta-resources>

(including environmental matters and human rights) then it must specifically state which of these kinds of information it does not contain. There is a passing reference to this in appendix 2 on page 39, but this could be easily missed if excluded from the main guidance. For the sake of complete information [for the benefit of the shareholders' / readers' understanding] it would be appropriate for the company to add an explanation as to why such information has not been included. This would be particularly relevant with regard to human rights issues, given the Government's stated expectations that human rights policies should be in place and reported on by companies.

This will also address situations where a company's directors may not themselves view the necessity to have proper policies and practice with regard to areas such as environmental matters or human rights. Having to specifically comment on inclusion or exclusion of such matters will enable shareholders themselves to take a view as to whether the directors are performing adequately in this regard.

Question 8, 9 and 10 No comment
