Department for
Business, Energy
& Industrial Strategy

THE NON-FINANCIAL REPORTING DIRECTIVE

The Government Response to the consultation on implementation of the Directive

NOVEMBER 2016

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Executive Summary

The European Union (EU) recognised the importance non-financial information for a range of users of company reports and in April 2014 it agreed a Directive[1] to harmonise non-financial reporting regulations across member states. In February 2016 the Government consulted on the best way to transpose the Directive, including how best to address the differences between the EU and existing UK frameworks and how to use the flexibilities that the Directive offered.

The consultation sought views on placing information flexibly and the possible use of the separate report, an option available in the Directive. Although many organisations broadly supported increased flexibility within the annual report, there was little support for the option to prepare a separate report. The government sought views on 2 options for the question on the scope of the Directive. One was a minimal implementation, and the other to repeal the UK requirements for companies outside the scope. Respondents also suggested extending the requirements to all listed companies as well as those private businesses in scope.

The Government will create legislation to require companies that fall within the scope of the directive to report using the requirements laid out in the Directive. It will also allow companies outside the scope of the Directive to adopt the EU requirement voluntarily or to continue to use the existing requirements in the Strategic Report. The consultation sought views on independent verification. We will not make verification a mandatory requirement but companies may voluntarily seek independent verification if they wish.

It also sought views on current practice in electronic reporting; the advantages and disadvantages of sending the annual report electronically. There was some support for delivery of reports electronically and government will continue to work with the FRC to encourage innovative digital reporting.

We also sought suggestions on other reforms. The Government will consider the comments received carefully and will explore with stakeholder, the impact of such amendments in a future consultation.

[1] Directive 2014/95/EU of the European Parliament and The Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

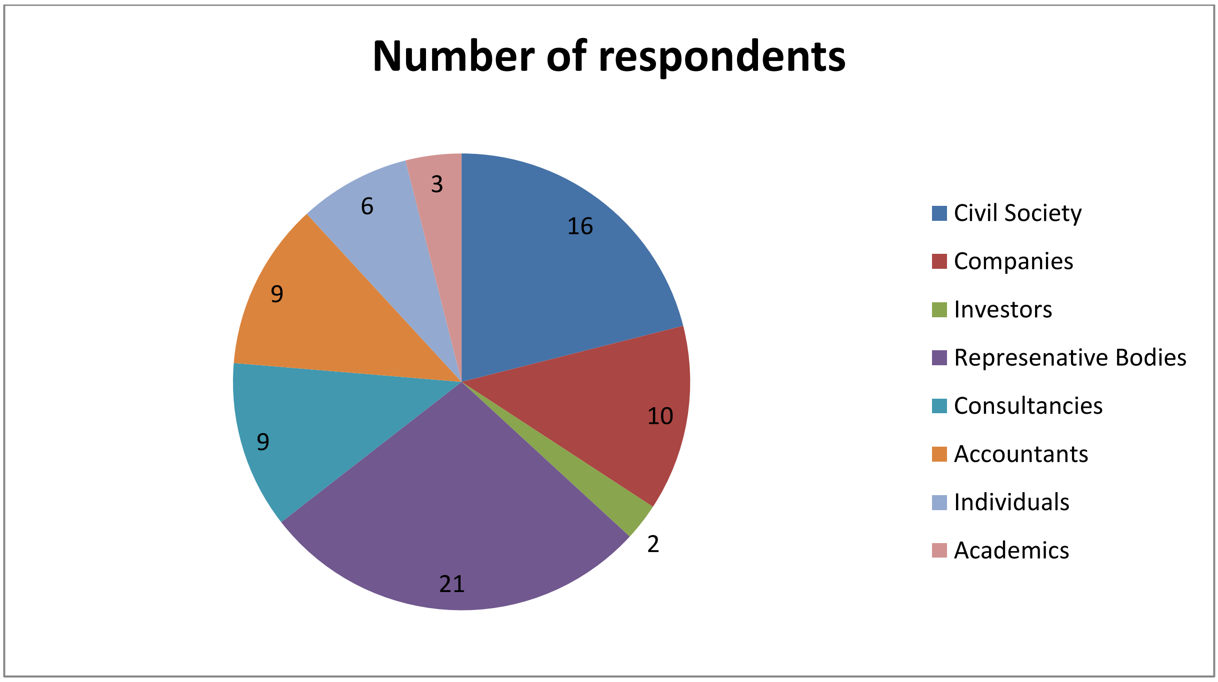
Introduction

Annual reports are an important communication channel for businesses to show the company's strategy for ensuring long-term growth, how the company will respond to future customer demands and new market risks and opportunities, and deliver strong returns to investors over the long-term. Recognising the importance of high-quality, comparable non-financial information, the UK introduced a new narrative reporting framework in October 2013. Subsequently The European Union (EU) has also recognised the importance of non-financial information for a range of users of company reports and in April 2014 it agreed a Directive[2] to harmonise non-financial reporting regulations across Member States. The EU's disclosure requirements broadly reflect the UK's framework. However, there are some differences which require changes to the UK regulations.

In February 2016 the Government consulted on the best way to transpose the Directive, including how best to address the differences between the EU and existing UK frameworks and how to use the flexibilities that the Directive offered. In addition the consultation offered the opportunity to consider other aspects of the current UK framework and sought views on, and suggestions for improving, the regulatory framework more widely, particularly deregulation.

Consultation responses

76 responses were received. The chart below shows a breakdown of responses by sector.



Summary of responses

[2] Directive 2014/95/EU of the European Parliament and The Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

Placement of information (Questions 1 to 3)

Questions 1-3 sought views on providing companies with flexibility on where to place information (within the boundaries of the Directive) and the possible use of the separate report, an option available in the Directive.

Flexible placement of Information

35 of the 56 Respondents to this question raised concerns that placing information flexibly, on the company's website for example, would threaten the integrity of the annual report. Many felt, however, that the changes should provide scope for companies to place more detailed, supporting information where they feel most appropriate and there was general consensus that this should not disadvantage stakeholders. This approach would ensure that only relevant information remains in the annual report, in line with the Financial Reporting Council's Clear & Concise initiative and Guidance on the Strategic Report.

Separate Report

This question received 36 responses with 31 respondents raising concerns on the use of the separate report. These centred on the flexibility to publish a non-financial statement up to 6 months later than the management report and accounts. Many felt that the possible delay between the publication of the accounts and non-financial information would not be helpful in giving shareholders a holistic picture of the business.

Government response:

We note the interest from respondents for increased flexibility in placing information and will continue to work with the Financial Reporting Council to encourage companies to use the scope in the Directive for innovation and flexibility.

The Government acknowledges the concerns raised by respondents concerning the use of the separate report and will not pursue this further.

Scope of the Directive (Questions 4 to 6)

The consultation document presented 2 options for stakeholders to consider:

- to implement the Directive as an addition to the current UK strategic reporting framework (Option1)

or

- simplify the framework by removing reporting obligations to smaller quoted companies outside the scope of the Directive (Option 2).

28 responses were received for this question. 9 respondents did not favour either of the two options suggested in the consultation. 5 respondents favoured option 1. Stakeholders cited that this option would maintain the current levels of transparency for companies outside the scope of the Directive. However many commented that this option would lead to complexity, a possible loss of comparability and inefficiency of administering two frameworks.

3 respondents were in favour of option 2. These respondents regarded the reduction in requirements as advantageous. It was also suggested that additional reporting could be undertaken on a voluntary basis to fulfil the needs of shareholders. However the majority of respondents who commented on this option were critical and felt that the loss of transparency for smaller listed companies would weaken the UK's position as a leader in corporate reporting.

11 stakeholders suggested applying the Directive to all listed companies as well as the small amount of private companies that are in scope. They suggested that the similarity between the frameworks would allow application of the Directive to all quoted companies. This would remove the small differences and allow comparability between companies thus avoiding a two-tier system. However, this would impose unnecessarily a greater reporting burden on those companies obliged to report under the UK's existing framework but not within scope of the Directive.

Government response:

Obliging companies outside the scope of the Directive to report under the new framework would go beyond the minimum requirements of the Directive, place a greater burden on these companies and effectively "gold plate" an EU requirement. Therefore, the Government will create legislation to require companies that fall within the scope of the Directive to report using the requirements laid out in the Directive(Option 1) .

Companies outside the scope of the Directive will continue to be required to comply with the current UK requirements. However, we wish to avoid a situation where a company may, because of a change in size of their workforce for example, report using the UK framework one year and the EU's the next. Therefore, the legislation will permit companies to voluntarily comply with the EU requirements and will exempt those who do so from the comparable domestic provisions. This will avoid companies at the margins of the Directive's scope incurring additional costs as a consequence of moving between regimes due to changes in their size year to year.

Third party verification of non-financial information (questions 7 to 9)

The Government sought views on current practice in UK business, the advantages and disadvantages of a mandatory requirement and other options. 35 respondents answered this question.

13 responses were supportive of introducing a mandatory requirement for verification. The main point raised was that some form of verification would help to increase the confidence of users of this information and so promote confidence in UK business.

By contrast, many respondents argued that further verification should be a market led initiative and not a mandatory requirement. 24 respondents noted the additional expenses and administrative burdens of undertaking further assurance or verification, drawing attention to the lack of a standard for non-financial reporting that would make any form of verification difficult. Additionally, respondents highlighted the current requirement for the auditor to assess that the consistency between the financial and non–financial information. Their view was that a mandatory requirement would undermine this work and possibly add unwelcome delays in publication.

Government Response

The Government will not mandate independent verification of non-financial information. However, as now, companies may voluntarily seek independent verification of non-financial disclosures if they wish.

Current practice in electronic reporting (10 to 12)

Questions 10-12 sought views on current practice in electronic reporting; the advantages and disadvantages of sending the annual report electronically. 32 respondents answered these questions.

30 respondents felt that the advantages of electronic reporting stemmed from the ease of access, the scope for creatively presenting information in a more accessible medium and a reduction in printing costs. In addition, many cited the Government's own "digital by default" agenda.

However, there were some concerns raised. Respondents indicated that the annual report may not be easy to find but did point to the Modern Day Slavery Act schedule 54 which requires that disclosure made to comply with this be in a prominent place. Many respondents highlighted that the annual report is a time-bound document and the information should not be subject to change. Concern was also expressed about the application of the safe harbour provision when relating to e-reporting.

Government Response

The legislation already provides the option to send annual reports electronically. We will continue to work with the FRC to encourage innovative digital reporting.

Gender Reporting (questions 13 to 16)

Question 13 and 14 sought views on how the definition of senior manager in the gender reporting requirement could be improved. This requirement was introduced as part of the Strategic Report in 2013. 43 responses were received for these questions. Most respondents argued that the definition could be improved. Two approaches to redefining "senior managers" to better match business structures received particular support.

The first approach, favoured by 15 respondents, suggested defining a "senior manager" to better match business structures by dividing "senior managers" into 3 separate categories, these being:

- Employees who are members of the Executive Committee
- Employees who are direct reports to members of the Executive Committee
- Employees in all other management grades.

The second approach, using the description of Key Management Personnel set out in international accounting standard IAS 24 (and in FRS 102) was supported by 7 respondents. The IAS 24 contains a definition, for a person of significant control. This could be used to define a senior manager as a person who "has significant influence over the entity or is a member of the key management personnel of the entity".

Other suggestions were to align with the Government Equalities Office's regulations on gender pay gap reporting or use the figures in the remuneration report.

Government Response

The government will explore these options with business and other stakeholders to consider how best to help companies make high quality disclosure to fulfil this requirement.

Other regulatory reforms (15 – 16)

Questions 15 and 16 sought views on reporting regulations that could be repealed. 24 responses containing suggestions for regulatory reforms were received.

Government Response

The Government will consider the comments and suggestions received carefully. Where appropriate, we will explore any proposals for amendments with stakeholders in future consultations.

Annex A

List of Organisations who responded

AC(I) 100 Group
Addison 30% Club
Amnesty International
The Association of Investment Companies
Association of British Insurers The Association of Chartered Certified Accountants
Aviva
BDO
Black Sun
The British Bankers Association
British Columbia Investment Management Corporation
BP
British Standards Institute
British Private Equity & Venture Capital Association
The British Psychological Society
The British Retail Consortium
CAFOD
Carbon Tracker
Catalyst
CDSB
Chartered Institute MA
Christian Aid

City University London
ClientEarth
Climate Disclosure Standards Board and CDP
The Confederation of British Industry (CBI)
CORE
Deloitte
Ernst And Young
Egon Zehnder
Financial Reporting Council (FRC)
GC100
Glaxo Smith Klein
The Global Reporting Initiative
Grant Thornton
Institute of Chartered Accountants in England and Wales
Institute of Chartered Secretaries and Administrators
Institute of Directors
Institute of Environmental Management and Assessment
Institute of Health and Safety
Invesco Perpetual
The Investment Association
The Investor Relations Society
Joelle Warren

KPMG
KPMG LLP UK
Lloyds Banking Group
Luke Main
Mazaars LLP
Dr Almuth McDowel
MMW Consulting
Novus Consulting
Odgers Berndtson
Oxfam GB
PRI
PWC
Quoted Companies Alliance
Radley Yeldar
Renuma Consulting
Ricardo Energy & Environment
ShareAction
Sharesoc
Shell
Shift
Simply Sustainable
Sir Phillip Hampton and Dame Helen Alexander
Social Value UK
Trade Union Congress

Trinity Mirror plc
UK Sustainable Investment and Finance Association
Unicef
Virgin Money
Professor Martin Walker
Whirlpool Europe SRL
World Wildlife Fund Denise Wilson OBE
The Zygos Partnership
Professor Steven Young
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