THE TRUE AND FAIR REQUIREMENT
SOCIAL VALUE INTERNATIONAL

OPINION

BATES WELLS
10 Queen Street Place
London
EC4R 1BE

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OPINION

Preliminary

1 I have been asked various questions by Instructing Solicitors concerning the preparation of annual accounts required by the Companies Act 2006 ("the Act") for companies incorporated under that Act.[1] These questions are directed at the statutory provisions concerning the content and presentation of annual accounts, and the duties of directors and auditors in that regard, in the context of the requirement for annual accounts to present a true and fair view of the company's assets, liabilities, financial position and profit and loss.

2 The context of my Instructions is the rapidly increasing awareness of the need for environmentally responsible behaviour throughout the global community, including businesses of all descriptions, along with the emerging risks and opportunities for enterprises. Most recently, over the last months, there has been a spate of activity among different organisations following the issue in June 2023 of the International Sustainability Standards Board's two sustainability disclosure standards, IRFS S1 and IFRS S2.

3 Well before that, however, there had already been an increasing emphasis in the narrative reporting by larger companies of information concerning their conduct and approach. This had been established with the amendment of sections 414C to 414CB of the Act, at the start of 2022, to have climate-related financial information included in the strategic report as part of a non-financial and sustainability information statement.[2]

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[1] In this Opinion I am concerned only with such companies, although for the most part LLP's are subject to the same considerations. Further, in this Opinion I focus on single company financial reporting, although much of what is discussed applies equally as regards group accounts.

[2] The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/31). This Statutory Instrument was to require disclosures as to companies' governance, strategy, risk management and

4 But at the same time the linkage between narrative and financial reporting was receiving attention. So, for example, the Financial Reporting Council had, in November 2021, published "FRS 102 Factsheet 8, Climate-related matters", referred to later in this Opinion, drawing attention to the need for consideration, when preparing accounts, of the impact which climate-related matters might have upon the financial statements, including with regard to risks, uncertainties, judgments and estimations, in particular as to recognition and measurement of items and to the disclosures made or required. This same document, in a part dealing with "Financial Statement Presentation", explained "*Although FRS 102 does not make any specific requirements for climate-related disclosures, all entities should consider any additional disclosures they need to make to enable users to understand the impact of climate-related issues on the figures presented within the financial statements*".

5 Now urgent attention is being given by those instructing me to ways in which enterprises in the UK may be assisted or encouraged to manage themselves responsibly and, as part of this, to report on and reflect in the accounts relevant material information which goes to the presentation of a true and fair view of the financial position of the enterprise.

The True and Fair Requirement - Sustainability Related Information

6 The principal question I have been asked is:

> **"To what extent, if at all, must directors and auditors consider whether, in order to satisfy the True and Fair Requirement, sustainability related information set out in International Sustainability Standards needs to be disclosed in the accounts, as an additional disclosure(s)?"**

7 In this question "the True and Fair Requirement" is the statutory duty placed on directors by section 393(1) of the Act not to approve accounts for the purposes of Chapter 4 in Part 15 of the Act unless "*satisfied that they give a true and fair view of the assets, liabilities, financial position and profit and loss*" of the company (or, as the case may be, of the undertakings included in the company's group accounts).

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metrics and targets related to climate change, with a view to promoting the management of climate-relate financial risk and opportunities across the economy and financial system. The Explanatory Memorandum to the Statutory Instrument acknowledged that the disclosures were in line with recommendations of the Taskforce on Climate-Related Financial Disclosures published in 2017.

8 The True and Fair Requirement is expressed negatively in section 393 of the Act. However, the duty is in fact a positive one: when a company's directors approve accounts, as they are required to do in performance of their duties to produce, circulate and file accounts for their company, they need to satisfy themselves as to the matters referred to in the previous paragraph. That clearly requires the directors to consider the question whether the accounts give the necessary true and fair view; and the directors need to apply themselves with proper care and diligence in deciding how the question is to be answered. I return to this later, when answering Question 4 below.

9 Correspondingly, the company's auditors when carrying out their functions under the Act in relation to the company, must have regard to the True and Fair Requirement (section 393(2)) of the Act. Their audit report under section 495(3) of the Act must give their view on the question, among others, whether the relevant accounts (that is, balance sheet and profit and loss account) give a true and fair view.[3]

10 There are, of course, two alternative accounting frameworks which may be used for UK companies' accounts, namely (a) the UK GAAP financial reporting framework based in the Act but elaborated on in Financial Reporting Standards issued by the Financial Reporting Council for the purposes of the Act and Regulations made thereunder, and (b) International Financial Reporting Standards under the aegis of the IAS Board insofar as adopted for the UK[4] ("adopted IFRS").

11 As to the former framework, the Act together with delegated legislation makes provision for the form and content of the accounts, referred to in the Act as "Companies Act individual accounts" or, as the case may be, "Companies Act group accounts". Accounts prepared in accordance with the latter framework are referred to as "IAS individual accounts" or "IAS group accounts"; but in this case the Act makes only minimal provision concerning form and content.[5]

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[3] The auditors are also required to report on other matters, notably in respect of the directors' report and the strategic report with the annual accounts (section 496 of the Act).

[4] The UK Endorsement Board is now tasked, in exercise of powers delegated by the Secretary of State, with future adoption of international accounting standards.

[5] Sections 397 and 406 of the Act.

12 In the case of Companies Act accounts the overarching[6] nature of the True and Fair Requirement is reflected in the requirement that the accounts must comprise a balance sheet and profit and loss account, and that (emphasis added) they "*must ... in the case of the balance sheet, give a true and fair view of the state of affairs of the company as at the end of the financial year*" and "*must ... in the case of the profit and loss account, give a true and fair view of the profit or loss of the company for the financial year*" (section 396(2) of the Act; section 404(2) of the Act makes equivalent provision for group accounts). Further, the form and content of the accounts may be prescribed by the Secretary of State, as may "*additional information to be provided by way of notes to the accounts*" (sections 396(3) and 404(3) of the Act). Again, where compliance "*would not be sufficient to give a true and fair view, the necessary additional information must be given in the accounts or a note to them*"; while the company's directors "must" depart from compliance with any provision if in special circumstances compliance would be inconsistent with giving a true and fair view (sections 396(4)&(5) and 404(4)&(5) of the Act).

13 The True and Fair Requirement set out in section 393 of the Act applies both to Companies Act accounts and to IAS accounts, although not the provisions described in the previous paragraph. In other words, the requirement as regards IAS accounts is reflected exclusively in (a) the directors' duty (that is "the True and Fair Requirement", above), and (b) the auditors' duty in that regard and in reporting on the accounts in accordance with section 495 of the Act.

14 The FRC's "Forward to Accounting Standards" (January 2022) explains, when summarising in paragraph 5 the scope of accounting standards, that "*The whole essence of accounting standards is to provide for recognition, measurement, presentation and disclosure for specific aspects of financial reporting in a way that reflects economic reality and hence provides a true and fair view*". The premise is that compliance with the standards normally gives expression to economic reality and, it follows, a true and fair view. Certainly, as business and finance has become ever more complex and sophisticated, the principles and rules aimed at standardising the ways in which such matters are accounted for and ensuring a connection with reality have themselves evolved and become more detailed. The expectation was and is that, if the recognised principles and rules are followed and applied,

[6] "Overarching" is the expression use in para 646 of the Explanatory Notes on the Companies Act 2006 when describing the True and Fair Requirement.

in accordance with the letter and spirit, with additional disclosures where necessary, the resulting accounts will give a true and fair view.

15 I have been provided with copies of several Opinions dealing with the true and fair concept and, in particular, its meaning as used in the True and Fair Requirement in the Act. The seminal Opinions are without question those given by Lord Hoffmann and Dame Mary Arden in 1983 and 1984. Further opinions on the topic have been given since then, most recently one given on 11 April 2022 by Michael Todd KC and Jack Rivett on the instructions of the UK Endorsement Board. From these, together with the case law, the following principles may be extracted:

15.1 "*True and fair view*" is a legal concept and so the question whether accounts comply with the concept is for the court.

15.2 The courts have never attempted to define the concept because it must be applied to an infinite variety of facts. Application of the concept involves judgment in questions of degree. There may be room for differences over the method to adopt in order to give a true and fair view.

15.3 Cost-effectiveness must play a part in deciding the amount of information which is sufficient to make accounts true and fair. If information can be provided only with great expense and difficulty, it would not be reasonable to insist upon it. Generally, the wide range of and sophistication of users of the accounts of publicly-listed companies justifies greater disclosure than in the case of small, private companies.

15.4 Although the question whether accounts give a true and fair view is a legal one, the courts will look for guidance to the ordinary practices of professional accountants. This is partly because accountants can express an informed professional opinion on what it is thought that accounts should reasonably contain. In addition, the practices of accountants will mould the expectations of the readers of accounts, namely businessmen, investors, bankers and so forth. Therefore, the value of an accounting standard to a court is two-fold; first, the standard crystallises professional opinion and reduces penumbral areas in which divergent practices can exist; secondly, it creates an expectation among readers that the accounts will be in conformity with the prescribed standards. The effect of the issue of standards has been to create a

common understanding between users and preparers of accounts, though accounting standards are also living and dynamic and are informed by changes in practice, which is reflected in current responses to sustainability related matters. The development of the ISSB standards and of new categories of useful sustainability related information represents a notable shift in the standards regime.

15.5 Although an accounting standard has no direct legal effect, it is likely to have an indirect effect on the content which the courts will give to the true and fair concept. The issue of an accounting standard creates a *prima facie* presumption that accounts which do not comply are not true and fair (and vice versa, where any necessary additional disclosures are made). This presumption is then strengthened or weakened by the extent to which the standard is actually accepted or applied.

15.6 However, the preparation of financial statements is not simply a mechanical process under which compliance with relevant accounting standards will automatically and necessarily achieve a true and fair view: professional judgment will be required, in varying degrees depending on circumstances, in applying the requirements of the standards and in determining what additional disclosures, if any, are needed to provide a true and fair view of the reality of the enterprise.[7]

15.7 The true and fair concept is dynamic and subject to continuous rebirth in the sense that the content given to it will evolve and change over time.

16 The FRC has published a document explaining the True and Fair Concept. This, in its current iteration (September 2023) available on the FRC's website,[8] explains the application of the concept, and its overriding nature, as follows:

> *"Directors must consider whether, taken in the round, the financial statements that they approve are appropriate. Similarly, auditors are required to exercise professional judgment before expressing an audit opinion. As a result, ... it will not be*

[7] Factsheet 8, referred to above, illustrates the relevance of judgment in the preparation of financial statements: it explains, in the section headed "Financial Statement Presentation", *"Small entities applying Section 1A of FRS 102 are not specifically required to comply with the full disclosure requirements of the remainder of FRS 102. However, they are required to provide disclosures in addition to those set out in Section 1A where necessary in order to give a true and fair view ... and may therefore need to exercise a greater amount of judgment in determining what additional disclosures are needed [sc. ... to enable users to understand the impact of climate-related issues on the figures presented within the financial statements]"*.

[8] https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/true-and-fair-concept

sufficient for either directors or auditors to reach such conclusions solely because the financial statements were prepared in accordance with applicable accounting standards."

17 The inter-action between the True and Fair Requirement on the one hand (that is, the statutory duty in section 393(1) of the Act described in paragraph 7 above), and on the other the expectation that compliance with applicable accounting standards will result in true and fair accounts, is captured in paragraphs 3.2 and 3.4 of FRS 102 ("The Financial Reporting Standard as applicable in the UK and Republic of Ireland") as published by the FRC in January 2022:

> "3.2 *The financial statements shall give a true and fair view of the assets, liabilities, financial position, financial performance and, when required to be presented, cash flows of an entity.*
> *(a) The application of this FRS, with additional disclosure when necessary, is presumed to result in financial statements that give a true and fair view of the financial position, financial performance and, when required to be presented, cash flows of entities within the scope of this FRS.*
> *(b) [Deleted]*
> *The additional disclosures referred to in (a) are necessary when compliance with the specific requirements in this FRS is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance."*
>
> ...
>
> *"3.4 In special circumstances when management concludes that compliance with any requirement of this FRS or applicable legislation (only when it allows for a true and fair override) is inconsistent with the requirement to give a true and fair view, the entity shall depart from that requirement in the manner set out [below, giving explanation and further disclosure]."*

18 The position, so far as concerns adopted IFRS, may be taken to be the same: the duty imposed by section 393(1) of the Act, the True and Fair Requirement that is to say, is not contradicted by adopted IFRS. This, at any rate is the view expressed by Mr Todd and Mr Rivett in their Opinion and accepted by the UK Endorsement Board. So while IAS1 provides, by paragraph 15, that "*The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation*", by paragraph 19 IAS1 acknowledges that there can be "*extremely rare circumstances*" in which this presumption will be displaced, and that then there can be a departure from the requirement of the IFRS along with explanation and further disclosure. For this purpose the fair presentation concept is taken to be the same as the true and fair concept.

19 The short of this summary is that a company's directors, when preparing annual accounts, cannot simply assume that because the accounts have been prepared in accordance with the applicable standards according to the relevant accounting framework (that is UK GAAP or adopted IFRS), the True and Fair Requirement will be met: the directors have also to ask themselves whether they are satisfied that the accounts give a true and fair view. This is the point made in the FRC document referred to in paragraph 16 above.

20 The question asked in my Instructions, however, is directed at sustainability-related information identified in International Sustainability Standards as relevant for responsible corporate reporting. The two such standards issued so far are IFRS S1 and S2, the first being titled "General Requirements for Disclosure of Sustainability-related Financial Information", the second "Climate-related Disclosures". What has to be considered is the relevance of the requirements concerning this sustainability-related information to the production of accounts to which the True and Fair Requirement applies.

21 When first, in 1929, UK companies become subject to a requirement to produce annual accounts with a prescribed form and content, the accounts were to comprise a balance sheet and profit and loss account, with notes to amplify or explain certain items; and the balance sheet was to have attached to it a directors' report "*with respect to the state of the company's affairs*" and recommendations for dividends and reserve funds (Companies Act 1929, sections 123 to 129). When, almost 20 years later, the True and Fair Requirement was first imposed on directors, it was expressed as a requirement similar to that in what is now section 396(2) of the Act, explaining in the imperative that "*Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year*", and making it an offence if a director failed to take all reasonable steps to secure compliance.[9] The requirement was not expressed as having application beyond, in effect, these financial statements, that is these two depictions in monetary terms of the amounts of assets and liabilities, profits and losses, along with notes and explanations of specific items which, by tradition, measure the progress and position of a business. In other words, the requirement was directed at recognition and measurement of amounts along with explanations.

[9] Companies Act 1948, sections 149(1)&(6) (re-enacting s.13 of the Companies Act 1947).

22 With the increasing complexity of the world of business and business structures, there have been two notable changes relevant for present purposes, in addition to the increasing sophistication and detail of principles for recognition and measurement of amounts. First, there has been the development of an elaborate hierarchy of requirements concerning accounting and reporting by companies of different sizes and importance. Second, there has been an increasing emphasis on narrative reporting of aspects of a company's business and affairs which may not be directly reflected in the basic financial statements along with notes and explanations.

23 The hierarchy of requirements is expressed in Diagram 2 in paragraph 2.7 of the FRC's "Overview of the financial reporting framework" (January 2022) which depicts "*Increasing complexity*" as one moves from the "micro-entities regime" to the "small entities regime" to "FRS 102" and ultimately to "adopted FRS". Even within these groups there are distinctions: the "FRS 102" regime in Diagram 2 captures both medium-sized and large-sized companies regimes, while there are special regimes for insurance and banking companies. Overall, the range of different entity qualifications and different reporting requirements is extensive.

24 Indeed, at the simplest level in the hierarchy, that is the regime available for micro-entities, the True and Fair Requirement is merged into conformity with quite elementary rules for recognition, measurement and reporting, and ceases to have any independent function: as explained in paragraph 3 of the FRC's Forward (referred to above), "*In the case of a micro-entity, financial statements drawn up in accordance with the micro-entity provisions of company law are presumed to be a true and fair view*".[10] At the most elaborate level in the hierarchy, for quoted and listed companies[11], the reporting requirements are extensive and complex.

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[10] Cf. sections 393(1A) and 396(2A) of the Act. Given that micro-entities are expressly only required to follow the minimum disclosure requirements listed in the Act, such entities likely need not disclose additional sustainability-related information. This Opinion is therefore only likely to be relevant to micro-entities if the directors include additional information in the accounts on a voluntary basis. In that event, the directors would need to have regard to the relevant accounting standard: s.393(1A)(c) of the Act.

[11] Quoted companies will have additional disclosure obligations under the Listing Rules in the FCA's Handbook (eg Listing Rules 9.8.6 R(8) and 14.3.27 R) by reference to the recommendations published by the Taskforce on Climate-related Financial Disclosure. AIM-listed companies will have additional obligations under the applicable listing rules.

25 Unquestionably though, apart from accounts prepared for micro-entities and applying the micro-entity provisions, the True and Fair Requirement stands as a separate consideration apart from the applicable accounting and reporting principles and rules. Further, as a general proposition it is permissible for companies voluntarily to move up in the reporting hierarchy and to apply a more elaborate regime than necessary, it is not possible to "trade down", as it were.

26 Since the introduction of the requirement for there to be a directors' report to accompany annual accounts, for larger entities there has been the introduction of requirements for further reports to included. This is in addition to the development in the range of additional notes and explanations of items required in relation to the core financial statements. For a "quoted company" as defined in section 385 of the Act or an unquoted traded company the additional reports include a directors' remuneration report, while a strategic report is required unless the company qualifies for the small companies regime (section 414A of the Act), this report containing more or less detail depending on the particular character of the company.

27 Section 414C(1) of the Act explains 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 of the Act. Section 414C(2) of the Act requires the report to contain a fair review of the company's business and a description of the principal risks and uncertainties.

28 Reference has been made already, at the outset of this Opinion, to the requirement in section 414CA of the Act for a non-financial and sustainability information statement to be included in the strategic report, this being required for companies at the highest level in the reporting regime hierarchy but nevertheless permissible for any company to include in its strategic report (section 414CA(10) of the Act). Essentially the statement has to include the climate-related financial disclosures of the company (section 414CB of the Act), along with (among other matters) *"environmental matters .. including the impact of the company's business on the environment"*. "Climate-related financial disclosures" is a defined term, with a meaning specified in section 414CB(2A).[12] The requirement for disclosure of this climate-

[12] "In this section, 'climate-related financial disclosures' mean—
(a) a description of the company's governance arrangements in relation to assessing and managing climate-related risks and opportunities;

related financial information was in line with recommendations for the Task Force on Climate-Related Financial Disclosures made in 2017.

29 Section 172 of the Act, referred to above, is directly connected with the reporting in the statement of sustainability-related information. That section, setting out in sub-section (1) the directors' core duty of acting in the way the director considers, in good faith, most likely to promote the success of their company for the benefit of members, requires directors to have regard to, among other matters, "*the impact of the company's operation on the community and the environment*", and the need to maintain a reputation for high standards of business conduct. The success of the company is not to be measured, in other words, simply by the returns being made to shareholders, but requires attention to the company's wider social responsibility (including towards the environment).

30 As noted above, at the highest level in the reporting hierarchy referred to in the diagram in the FRC's "Overview" stands "adopted IFRS" reporting. Companies using this framework and preparing "IAS individual accounts" or "IAS group accounts" within the meaning of sections 397 and 406 of the Act are likely to be those where there is a requirement for a non-financial and sustainability information statement within a strategic report. It is here that the IFRS Sustainability Disclosure Standards are most likely to have their immediate impact.

31 If one ignores substance, it might seem that the disclosure standards are concerned only with narrative reporting and, as with information to be contained in the non-financial and sustainability information statement within a strategic report, to have no direct effect so far as concerns the recognition or measurement of items, or in the notes and explanations, in a

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(b) a description of how the company identifies, assesses, and manages climate-related risks and opportunities;
(c) a description of how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management process;
(d) a description of—
(i) the principal climate-related risks and opportunities arising in connection with the company's operations, and
(ii) the time periods by reference to which those risks and opportunities are assessed;
(e) a description of the actual and potential impacts of the principal climate-related risks and opportunities on the company's business model and strategy;
(f) an analysis of the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios;
(g) a description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; and
(h) a description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based."

company's core financial statements. As to this, the IFRS Foundation's updated educational material, republished in July 2023, "Effects of climate-related matters on financial statements"[13], acknowledges that "*IFRS Accounting Standards do not refer explicitly to climate-related matters*".

32 However, the same document goes on to explain that "... *companies must consider climate-related matters in applying IFRS Accounting Standards when the effect of those matters is material in the context of the financial statements taken as a whole*". The document explains that "*information about how management has considered climate-related matters in preparing a company's financial statements may be material with respect to the most significant judgments and estimates that management has made*"; and it then goes on to give further examples to illustrate occasions when IRFS Accounting Standards may require companies to recognise the effects of climate-related matters in applying the principles in various of the standards. An obvious one of these examples is where assumptions about the future give rise to the risk of material adjustments to the carrying amounts of assets and liabilities with respect to the next financial year. Another less obvious example would be where a sustainability related commitment meets the relevant criteria necessary to qualify as a constructive obligation which needs to be reflected in the accounts.

33 So also, FRS 102 Factsheet 8 (referred to above) outlines "*the way in which climate-related matters may impact a set of financial statements prepared under FRS 102 ...*", while also setting out information intended to "*support entities in considering how to achieve the required linkage between their financial and narrative reporting*". Factsheet 8 identifies, by reference to sections of FRS 102, numerous different disclosure requirements of the standards, which may be affected in the case of any given company by climate-related issues and where such issues might impact the figures presented.

34 As matters stand at present, the IFRS Sustainability Disclosure Standards have not been adopted by any standard setting body for use by companies subject to UK accounting requirements. It appears that the Government intends to endorse the standards with a view to creating UK Sustainability Disclosure Standards by July 2024 ("Mobilising Green

[13] https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf

Investment" 2023, para 44 on page 43[14]). It follows that no UK company which is at present preparing financial statements within the adopted IFRS framework is bound to have regard to the IFRS Sustainability Disclosure Standards. Any narrative reporting would have to be by reference to section 414CB of the Act (and, it may be, the requirements imposed on quoted or listed companies).

35 This said, it can be expected that soon the IFRS Sustainability Disclosure Standards, or something very much like, will become part of the adopted IFRS financial reporting framework for UK companies. But meanwhile there is an extensive overlap between the IFRS Sustainability Disclosure Standards and the Taskforce on Climate Related Financial Disclosures Recommendations, as explained in the IFRS Foundations' "Comparison – IFRS S2 Climate-Related disclosures with the TCFD Recommendations" (July 2023). Examples from the IFRS Foundations' educational material, "Effects of climate-related matters on financial statements" (referred to above) demonstrate that multiple existing IFRS accounting standards may require disclosure of climate-related matters. By way of example:

35.1 Companies must consider climate-related matters in applying IFRS accounting standards when the effect of those matters is "*material*"[15] in the context of the financial statements taken as a whole. The need for such materiality judgments could affect any part of financial statements.

35.2 Paragraph 112(c) of IAS 1 requires disclosure of information that is not specifically required or presented elsewhere in the financial statements, but is relevant to understanding any of them. Additional disclosures could be needed under paragraph 31 of IAS 1 if compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of climate-related or sustainability-related "*events and conditions*" on the company's financial position and financial

[14] "Mobilising Green Investment" explains, at para 42, that following the publication of the first two IFRS Sustainability Disclosure Standards there will be an assessment aimed at ensuring "the standards endorsed by the Government for use in the UK are appropriate for UK companies. These standards will provide the basis for future obligations within company law and FCA requirements for listed companies, ensuring a single set of standards is applied across the UK regulatory framework. Further standards will be similarly assessed".

[15] Information is "*material*" if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a reporting entity: IAS 1, paragraph 7.

performance. These events or conditions could also affect a company's ability to continue as a going concern (IAS 1).

35.3 Climate-related matters could affect the estimated residual value and expected useful lives of assets (through obsolescence, legal restrictions or inaccessibility of the assets), affecting the amount of depreciation and amortisation recognised in current and subsequent periods (under IAS 16 and 38).

35.4 Climate-related (and sustainability-related) matters could cause a fall in demand for certain products that emit greenhouse gases or lead to regulation banning such products. Either of these consequences could lead to the impairment of an asset under IAS 36 (such as the manufacturing plant producing those products).

36 One area of particular sensitivity, requiring the exercise of judgment in the preparation of accounts, is likely to be that of constructive obligations. In the face of the unfolding issues surrounding sustainability, there may be numerous different ways in which companies adjust their business models or make promises or commitments to do so. These adjustments, or the promises or commitments, may naturally have an impact on what is disclosed in accounts and, indeed, on the recognition and measurement of items in financial statements.

37 A constructive obligation is by definition, by the use of the word "constructive", something which is not normally enforceable directly against the relevant company. There may, however, be circumstances where the company has so bound itself that it no longer has complete freedom over its course of action. As to this, there is a definition of the constructive obligations in paragraph 10 of IAS 37. A constructive obligation is:

> *"an obligation that derives from an entity's actions where (i) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (ii) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities".*

38 Where something happens to create a valid expectation in other parties that an entity will discharge a constructive obligation, the obligation may require recognition as a provision (cf IAS 37 para 14). In principle, a sustainability-related commitment could amount to a constructive obligation, provided that the commitment is *"sufficiently specific"*.

39 This is the point made on page 4 of the IFRS Foundation's educational material of July 2023, referred to above, when describing the effects of climate-related matters on financial statements. This envisages possible liability disclosures where restructurings are needed to redesign products or services to achieve climate-related targets (under IAS 37). The implication is that, where a restructuring plan to achieve the target has been devised and committed to, the commitment has become "*sufficiently specific*" to merit disclosure. Such a plan might also presumably have created a "*valid expectation*" among other parties. There are other examples in the Climate Disclosure Standards Board's publication, "Accounting for Climate (Integrating climate-related matters into financial reporting)" of December 2020.[16]

40 By way of further example, FRS 102 Factsheet 8 addresses climate-related targets in the context of employee and executive pay (under the heading "Section 28"). It reasons (at page 15) that, if the relevant targets are measurable and attainable, and the entity has plans in place to work towards these targets, then it should be possible to estimate the degree to which the targets will be met. If an employee-related expense or liability can be recorded on this basis, other expenses and liabilities in relation to sustainability commitments may be too.

41 However, Factsheet 8 cautions that a target to "*cut carbon emissions to zero*" is of itself and unaccompanied by more specific commitments only "*open-ended and aspirational*", and without greater specificity and context may not be possible to make a reliable estimate so as to allow recognition and measurement. Much is therefore likely to depend on the way the climate-related targets are formulated and whether they are accompanied by and engender expectations of plans to meet those targets and associated timelines. On the other hand, a company which actively wants to make concrete sustainability commitments might deliberately choose to structure its commitments in such a way as to create future or even present year obligations which impact upon the accounts, such as where a company commits to buy carbon credits to offset its emissions on an ongoing basis.

42 An obvious point, though, is that the IFRS Sustainability Disclosure Standards, having regard to the subjects they are dealing with, may only have quite general relevance to certain companies.. No doubt there will be some companies where such considerations as the

[16] CDSB 20Dec20_climateaccountingguidance_d_110121.pdf

"community and the environment" in s172(1) have little or no immediate practical effect on their business or prospects, and therefore these do not require any recognition or acknowledgment in the financial statements. But even in the case of these companies the directors should have thought about the question, when reminding themselves of their duty under section 172 of the Act, and also when finalising their companies' accounts, to see that the True and Fair Requirement is satisfied.

43 In summary, therefore, directors and auditors, considering whether the True and Fair Requirement has been met by them as regards any particular annual accounts, must be aware of possible impacts on the financial report flowing from sustainability-related issues[17], just as they must in the case of any other areas of material risk or probable or possible change which may be relevant to their company's activities. But as the present trend is for continuously increasing emphasis on accounting for sustainability-related issues, with recognition and measurement of the impacts of those issues, IFRS S1 and IFRS S2 assist with the identification of these possible impacts on the annual accounts, not least of all by providing a structured approach towards consideration of the relevant issues.

Useful Information and The True and Fair Requirement

44 The second question from instructing solicitors, which overlaps with the first, is:

> ***Given that the international sustainability standards prepared by the ISSB are intended to disclose information which is "useful to primary users of general purpose financial reports", does this weigh in favour of disclosure in the accounts? Is there a risk that failure to disclose such information might cause accounts to fail to provide a true and fair view?***

45 The IFRS use the expression "useful" to refer to the objective of properly prepared accounts giving complete and accurate information (see, for example, para 1.2 in the Conceptual Framework; para 9 in IAS1). As the FRC puts it, "*the concepts of usefulness and true and fair are, in the context of financial statements, inseparable - for financial statements to be useful they must present a true and fair view*"[18]. As it was put by Lord Hoffmann and Dame Mary Arden in their 1983 Opinion at paragraph 8, "*accounts will not be true and fair unless the*

[17] These have been emphasised in the IFRS Foundation's "Educational Material", referred to above.

[18] FRC, "*True and Fair*" (June 2014).

information they contain is sufficient in quantity and quality to satisfy the reasonable expectations of the readers to whom they are addressed".

46 In advance of the UK-adoption of the IFRS Sustainability Disclosure Standards (including the associated due diligence and consultation) and accounting practices coalescing, it is difficult to say that, as a general proposition, disclosure of sustainability related information will be necessary to satisfy the expectations of readers (to the extent that they have such expectations) or that the lack of such disclosure would mean that the accounts are at risk of failing to provide a true and fair view. Certainly, IFRS S1, for example, starts at paragraph 1 by explaining that "*The objective of IFRS S1 General Requirements for Disclosure of Sustainability-Related Financial Information is to require an entity to disclose information about its sustainability-related risks and opportunities that is useful to primary users of general purpose financial statements in making decisions relating to providing resources to the entity.*" But this aim does not without more add to the True and Fair Requirement resting on directors or on the duty of auditors in that regard, partly for the reasons outlined at paragraph 34 above and partly because the concept of usefulness in the context of sustainability-related information is still evolving.

47 Nevertheless, as has been emphasised in the Opinions and in the FRC's Factsheet 8, directors and auditors will need to exercise professional judgment in deciding what and whether sustainability-related disclosures are needed to ensure the accounts provide a true and fair view. As outlined at paragraph 43 above, IFRS S1 and IFRS S2 provide a useful roadmap in this regard, in identifying items of disclosure that are likely to or may be useful for users of accounts.

Considering Disclosure in the Accounts of Sustainability Related Information

48 The third question from instructing solicitors invites attention to the approach to be taken by directors and auditors where there is some sustainability-related issue which has been identified and consideration is being made about the way in which, if at all, the issue should be addressed in financial statements:

> ***What approach would Counsel recommend to directors and auditors when determining whether or not to disclose sustainability related information in the accounts?***

49 On any basis, the issue of IFRS S1 and IFRS S2 provides an important reminder to directors and auditors of the relevance of sustainability-related issues to the circumstances of companies, and of the need to keep these in mind when preparing accounts. As to this, reference may be made to my answer to Question 1 above. I would recommend, for example, that directors and auditors follow the guidance set out in the IFRS Foundations' educational material, "Effects of climate-related matters on financial statements" and the FRC's Factsheet 8, in considering whether to disclose sustainability-related information in the accounts.

50 Reference may also be made to the directors' duties under sections 172 and 174 of the Act and my answer to Question 4 below. In order to comply with their duty under s.172, directors are required in discharging their functions to have regard to "*the impact of the company's operation on the community and the environment*"; so the types of issues identified in IFRS S1 and IFRS S2 will need to be considered, both as regards the company's operations and ,it follows, the preparation of the company's financial statements. Further, the exercise of judgment involved in disclosing sustainability related information in the accounts will also engage the directors' duty under s.174, as is best demonstrated by paragraph 21 of *ASIC v Healey* [2011] FCA 717, discussed below.

51 Further, while certain disclosures by way of notes to accounts are mandatory (as described above in para 12 in connection with Question 1), it does not follow that additional disclosures are prohibited and that explanations and comment are not allowed where directors consider that a user of the accounts would find further information useful.

Failure to Disclose Relevant Material Sustainability Related Information

52 The fourth question I have been asked in my instructions is directed at the consequences for those responsible where accounts fail to give a true and fair view:

> ***What are the risks if directors and auditors fail to meet the True and Fair Requirement by failing to disclose relevant material sustainability related information in the accounts?***

53 I have referred already to the True and Fair Requirement, the duty imposed by section 393(1) of the Act, as well as to the requirement in sections 396 and 404 for Companies Act accounts to give a true and fair view, so far as concerns the balance sheet and profit and loss account. I have also referred to the duty imposed on directors by section 172 of the Act and owed to their company when discharging their functions as directors. Also owed to their

company is the directors' duty of care set out in section 174 of the Act: this requires directors to use reasonable care, skill and diligence, measured by reference to their own general knowledge, skill and experience as well as by reference to what might be expect of someone in their position.

54 An obvious consideration is that a director found to be in breach of duty would be at risk of civil liability for any loss suffered by the director's company as a result of the breach. One might envisage circumstances in which the director had assumed also a duty of care owed to some third party who had suffered loss by reason of the director's breach. Yet further, the breach might provide the grounds for a disqualification proceeding against the director under the Company Directors Disqualification Act 1986. Finally, reference should be made to section 414(4) of the Act which makes criminally liable any director of a company whose annual accounts are approved but which do not comply with the requirements of the Act, provided the director knew or was reckless as to the non-compliance or failed to take reasonable steps to secure compliance or to prevent the accounts from being approved.

55 An obvious issue which will face any director, particularly where the company is large, the business complex, and the accountants and auditors believed to be highly skilled and of competence and integrity, is the extent to which the director has to engage personally with the content of the accounts before the accounts are approved. As to this, it is perhaps simplest to quote directly from the judgment of Middleton J in the case of Australian Securities and Investment Commission v Healey [2011] FCA 717 at paragraphs 10 to 22: these paragraphs are set out in Appendix A to this Opinion. The point, well expressed in the judgment, is that directors do need to exert themselves and cannot simply rely on their having delegated responsibly.

56 The auditor's exposure is similar. I have referred already to the auditor's duty in section 393 of the Act concerning the True and Fair Requirement, as well as to the duty imposed by section 495 of the Act. Breach of these duties could found an action by the company concerned; and there is a volume of case law on circumstances where auditors have been found liable to third parties relying on the accounts. Besides this, the auditor faces the possibility of criminal liability were the auditor knowingly or recklessly causes a section 495 audit report to include any matter which is misleading false or defective in a material respect.

57 The FRC also may have an involvement where accounts are defective and fail to give a true and fair view:

57.1 There is a statutory power to compel revision of defective accounts. Under s.456(1) of the Act, the Secretary of State, or the relevant delegated authority (the FRC), can apply to the court for a declaration that the annual accounts of a company do not comply "*with the requirements of this Act*" (including the True and Fair Requirement). The directors can be ordered to bear the costs of the application and of producing the revised accounts (s.456(5)). Before making that application, the FRC can require the production of documents, information or explanations if it thinks there are unanswered questions about a company's accounts (s.459 of the Act).

57.2 An auditor who permits accounts to be approved that do not comply with the True and Fair Requirement has failed to discharge properly his legal and professional[19] responsibilities. The auditor can face criminal liability under s.507 CA by causing a report under s.495 to "*include any matter that is misleading, false or deceptive in a material particular*". There may separately be a possible negligence[20] claim against the auditor (although loss will need to be proved). The FRC can also carry out investigations into audit work and can impose disciplinary sanctions[21].

The True and Fair Requirement - Conclusion and Summary

58 The overarching nature of the True and Fair Requirement and its relationship to new categories of sustainability-related information may therefore be summarised as follows.

59 It is accepted that the question of what is a "true and fair view" is a legal concept and so the question whether accounts comply with the concept is for the court. The true and fair concept is dynamic and subject to continuous rebirth in the sense that the content given to

[19] See the International Standard on Auditing 700 in this regard (including paragraphs 25, 36 and A24).

[20] The court is likely to attach significant weight to any non-compliance with accounting or auditing standards.

[21] The Statutory Auditors and Third Country Auditors Regulations 2016 (SI 2016/649), regulation 3(1)(l) and (m).

it will evolve and change over time. The courts have never attempted to define the concept because it must be applied to an infinite variety of facts. Application of the concept therefore involves judgment in questions of degree on the part of directors and auditors.

60 The True and Fair Requirement stands as a separate legal consideration apart from the applicable accounting and reporting principles and rules, which creates a positive duty for directors and auditors. When a company's directors approve accounts, as they are required to do in performance of their duties to produce, circulate and file accounts for their company, they need to satisfy themselves that the accounts "*give a true and fair view of the assets, liabilities, financial position and profit and loss*" of the company or group. The True and Fair Requirement is directed at recognition and measurement of amounts along with explanations in the accounts, as opposed to related narrative disclosure and reporting requirements which accompany the accounts.

61 The True and Fair Requirement clearly requires the directors to consider the question whether the accounts give the necessary true and fair view of assets, liabilities, financial position and profit and loss; and the directors need to apply themselves with proper care and diligence in deciding this question. The company's auditors when carrying out their functions under the Act in relation to the company, must also have regard to the True and Fair Requirement and have a corresponding duty. Their audit report must give their view on the question, among others, whether the relevant accounts (that is, balance sheet and profit and loss account) give a true and fair view of the relevant matters.

62 In the case of Companies Act accounts, the overarching nature of the True and Fair Requirement is reflected in the requirement that the accounts "*must ... in the case of the balance sheet, give a true and fair view of the state of affairs of the company as at the end of the financial year*" and "*must ... in the case of the profit and loss account, give a true and fair view of the profit or loss of the company for the financial year*". And, where compliance "*would not be sufficient to give a true and fair view, the necessary additional information must be given in the accounts or a note to them*"; while the company's directors "*must*" depart from compliance with any provision if in special circumstances compliance would be inconsistent with giving a true and fair view (sections 396(4)&(5) and 404(4)&(5) of the Act.

63 Whilst there is generally a *prima facie* presumption that accounts which do not comply with the applicable accounting standards will not give a true and fair view to enable the True and Fair Requirement to be satisfied (and vice versa), the preparation of financial statements is not simply a mechanical process under which compliance with relevant accounting standards will automatically and necessarily achieve a true and fair view: professional judgment will be required, in varying degrees depending on circumstances, in applying the requirements of the standards. It is also for directors and auditors to judge whether, in addition to the application of accounting standards, additional disclosures are needed in the circumstances to meet the True and Fair Requirement.

64 A company's directors and auditors cannot therefore simply assume that because the accounts have been prepared in accordance with the applicable accounting standards, the True and Fair Requirement will be met: the directors also have to ask themselves whether they are satisfied that the accounts give a true and fair view and apply proper care and diligence to that question. In practice, directors and auditors now need to consider the relevance of new forms of disclosure of sustainability-related information to the production of accounts to which the True and Fair Requirement applies.

65 It is expected that the IFRS Sustainability Disclosure Standards will be incorporated into the adopted IFRS financial reporting framework for UK companies. But meanwhile there is an extensive overlap between the IFRS Sustainability Disclosure Standards and the Taskforce on Climate Related Financial Disclosures Recommendations. There are multiple existing IFRS accounting standards which may require disclosure of climate-related matters. Companies must consider climate-related matters in applying IFRS accounting standards when the effect of those matters is "material" in the context of the financial statements taken as a whole. The need for such materiality judgments could affect any part of the financial statements. Additional disclosures of sustainability related information could be needed if compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of climate-related or sustainability-related "*events and conditions*" on the company's financial position and financial performance. These events or conditions could also affect a company's ability to continue as a going concern. Sustainability-related matters could affect the estimated residual value and expected useful lives of assets (through obsolescence, legal restrictions or inaccessibility of the assets), affecting the amount of depreciation and amortisation recognised in current and subsequent periods. Sustainability-related matters could also cause a fall in demand for certain products that

emit greenhouse gases or lead to regulation banning such products. Either of these consequences could lead to the impairment of an asset.

66 FRS 102 Factsheet 8 outlines "the way in which climate-related matters may impact a set of financial statements prepared under FRS 102 ...", while also setting out information intended to "support entities in considering how to achieve the required linkage between their financial and narrative reporting". Factsheet 8 identifies, by reference to sections of FRS 102, numerous different disclosure requirements of the standards, which may be affected in the case of any given company by climate-related issues and where such issues might impact the figures presented.

67 In summary, therefore, directors and auditors, considering whether the True and Fair Requirement has been met by them as regards any particular annual accounts, must be aware of possible impacts on the financial statements flowing from sustainability-related issues, just as they must in the case of any other areas of material risk or probable or possible change which may be relevant to their company's activities. But as the present trend is for continuously increasing emphasis on accounting for sustainability-related issues, with recognition and measurement of the impacts of those issues, IFRS S1 and IFRS S2 assist with the identification of these possible impacts on the annual accounts, not least of all by providing directors and auditors with a structured approach and new categories of sustainability related information which support consideration of the relevant issues.

68 To paraphrase the judgment of Middleton J in the case of ASIC v Healey [2011] FCA 717, this means that each director is expected to take a diligent and intelligent interest in the sustainability related information available to the director, to understand that information, and apply an enquiring mind with respect to the relevance of that information to the responsibilities placed upon the director in adopting and approving the financial statements, including making further enquiries if matters revealed in the sustainability related information disclosed appear to be material and have an impact on the financial statements. Directors need to exert themselves and cannot simply delegate to others.

George Bompas KC

4 Stone Buildings
Lincoln's Inn
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APPENDIX A

Extract from judgment of Middleton J in ASIC v Healey [2011] FCA 717

In this Australian case, against a legislative background very similar to the Act, directors of a major company, with accounts which had failed to include reference to very large contingent liabilities, were found liable and fined for having approved the accounts. the context Middleton J said:

10. *... This proceeding is not about a mere technical oversight. The information not disclosed was a matter of significance to the assessment of the risks facing [the companies]. Giving that information to shareholders and, for a listed company, the market, is one of the fundamental purposes of the requirements of the Act that financial statements and reports must be prepared and published. The importance of the financial statements is one of the fundamental reasons why the directors are required to approve them and resolve that they give a true and fair view.*

11. *The significant matters not disclosed were well known to the directors, or if not well known to them, were matters that should have been well known to them.*

12. *In the light of the significance of the matters that they knew, they could not have, nor should they have, certified the truth and fairness of the financial statements, and published the annual reports in the absence of the disclosure of those significant matters. If they had understood and applied their minds to the financial statements and recognised the importance of their task, each director would have questioned each of the matters not disclosed. Each director, in reviewing financial statements, needed to enquire further into the matters revealed by those statements.*

13. *The central question in the proceeding has been whether directors of substantial publicly listed entities are required to apply their own minds to, and carry out a careful review of, the proposed financial statements and the proposed directors' report, to determine that the information they contain is consistent with the director's knowledge of the company's affairs, and that they do not omit material matters known to them or material matters that should be known to them.*

14. *A director is an essential component of corporate governance. Each director is placed at the apex of the structure of direction and management of a company. The higher the office that is held by a person, the greater the responsibility that falls upon him or her. The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.*

15. *This proceeding involves taking responsibility for documents effectively signed-off by, approved, or adopted by the directors. What is required is that such documents, before they are adopted by the directors, be read, understood and focussed upon by each director with the knowledge each director has or should have by virtue of his or her position as a director. I do not consider this requirement overburdens a director, or as argued before me, would cause the boardrooms of Australia to empty overnight. Directors are generally well remunerated and hold positions of prestige, and the office of director will continue to attract competent, diligence and intelligent people.*

16. *The case law indicates that there is a core, irreducible requirement of directors to be involved in the management of the company and to take all reasonable steps to be in a position to guide and monitor. There is a responsibility to read, understand and focus upon the contents of those reports which the law imposes a responsibility upon each director to approve or adopt.*

17. *All directors must carefully read and understand financial statements before they form the opinions which are to be expressed in the declaration required by s 295(4). Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director. These include the following: a director should acquire at least a rudimentary understanding of the business of the corporation and become familiar with the fundamentals of the business in which the corporation is engaged; a director should keep informed about the activities of the corporation; whilst not required to have a detailed awareness of day-to-day activities, a director should monitor the corporate affairs and policies; a director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements; a director, whilst not an auditor, should still have a questioning mind.*

18. *A board should be established which enjoys the varied wisdom, experience and expertise of persons drawn from different commercial backgrounds. Even so, a director, whatever his or her background, has a duty greater than that of simply representing a particular field of experience or expertise. A director is not relieved of the duty to pay attention to the company's affairs which might reasonably be expected to attract inquiry, even outside the area of the director's expertise.*

19. *The words of Pollock J in the case of Francis v United Jersey Bank (1981) 432 A 2d 814, quoted with approval by Clarke and Sheller JJA in Daniels v Anderson (1995) 37 NSWLR 438, make it clear that more than a mere 'going through the paces' is required for directors. As Pollock J noted, a director is not an ornament, but an essential component of corporate governance.*

20. *Nothing I decide in this case should indicate that directors are required to have infinite knowledge or ability. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her. Such a responsibility arises in this proceeding in adopting and approving the financial statements. Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in these financial statements call for such enquiries.*

21. *No less is required by the objective duty of skill, competence and diligence in the understanding of the financial statements that are to be disclosed to the public as adopted and approved by the directors.*

22. *No one suggests that a director should not personally read and consider the financial statements before that director approves or adopts such financial statements. A reading of the financial statements by the directors is not merely undertaken for the purposes of correcting typographical or grammatical errors or even immaterial errors of arithmetic. The reading of financial statements by a director is for a higher and more important purpose: to ensure, as far as possible and reasonable, that the information included therein is accurate. The scrutiny by the directors of the financial statements involves understanding their content. The director should then bring the information known or available to him or her in the normal discharge of the director's responsibilities to the task of focussing upon the financial statements. These are the minimal steps a person in the position of any director would and should take before participating in the approval or adoption of the financial statements and their own directors' reports. ...*

[Emphasis added]