

PRESS RELEASE UNDER EMBARGO UNTIL 24TH JANUARY 2024

New legal opinion on true and fair shows company directors how to include sustainability in their financial accounts

London, 24th January 2024 – A leading company law King’s Counsel has issued a new legal opinion on the requirement for company accounts [also known as financial statements] to provide a true and fair view of the position of the company. Directors of UK companies must consider whether and how to reflect relevant sustainability issues, such as their contribution to climate change, in their financial statements, in order to provide a true and fair view.

This new opinion on the true and fair requirement for company accounts, commissioned by Social Value International (SVI), is the first to consider the inclusion of sustainability issues. It states that directors and auditors have a ‘positive duty’ to consider if sustainability issues have consequences for the financial statements, for example creating liabilities or impairing asset values.

Mervyn King, the Former Governor of the Bank of England said:

‘The financial and non-financial assets of a company are integrated 24\7 operationally. To report them in two silos is divorced from reality. The most informed body of this integration is the board. The board should do an integrated report showing this integration in clear, concise and understandable language. If the user requires more specific information, they can turn to the specifics in the financial or sustainability report.’

The ‘true and fair’ legal requirement has existed for many years but its interpretation evolves with society’s expectations. It has been over ten years since the last legal opinion on the interpretation of the true and fair requirement was published. Since then, the challenges posed by climate change and widening inequality have grown. The fact that the International Financial Reporting Standards Foundation (IFRS Foundation), the body responsible for setting accounting standards, has established the International Sustainability Standards Board (ISSB) is proof that accounting practice is already responding to changes in societal attitudes towards sustainability.

This new opinion, issued by George Bompas KC, opens the door for the integration of some sustainability issues in the financial statements as opposed to disclosures in a separate sustainability report. It requires company directors to think holistically about sustainability issues and not just rely on international accounting standards to meet the true and fair requirement. It clarifies directors’ duties and empowers directors to include their contributions to sustainability issues in the financial statements should they consider it relevant to the users (of their financial statements).

Relevance for UK small businesses

Although true and fair is a requirement for all businesses, this legal opinion is especially relevant to the 5.5 million small businesses in the UK (those employing fewer than 50 people).

Existing sustainability reporting requirements are complex and predominantly designed for the country's 43,000 medium and large businesses. Directors of small businesses know that their operations contribute to issues such as climate change and inequality and may want to recognise this but often find it hard to see how.

Staffordshire Chambers of Commerce is an example of one small business that has already taken a lead in disclosing its impacts on climate change in its financial statements. Its directors included a note in their audited financial statements, for the year ending 31 March 2023, that estimates the social cost of its use of carbon. In addition, the Directors' Report states that future financial statements will address their contribution to other sustainability issues in line with the UN Sustainable Development Goals.

A spokesperson from the British Chamber of Commerce said:

'Green innovation and reaching Net Zero are key priorities for the British Chambers of Commerce. Our research suggests that while firms are taking steps to be more environmentally sustainable, many smaller ones would benefit from additional help and guidance to stay on track. This initiative appears to be a good step forward for businesses, making adaptations, to reduce their carbon footprint and be more socially responsible. We look forward to seeing how it develops.'

Many directors feel that there is a moral imperative to address sustainability issues and there is a commercial rationale for directors to include sustainability information in their financial statements (rather than a separate sustainability report).

Ben Carpenter, CEO of Social Value International, said:

'It [disclosing sustainability issues in the financial statements] makes it very real for directors and will accelerate decisions to reduce negative impacts and make the business more resilient and competitive in the long term.'

Implications of the opinion

The opinion clarifies two things. Firstly, it clarifies the legal duties of directors to depart from existing accounting standards, where necessary, to meet the requirements for true and fair within the context of sustainability issues. Secondly, it clarifies the powers and discretion that directors have to include additional information in the financial statements about their contribution to sustainability issues.

Where directors make statements that indicate that they accept a responsibility to pay for this contribution, this could create a constructive obligation. A constructive obligation is not based on a contract and therefore not normally enforceable but these obligations should be included in the financial statements. Where there is some uncertainty around the existence, outcomes or measurement of such an obligation, the directors may consider that the information is

necessary in order to provide a true and fair view and that the best place to disclose the information may be in the notes to the financial statements.

Next steps

Based on the new opinion, Social Value International and Social Value UK are launching a Campaign for True and Fair accounts. Working with business networks including Business Declares, Capitals Coalition and Social Enterprise UK, they will be developing guidance and support for directors who want their companies to ‘put their money where their mouth is’ in accounting for their impact on people and planet.

SVI have been working closely with law firm Bates Wells, who instructed George Bompas KC. **Luke Fletcher, the partner at Bates Wells who led the work, said:**

‘It is now clear that directors and auditors of companies have a positive legal duty to carefully consider how new forms of sustainability related information and narrative reporting impact on the numbers in the financial statements. It is not enough to tell a good story and rely on accounting standards. Directors and auditors need to go further and apply themselves personally as professionals and satisfy themselves that the financial statements they are approving are true and fair. This should come as a wake-up call and encourage deeper thought and reflection by directors and auditors on asset and liability values and related assumptions in the face of climate change.’

The Campaign for True and Fair Accounts is not limited to the UK. SVI will be working with the Global Alliance for Impact Lawyers (GAIL) in six other countries to explore how other jurisdictions can evolve their interpretation of true and fair to encourage compliance with legal duties and empower directors to integrate sustainability information into their financial statements.

Ada Yip, Co-Chair of Social Value International, said:

‘Clarity reduces fear of change. We hope more directors and companies are inspired to revisit and discuss their commitment at the leadership level about explicitly incorporating sustainability in their annual financial statements, and their everyday decision making and governance, and not just in the sustainability reports.’

Stephanie Robertson, Co-Chair, Social Value International, said:

‘Company directors are increasingly asked to report on how corporate actions might diminish social and environmental well-being today, and how they impact the quality of life of future generations. This new opinion on true and fair is the launching point for much needed,

significant examination into the duty of directors to integrate sustainability information within financial statements.’

SVI invites anyone interested in these issues to register their interest here: www.socialvalueint.org/true-and-fair to receive updates about the Campaign for True and Fair Accounts.

###

Notes to Editors

1. The Opinion – In More Detail

Under the Companies Act 2006, UK company directors can only legally approve financial statements when they are satisfied these financial statements give a ‘true and fair’ view of the assets, liabilities, financial position and profit or loss of a company.

In 2023, Social Value International commissioned law firm Bates Wells who instructed George Bompas KC to establish a new legal opinion and interpretation of ‘true and fair’ under the law as it applies to UK companies.

The opinion is the first to look specifically at the relationship of new categories of sustainability related information being generated by companies and the legal duties of directors and auditors. It is expected to accelerate the integration of sustainability issues into accounting practice.

New categories of sustainability related information are being disclosed in narrative reporting by a wide range of companies under new International Sustainability Standards Board standards. The standards are voluntary but the UK is considering whether to make them mandatory for certain companies.

However, the new opinion clarifies that directors already have legal duties in relation to these issues and in doing so undermines the artificial separation often made between financial statements and sustainability reports.

Mr Bompas’ opinion

- clarifies the relationship between:
 - the requirement under English company law that directors must not approve financial statements unless they are satisfied they give a ‘true and fair view’; and

- the introduction of international sustainability standards and the related disclosure of sustainability related information which is useful to users of financial statements.
- reiterates the established principle that what is a ‘true and fair view’ is a legal concept that will evolve and change over time, and which involves judgement and discretion from directors and auditors. However, it is the first to apply the true and fair requirement to sustainability information.
- highlights that directors must depart from a specific accounting standard if this would not be sufficient to give a ‘true and fair view,’ and additional disclosures must be provided in the financial statements or a note to them if needed to give a ‘true and fair view’. In light of emerging international sustainability standards, directors and auditors ‘now need to consider the relevance of new forms of disclosure of sustainability-related information to the production of accounts.’
- specifically states the possibility that constructive obligations may have been created and that the directors may decide to make sustainability statements that specifically create constructive obligations if they choose to do so.

The Opinion

George Bompas KC’s opinion on the True and Fair requirement can be found here: www.socialvalueint.org/true-and-fair

2. Interviews and additional information

For more information and to arrange interviews please contact:

Ben Carpenter

CEO, Social Value International

ben.carpenter@socialvalueint.org +44 (0) 7841 448418

For more information and to register for updates visit: www.socialvalueint.org/true-and-fair

3. About Social Value International

Social Value International (SVI). SVI is a global network which comprises regional membership bodies of social value experts from different sectors and disciplines. SVI supports the measurement and analysis of social value and develops related social value principles, which

SOCIAL VALUE
INTERNATIONAL

enable decision-makers to account for the effects of decisions on people and the environment.

www.socialvalueint.org