Department for Business, Innovation & Skills

Non-Financial Reporting consultation response form

The consultation is available at: https://www.gov.uk/government/consultations/non-financial-reporting-directive-uk-implementation

The closing date for responses is 15 April 2016

Please return completed forms to:

Mark Jackson
Business Environment
Department for Business, Innovation and Skills
Third Floor
Piccadilly Gate
Store Street
Manchester
M1 2WD

Tel: 020 7215 0352:
Email: mark.jackson@bis.gsi.gov.uk

Please be aware that we intend to publish all responses to this consultation.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes. Please see page 9 of the consultation for further information.

If you want information, including personal data, that you provide to be treated in confidence, please explain to us what information you would like to be treated as confidential and why you regard the information as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

I want my response to be treated as confidential ☐

Comments: Click here to enter text.

Questions

Name: Rachel Haworth, Policy Officer

Organisation (if applicable): ShareAction

Address: 16 Crucifix Lane, London SE1 3JW

Please tick which best describes your organisation.

	Respondent type
☐	Business representative organisation/trade body
☐	Central government
☒	Charity or social enterprise
☐	Individual
☐	Large business (over 250 staff)
☐	Legal representative
☐	Local government
☐	Medium business (50 to 250 staff)
☐	Micro business (up to 9 staff)
☐	Small business (10 to 49 staff)
☐	Trade union or staff association
☐	Other (please describe)

Q1) Flexibility on where to provide the non-financial statement: What is your view on permitting companies flexibility to place information where they feel most appropriate within the boundaries laid out by the EU NFR Directive? Please explain your reasons.
Comments Our starting point is that what falls in the category of non-financial information can often have a material financial impact for companies and for investors, particularly over the medium to long term. There is increasing evidence[1] showing that companies that perform well on environment, social and governance ("ESG") issues tend to produce better returns for investors, particularly over the long term. The non-financial statement should be integrated within the company's strategic report. The purpose of the strategic report is to inform the shareholders of the company and help them assess how the directors have performed their duty under section 172 (the duty to promote the success of the company). Non-financial information on company activity relating to environmental, social, employee and anti-corruption matters is necessary for forming a thorough understanding of how well directors are meeting their duty to promote the success of the company, particularly over the medium to long term. Evaluation of the risks and opportunities associated with non-financial information is playing an increasingly central role in investors' selection, retention and stewardship of their investments. If non-financial information is disclosed separately from the strategic report, this creates an additional layer of complexity for investors. In the Eurosif and ACCA 2013 survey *What do investors want from non-financial reporting?*,[2] 92% of investors surveyed agreed or strongly agreed that financial and non-financial information should be more integrated. By way of example, the Investment Association's recently published *Productivity Action Plan*[3] states that investors want to "see improvements in reporting on the long-term drivers of sustainable value creation", particularly highlighting the need for companies to report on how their human capital management has impacted their productivity and long-term prospects. The importance of environmental considerations for institutional investors was also recently highlighted, when the 2015 diesel emissions scandal resulted in a coalition of 19 investors with over £625 billion in assets under management writing to 11 major automobile companies to call for improved reporting of their public policy interventions on emissions standards.[4] Allowing companies to prepare a separate non-

[1] Arabesque Partners and University of Oxford (2015). *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance.* Available at http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11 [accessed 15 April 2015].

[2] ACCA and Eurosif (2013). *What do investors want from non-financial reporting?* Available from: http://www.accaglobal.com/content/dam/acca/global/PDF-technical/sustainability-reporting/tech-tp-wdir.pdf [accessed 15 April 2016].

[3] Investment Association (2016). *Supporting UK Productivity with Long-Term Investment: The Investment Association's Productivity Action Plan*. Available from: http://www.theinvestmentassociation.org/media-centre/press-releases/2016/press-release-2016-03-22.html [accessed 15 April 2016].

[4] Phillips, J. (2015). *Concerned investors with over £625 billion under management call for greater clarity on emissions lobbying by automobile companies*. Available from: https://shareaction.org/press-release/concerned-investors-with-over-625-billion-under-management-call-for-greater-clarity-on-emissions-lobbying-by-automobile-companies/ [accessed 15 April 2016].

financial report seems contrary to the government's policy objective of making reporting more concise, streamlined, relevant and useful to customers, shareholders and other stakeholders.

Furthermore, if companies are to be encouraged to incorporate significant risks and opportunities relating to social, environmental and anti-corruption issues into their strategic thinking, it will only make reporting more complex and time consuming if they need to subsequently separate this information from the financial information so that they can insert it into a separate report. These factors are relevant to the long-term financial health of the company. It is important that this information is fully integrated into the company's analysis of the development, performance and position of the company's business, and the principal risks and uncertainties facing the company.

Q2) Information that could be placed in a Separate Report:

We would welcome suggestions for information, currently required by law that could be placed in the separate report

Comments

No response.

Q3) Advantages and Disadvantages of a separate non-financial statement:

What do you see as the advantages and disadvantages, for your organisation of the separate statement?

Comments

If the non-financial statement is published as a separate document, key information will be more difficult to find because it will be distributed through a number of different documents, published at different times and on different pages of the company's website. This will make it more difficult for shareholders, investors, customers and other stakeholders to make a full assessment of the long-term prospects of the company. It will also increase complexities for the business itself in situations where it needs to respond to requests for information from stakeholders. If it can respond by saying 'it's all in the strategic report', this will be both helpful and powerful. Non-financial information may also be subject to a lower level of scrutiny from stakeholders if placed within a separate report, particularly if there is no requirement for the separate document to be approved by the board.

A possible advantage of using a separate statement for non-financial information was identified in the consultation document as reducing the resource pressure on companies in preparing and publishing non-financial statements to the same deadline as financial statements. However, as explained above, this is only an advantage if companies are considering the risks and opportunities associated with so-called non-financial information (which often becomes financially significant) separately from financial information. In order to maximise corporate performance over the medium to long term, it is important that financial and non-financial information are evaluated in an integrated way.

Q4) Advantages and disadvantages of the Implementation Options.

What do you see as the advantages and disadvantages of the various implementation options?

Comments

Option 1 (“Separate requirements for large PIEs within scope of the EU NFR Directive and for quoted companies within scope of the UK CA 2006 requirements”) is our preferred option out of the two presented in this paper. However, given the similarity in reporting requirements between the existing UK regime and the new NFR Directive, creating separate reporting requirements for large Public Interest Entities (PIEs) will not be helpful for business or stakeholders and would instead create a two-tier reporting regime based purely on company size. This would cause additional complexity for both companies and investors, and an uneven playing field from a competition perspective. As the Government acknowledges in this consultation paper, applying this option may mean than in one year, a company is subject to the EU NFR Directive and in the following year, due to a small decrease in its average number of employees, it becomes instead subject to the existing requirements in the Companies Act 2006. Furthermore, we believe that companies which raise public capital should be subject to the same requirements, regardless of the number of their employees.

Option 2 (“Ensure Strategic Report requirements only apply to companies within the scope of Article 19a and 29a of the EU Accounting Directive (as amended by the EU NFR Directive)”) would cause significant damage to the progress the UK has made on corporate governance and reporting, and would undermine its position as an international leader in this area.

The Financial Reporting Council (FRC) states in its 2015 report, *Clear & Concise: Developments in Narrative Reporting*[5] that “Investors have welcomed the recent changes to annual reports and tell us that the quality of reporting has improved significantly since the introduction of the strategic report… Investors increasingly say that they use the information in the strategic report to monitor investments and form a basis for engagement; forming views on the position, performance and prospects of a company.” Equally, the FRC found in its 2015 *Corporate Reporting Review*[6] that “Inadequate

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[5] Financial Reporting Council (2015). *Clear & Concise: Developments in Narrative Reporting*. Available from: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Clear-Concise-Developments-in-Narrative-Reporti.aspx [accessed 15 April 2016].

[6] Financial Reporting Council (2015). *Corporate Reporting Review: Annual Report 2015*. https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf [accessed 15 April 2016].

explanation of their results and descriptions of principal risks in their strategic report was… more likely from the Boards of smaller companies." Similar findings in earlier years prompted the FRC's three-year project to improve the quality of smaller companies' financial reporting. In June 2015, the FRC issued a consultation paper, reporting on the first phase of the project, which considered the results of research into root causes and proposed actions to facilitate improvement. In the course of this consultation, the FRC found that "directors often believe that investors place little value on smaller companies' annual reports and accounts, which can lead to Boards doing the minimum required to comply with relevant standards." However, it heard from investors that "they do consider the quality of corporate reporting when deciding whether to invest in smaller companies, partly because there is less information available about them."

It is in the long-term interests of businesses to report consistently and comparably. Advantages of non-financial reporting for business may include competitive advantage, investor confidence, improved access to capital, the ability to attract and retain the best talent and reduction of costs. It is also worth bearing in mind that many companies are also investors themselves, and would benefit from this information being made available in the strategic reports of other companies. It would seem illogical to undo the good work that has been done in this area.

Given the progress that has been made in corporate reporting as a whole and the growing demand from investors and other stakeholders for greater transparency, it would be very disappointing to see a reduction in the scope of the existing UK reporting requirements.

Q5): Preferred option relating to scope

Considering the possible advantages and disadvantages provided by the flexibilities contained within the EU NFR Directive, which would be your preferred option in terms of which companies should be required to disclose non-financial information?

Comments

We would recommend that the Government considers extending non-financial reporting requirements to large non-quoted companies, in addition to all quoted companies. Large private companies may, in much the same way as listed companies, be exposed to risks in relation to the environment, human rights (including labour issues), anti-corruption and bribery.

Q6) Alternative Options

Are there any other options for implementing the EU NFR Directive the Government should consider?

Comments

See response to question 5.

Q7) Assurance of Non-Financial Information Should the Government require that the non-financial statement be verified by an independent assurance service provider'?
Comments We would endorse ClientEarth's recommendation that the Government requires companies with a premium listing to have their non-financial statement verified by an independent assurance service provider. Companies which do not have a premium listing should be allowed to opt in on a "comply or explain" basis, but should still be subject to the requirement in section 496 of the Companies Act 2006 (that the auditor of the financial statements must state in their report on the company's annual accounts whether the information given in the strategic report is consistent with those accounts). In our experience, one of the key reasons investors may sometimes not make use of non-financial reporting is lack of verifiability. If investors are to price in environmental and social risks and opportunities, and considerable evidence suggests that it is in line with their material interests and fiduciary duties to do so, information on these issues must be treated as far as possible in the same way as financial information. 84% of investors surveyed in the Eurosif/ACCA 2013 survey[7] agreed or strongly agreed that non-financial disclosure should be independently verified. 92% of investors surveyed disagreed or strongly disagreed with the statement that company boards are sufficiently accountable for non-financial disclosure. NEST's response[8] to BIS's consultation on the Future of Narrative Reporting expressed concerns that "companies' metrics on people, community and the environment are at times inaccurate and this can be traced to a lack of verification and sign-off." NEST said that it understood that "the whole of the proposed strategic report will need to be signed-off by a company's board and subject to audit because it's part of its annual report. Nevertheless it remains far from clear whether the metrics behind the narratives will have been verified and by whom."
Q8) Advantages and Disadvantages of third-party validation What do you see as the advantages and disadvantages of requesting third party assurance?
Comments

[7] ACCA and Eurosif (2013). *What do investors want from non-financial reporting?* Available from: http://www.accaglobal.com/content/dam/acca/global/PDF-technical/sustainability-reporting/tech-tp-wdir.pdf [accessed 15 April 2016].

[8] National Employment Savings Trust (2012). *The Future of Narrative Reporting: A response to the Department for Business Innovation & Skills (BIS).* Available at: https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/the-future-of-narrative-reporting,PDF.pdf [accessed 15 April 2016].

Advantages of external verification are that accuracy of information reported tends to be improved and the incidence of vague, boilerplate reporting may be reduced. There is some risk of poor third-party verifications, such as audits, impeding better practices. However, we believe that external verification has a generally positive effect on the robustness of reporting.

Q9) Other Options

Are there any other options the Government should consider for Third Party Verification?

Comments

The only obvious alternatives to third-party verification are:

a) a more robust approach to enforcement, such that investors can have confidence that reported information meets minimum legal requirements and is fair, balanced and comprehensive; and

b) more prescriptive requirements on companies themselves, for example to disclose the assumptions behind figures and projections published in narrative reports.

Q10) Advantages and Disadvantages

What do you see as the advantages and disadvantages of preparing or receiving the non-financial statement electronically via a company's website?

Comments

We would welcome a move away from producing annual reports on paper, in line with the Government's Digital by Default agenda, provided paper annual reports are still made available to those who need them. It is principally shareholders who receive paper copies and annual reports are not consistently easy to find on company websites. A move towards digital distribution is therefore an opportunity to ensure that all stakeholders have access to this important information by making it accessible and easy to locate on the company's website. We recommend that the Government replicates the provision in section 54(7) of the Modern Slavery Act 2015 which requires companies to link to the relevant statement from a prominent place on the website homepage. It may also be worth considering setting up a central holding page for annual reports on the FRC's website, which would assist investors and other stakeholders with accessing and comparing reports.

Q11) Additional Protections

Considering your response to Q7, are there any additional protections that the government should consider?

Comments No response.
Q12) Number of Companies Providing an Electronic Report We are interested in the number of companies that currently send their annual report electronically. Considering your shareholders, how many, as a percentage, opt to receive their annual report as a printed copy?
Comments N/A
Q13) Definition of Senior Manager BIS would welcome suggestions as to how this definition may be improved to reflect better the intention of this requirement.
Comments No response.
Q14) Other Comments on this requirement BIS would also welcome other comments on this regulation including views on the approach suggested
Comments No response.
Q15) Reporting Regulations What other reporting regulations would you suggest that could be repealed?

Comments

We recommend that the potential adverse consequences for risk management and corporate governance are considered before any repeal is proposed, and that repeals are made only where there is a genuine duplication of disclosure requirements across different pieces of legislation.

A proposed repeal that we believe is particularly concerning is that in relation to the policy on the employment of disabled persons. The existing disclosure requirement under Part 3, Schedule 7 of the Large and Medium Companies and Groups (Accounts and Reports) Regulations 2008 contains precise requirements about the corporate disclosure required. It requires a statement of the company's policies to be made in relation to: giving full and fair consideration to applications for employment made by disabled persons; continuing the employment of, and for arranging training for, employees who have become disabled when they were employed by the company; and the training, career development and promotion of disabled persons employed by the company.

Article 20(1)(g) of the Accounting Directive, as amended by the EU NFR Directive, simply states that the company’s corporate governance statement must contain a description of the diversity policy applied in relation to the company's administrative, management and supervisory bodies with regard to, for instance, age, gender, educational and professional background, setting out the objectives of the policy, its implementation and the results obtained. Although the requirement to report on the results of implementing these policies is welcome, disability is not mentioned, even by way of example. Presumably, this would mean that companies within scope would no longer be required to state their policies in relation to the employment of disabled persons. Additionally, the existing requirement applies to any company with an average of 250 or more employees, whereas (depending on the option for transposition chosen) the NFR Directive will apply to companies with 500 or more employees, so the scope of reporting requirements would be significantly reduced by this proposed repeal.

In 2012, 46.3% of working-age disabled people were in employment compared to 76.4% of working-age non-disabled people. This demonstrates a 30.1 percentage point gap between disabled and non-disabled people, representing more than 2 million people.[9] We understand that the Government is working hard to make progress towards its objective of halving the disability employment gap, encouraging employers to recognise the untapped potential of disabled employees through schemes such as Disability Confident. Given the reduced access of employees to employment tribunals following the increase in tribunal fees under the previous administration in July 2013,[10] we feel the transparency provided by mandatory corporate reporting is an indispensable tool for promoting constructive company behaviour in this area. The data produced through reporting may also be of great use to government departments in assessing the impact of schemes such as

[9] Department for Work & Pensions and Office for Disability Issues (2014). *Official Statistics: Disability facts and figures.* Available from: https://www.gov.uk/government/publications/disability-facts-and-figures/disability-facts-and-figures [accessed 15 April 2016].

[10] September 2014 Ministry of Justice figures for April to June 2014 show an 81% drop in claims compared to the same period in the previous year. (See Unison (2015). *UNISON to continue fight over Employment Tribunal fees in Supreme Court*. Available at: https://www.unison.org.uk/news/press-release/2015/08/unison-to-continue-fight-over-employment-tribunal-fees-in-supreme-court/ [accessed 15 April 2016]).

Disability Confident. We feel that the proposed repeal would send mixed messages about the UK’s commitment to leading on disability employment issues.

Q16) Other Information

Is there any information that could be moved outside the Annual Report?

Comments

No response.

Q17) Analysis of the Costs and Benefits of implementing the NFR Directive

Type of Organisation

Q17a) Are you a company (not a PIE), a company which is a PIE (as described in para 2.6), an NGO, institutional investor or other type of organisation? If you are a PIE please specify whether you are a parent company or a subsidiary company.

PIE (Parent)	
PIE (Subsidiary)	
Non-Governmental Organisation	x
Institutional Investor	
Other (please specify	

When considering your answers, we would very much appreciate information on any costs you will incur as a result of the proposals for implementing the EU NFR Directive, both in terms of money and time (e.g. describe which type of staff will be involved, for how long). We would appreciate any information on new systems or practices your organisation may adopt, or existing processes that may change, because of the Directive.

Q17b) Do you expect to incur any “one off “or “ongoing costs” as a result of having to comply with the requirements of the EU NFR Directive over and above what you incur currently on your non-financial reporting obligations? Please describe these costs. (One off costs could include staff time to familiarise your organisation with the regulations or updating of internal guidance for staff; on-going costs could include additional time to review non-financial data in each year subsequent to first year)

Q18c) How would your costs change if you were allowed to provide your non-financial statement separately within six months of the balance sheet date on your financial report?' **Q18d) How would your costs change if you were allowed to provide this report electronically on your website and did not have the obligation to provide hard copies except in exceptional circumstances?'** **Q18e) What additional costs would you expect if the government required that an independent assurance services provider verify the non-financial statement? This may be in terms of money or resources costs such as staff time.'** Benefits to your company of the EU NFR Directive? **Q18f) Please describe any benefits to your company you expect will arise because of the EU NFR Directive (to your organisation or more widely).** If you are happy for BIS officials contact you with further questions about the impact of the EU NFR directive, please provide your contact details.
Comments N/A
Q18g) Any Other Comments Do you have any other comments about the costs and benefits that will result from the EU NFR Directive?
Comments Any costs incurred by companies as a result of the new requirements should be set against the long-term costs of companies failing to report the non-financial information needed by investors and the wider community, particularly in relation to risk management. We are aware that the Government is working towards the objective of removing £10 billion of regulatory costs to business by the end of this Parliament. However, it is vital that long-term costs are also weighed in the balance when these assessments are made, particularly in view of the important work that BIS has been doing to address the excessive focus on short-term performance in equity investment markets since the Kay Review[11] was published in 2012. Relaxing the requirements on company reporting would shift the burden of information-seeking onto investors, and ultimately onto individual savers and corporate investors. The

[11] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf.

resulting inefficiencies could well increase overall costs to the economy. It is therefore important that the Directive is transposed in a way that recognises the wider economic and business benefits of implementing these requirements.
Q19) Additional Comments Do you have any additional comments on this directive
Comments We welcome this Directive and the progress it represents for corporate reporting in Europe. Ultimately, ESG issues produce financial risks and opportunities that companies and their investors need to incorporate in their decision-making. It is in the long-term interests of businesses to report consistently and comparably. The advantages of reporting and the underlying internal processes it entails include investor confidence and understanding, greater board effectiveness, improved access to capital and the ability to attract and retain the best talent. We need to showcase the companies doing outstanding work in incorporating the risks and opportunities associated with ESG factors into their business models. These companies should be allowed to compete on a level playing field, rewarding their long-term thinking with the enhanced reputation and market rating they deserve. It is important to note that failing to take the necessary regulatory steps at this stage will only increase costs and complexity to companies, investors and the economy in the long term.

Workshops

BIS also intends to hold a series of workshops to discuss the issues in this consultation in more depth. We anticipate holding these in Spring 2016. If you would like to send a representative, pleased tick the box below and we will contact you in due course with further details.

☒ Yes, I would like to register interest to attend the BIS NFR Workshops

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☒

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

☒Yes ☐No