ShareAction»

63/66 Hatton Garden
Fifth Floor, Suite 23
London
EC1N 8LE
+44 (0) 20 7403 7800

Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Sent via email

5th February 2021

Future of Corporate Reporting Project: Consultation response

I am writing to respond to the Future of Corporate Reporting Project consultation on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the view of clients, beneficiaries and pension scheme members.

We have chosen to respond to questions 3, 4, 6, 7, 8 and 9, as we felt those were most relevant to our area of focus.

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?

We are strongly behind the idea of corporate reporting focusing on a wider group of stakeholders. Moreover, this recognition of the need to promote dialogue between companies and their stakeholders should not be limited to reports. ShareAction's recent report Fit for Purpose? The Future of the AGM[1] makes several recommendations to put stakeholders at the heart of the AGM of the future. In particular we highlight workers, trade unions, suppliers, customers, and communities – both directly and indirectly affected by corporate activities – as key stakeholders whose needs should be taken into account. For example, we recommend that this core list of stakeholder groups should be given a 'right to register' as stakeholders of a particular company, building directly on those named in Section 172. We have some concerns about the idea of corporate reporting being split up into multiple reports (see answer to question 9).

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?

[1] ShareAction (January 2021). *Fit for Purpose?: The Future of the AGM*. Available online at: https://shareaction.org/wp-content/uploads/2021/01/Future-of-the-AGM.pdf [accessed 5 February 2021].

The principles are useful and appropriate. However, we feel the way they are presented (the three levels of system level attributes, report level attributes and content communication) seems unnecessarily complicated, and we feel this may make it harder for companies to use them effectively. We would suggest using the principles proposed but condensing them to a single set of "reporting principles", that would apply to reporting generally.

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 support the principle of defining materiality as being not just about financial relevance, but about determining what is relevant for a particular objective.

However, if companies are allowed to define their own objectives for the Public Interest report (as per the 'obligations' they see themselves having to the public interest), we believe there is a risk that they may neglect to include information that stakeholders would consider relevant.

This risk can be addressed by setting clear regulatory standards and mandating reporting on particular criteria, as discussed in our answer to question 7. The FRC should also work with its regulated entities to provide further education, guidance and case studies to ensure the information being reported is material and the information being excluded immaterial.

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?

Yes, we believe there is a need for regulatory standards that ensure companies produce clear, comparable information. We are fully behind the FRC's stated aim for non-financial information to have the same importance as financial information, be consistent year on year and be comparable across companies. A fully principles-based approach to reporting under the non-financial reporting regulations often translates in practice to companies reporting 'good news stories' (i.e. successes or problems which have been solved) rather than the real difficulties and issues that investors and other stakeholders need to know about. For example, EY's 2018 Global Climate Change and Sustainability Service[2] found that more than half of respondents (56%) said that a company's non-financial disclosures are either not available or inadequate for meaningful comparison with those of other companies. Investors said that there is a lot of disclosure about formal governance documents, policies and practices that are in place, but what is missing are measures of accountability – information on how nonfinancial metrics are established and managed.

The 2019 report from the Alliance for Corporate Transparency[3] assessed more than 100 companies to provide early reflections on the implementation of the NFRD in practice. It stated that in order to drive better transparency that leads to substantial positive change, legislation needs to focus on clear indicators (such as human rights due diligence and disclosure in the context of concrete risks and incidents and their management), and that these requirements can be specified in guidance. For example:

[2] EY (29 November 2018) "Does your nonfinancial reporting tell your value creation story?" Available online at: https://www.ey.com/en_gl/assurance/does-nonfinancial-reporting-tell-value-creation-story [accessed 5 February 2021].

[3] Alliance for Corporate Transparency (February 2020) *2019 Research Report*. Available online at: https://allianceforcorporatetransparency.org/assets/2019_Research_Report%20_Alliance_for_Corporate_Transparency.pdf [accessed 5 February 2021].

- The vast majority of companies acknowledge in their reports the importance of environmental and social issues for their business. However, only 50% of reports present clear information on concrete issues, targets and principal risks for environmental matters, and less than 40% for social and anti-corruption matters.
- A majority of companies do not provide any information that would allow a stakeholder to understand how their commitments are put into practice. Over 90% of companies express in their reports a commitment to respect human rights and over 70% endeavour to ensure the protection of human rights even in their supply chains. But only 36% describe their human rights due diligence system, 26% provide a clear statement of salient issues and 10% describe examples or indicators to demonstrate effective management of those issues.

We therefore recommend that the FRC mandates reporting on specific criteria (both general and sector-specific). Standards should (1) be comprehensive across environmental and social issues and (2) take an approach to materiality that reflects impact on both companies and on the environment and society, adopting the concept of "double materiality" as used by the EU or the approach to materiality set out in GRI 101.

In doing so, it is critical that the FRC builds upon and works with existing initiatives: specifically, "The Five" global sustainability standard setting and corporate reporting organisations (CDP, CDSB, GRI, IIRC and SASB) who have already signalled their intent and started to work together towards greater consistency and harmonisation in their work. The FRC should also put these standards out for public consultation before finalising them.

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, but we are concerned about the onus being placed on the company to state how it views its obligations in respect of the public interest, and then report against how it has measured its performance against these obligations. This would seem to indicate that a company would only have to report on its performance on areas where it believes it has an obligation in respect of the public interest (if any).

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

We are concerned that having separate financial and "Public Interest" reports creates the risk that companies see this as an semi-optional CSR-type extra, rather than something inherent to their purpose as a company. Considering stakeholder interests is at the heart of UK company law (section 172, Companies Act 2006) and we believe it sends the wrong message to split them off into a separate report.

Financial and non-financial information is often so closely intertwined that separating them is a false dichotomy. When companies externalise their costs and fail to take responsibility for them, these costs come to bear on governments and communities (for example, in the form of pollution-related health issues or state-provided in-work benefits). In time, these costs will inevitably come to impact on the profitability of businesses. UNEP's executive director Achim Steiner has commented that companies that face up to these realities are likely to be the ones that thrive and remain competitive in a rapidly changing world where factors such as climate change and the dwindling availability of natural resources like water will shape future profit and loss and drive new markets.[4]

We would suggest that reporting is structured around the concept of double materiality. The financial performance of a company may be impacted by an issue, or the corporate itself may

[4] CIMA (May 2014). *Accounting for Natural Capital,* p. 6. Available online at: https://www.cimaglobal.com/Documents/Thought_leadership_docs/Sustainability%20and%20Climate%20Change/CIMA-accounting-for-natural-capital.pdf [accessed 5 February 2021].

impact on social and environmental concerns. As the European Commission states, "[t]hese two risk perspectives already overlap in some cases and are increasingly likely to do so in the future."[5] For example, corporate workforce practices have been shown to have a material impact on both companies and on society this year, during the COVID-19 pandemic. Asking companies to assess and evaluate their activities through this lens, using clear and comparable standards and in a single report, should avoid reinforcing the idea that their business activities take place within a bubble.

We agree that corporate reporting should present consistent and comparable quantitative and qualitative information that explains the company's performance and targets in respect of external outcomes and other public interest matters. We also agree that reporting should identify relevant stakeholders, such as workers, trade unions, suppliers, customers, and communities directly and indirectly affected by corporate activities. We suggest the FRC could set out minimum expectations of which stakeholders to include, with scope to give companies the opportunity to include more based on their particular sector.

Yours sincerely,

Rachel Haworth
UK Policy Manager, ShareAction

---

[5] European Commission (2019). "Guidelines on reporting climate-related information", p. 7. Available online at: https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf [accessed 5 February 2021].