Non-financial reporting regulations

The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013

The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (which implemented the EU directive on non-financial reporting (Directive 2014/95/EU))

Lead department	Department for Business, Energy and Industrial Strategy
Summary of measure	The regulations were introduced to reduce the asymmetry of information between directors, investors and wider stakeholders, around firms' operations. The main objectives were to: (a) increase transparency and accountability around non-financial risks and policies; and (b) enable more-informed investment decisions through greater comparability of reporting
Submission type	Post-implementation review
Implementation date	1 October 2013 and 26 December 2016
Department recommendation	Amend regulations
RPC reference	RPC-BEIS-5149(1)
Opinion type	Formal
Date of issue	16 May 2022

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The post-implementation review (PIR) is now fit for purpose following the RPC's initial review notice. The recommendation to amend the regulations is now supported with proportionate evidence and an explanation of why revoking or replacing the regulations would not be appropriate.

[1] The RPC opinion rating is based on whether the evidence in the PIR is sufficiently robust to support the departmental recommendation, as set out in the better regulation framework. RPC ratings are fit for purpose or not fit for purpose.

RPC summary

Category	Quality[2]	RPC comments
Recommendation	**Green**	The PIR recommends amending the regulations and explains why it would not be appropriate to revoke or replace them. The analysis shows that there remains some demand for better financial reporting and comparability between the information provided by corporate entities, and that revoking or replacing the regulations would negate any benefits achieved and progress towards the Government's objective of reducing the asymmetry of information between corporate entities and stakeholders.
Monitoring and implementation	**Satisfactory**	The PIR uses a logic model to assess the impact of the regulatory regime. This uses several sources of evidence, including two pieces of primary research commissioned by BEIS. The Department has explained the difficulty in assigning a 'market price' to the value of information provided by businesses in their non-financial reporting and, therefore, why a single metric may not be appropriate. This PIR now sets out more explicitly the questions that the next one will attempt to answer to evaluate the success of the policy, and the methods that will be used to gather the evidence required to achieve this.
Evaluation	**Satisfactory**	The use of several sources of evidence and primary research is proportionate for evaluating a policy of this scale. While the results of the stakeholder surveys may not show compellingly that the respondents were strongly in favour of the regulations, the PIR holds that the objectives of the policy have largely been met. Break-even analysis suggests that profits would need to rise by 0.1-0.2 per cent to offset the costs of non-financial reporting.

[2] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings [here](#).

Response to initial review

As originally submitted, the PIR was not fit for purpose for the following reasons:

1. Given the findings from the primary research (such as the simplification not being achieved and scepticism over the value of non-financial reporting, including to investors), the PIR did not make a clear case for retaining the regulations unamended as recommended initially.
2. The initial rationale for government intervention was based on a market failure of asymmetric information, but the PIR did not explain, in any measurable way (e.g., the value of stakeholders' investments), the impacts of this failure. The PIR did not, therefore, provide an objective metric for the extent to which the policy has improved investment decisions or social outcomes. Future PIRs will need a more-demonstrable measure of success of the policy and, therefore, the current PIR must also state clearly what data will be collected before then to provide a much-improved analysis.
3. The PIR did not enable a direct quantitative comparison between the costs and benefits of the policy. Hence, if a better method is not possible, the PIR should have provided some break-even analysis to show what monetary benefits a particular number of investors would need to gain in order to justify the initial, and ongoing, costs to business. This would allow readers to come to a better-supported conclusion about the policy.
4. The PIR stated that there were no unintended consequences arising from the policy but should have addressed this aspect in more detail, discussing what areas have been considered and how the Department came to the determination that no such unintended impacts existed.

The PIR has now:

1. changed its overall recommendation from 'Keep' to 'Amend' the regulations;
2. set out plans for future monitoring and evaluation of success as well as considering non-market valuation methods of the information provided by non-financial reporting;
3. produced a break-even analysis to estimate by how much returns to shareholders must increase for them to be compensated for the regulatory costs; and
4. acknowledged one unintended consequence of the policy and also explained why others were not.

These changes are discussed further below.

Summary of proposal

The non-financial reporting regime was intended to reduce the asymmetry of information between directors, investors and wider stakeholders, around firms' operations.

The main objectives were to:

- increase transparency and accountability around non-financial risks and policies, by simplifying and thereby addressing the asymmetry of information; and
- enable more-informed investment decisions through greater comparability of reporting.

The 2016 EU directive supplemented the 2013 Companies Act reforms, which required all companies, except those subject to the small companies' exemption, to produce annually:

a) a concise strategic report, which should include the high-level information that shareholders need, to gain an immediate understanding of the business; and
b) a simplified directors' report.

Quoted companies were required to report on:

- human rights issues;
- the number of women on the board and in the organisation as a whole;
- the company strategy and business model; and
- the length of time an auditor has been in place.

The EU directive then introduced changes including:

- the introduction of a new type of entity – the Public Interest Entity (PIE), which includes entities that trade debt securities on EU exchanges as well as unquoted credit institutions and insurers or those deemed to be of significant public relevance due to their size or activities;
- all PIEs with more than 500 employees being required to disclose information on environmental, social, employee, human rights and anti-corruption matters, to the extent necessary for an understanding of the company's development, performance and position, and the impact of its activities; and
- requirements that went beyond existing requirements for UK quoted companies, including reporting on diversity policy and anti-bribery and corruption matters.

PIR's recommendation

Following the RPC's initial review, the Department changed its overall recommendation from 'Keep' to 'Amend' the regulations. Recognising that changes are required, the PIR now states that "*Subject to Parliamentary approval, these improvements will be delivered through separate HMT primary legislation that is focused on introducing economy wide Sustainable Disclosure Requirements (SDR) in the UK. SDR will cover UK corporates, financial services firms, asset owners and financial products. BEIS would subsequently legislate for improved corporate disclosures through secondary legislation*." Given this will place additional requirements on companies, an assessment of the costs and benefits should be undertaken.

As recommended in the RPC's initial review, the PIR now also explains why it would not be appropriate to revoke or replace the regulations. This is because the analysis shows that there remains some demand for better financial reporting and comparability between the information provided by corporate entities, and some of these have not yet willingly embraced the opportunity to communicate better with stakeholders and may choose to cease entirely were the requirement to be removed. This would negate any benefits achieved and progress towards the Government's objective of reducing the asymmetry of information between corporate entities and stakeholders. The recommendation to amend the legislation is, therefore, now supported with a proportionate and fit-for-purpose analysis.

However, the RPC expects to see in due course, an impact assessment for the proposed new SDR legislation, including amendments related to this policy, which should contain a better cost-benefit analysis of the proposed changes against the new baseline.

Monitoring and implementation

The PIR uses a simple logic model to assess the impact of the new regulatory regime. Several sources of evidence are used, including two primary research studies commissioned by BEIS and undertaken by *PricewaterhouseCoopers* (PwC) and *Eunomia Research and Consulting*.

The RPC's initial review notice (IRN) stated that the impacts of the market failure, which the regulations were intended to address, were not explained in any measurable way and there was, therefore, no objective metric for the extent to which the policy had improved investment decisions or social outcomes.

In the revised PIR, the Department has explained the difficulty in assigning a 'market price' to the value of information provided by businesses in their non-financial reporting and, therefore, that a single metric may not be appropriate. The RPC accepts these arguments on proportionality grounds but would encourage the Department to progress with this work for future iterations of this analysis.

In particular, while it may be difficult to measure the impact of the regulations with a single metric, the Department should explore whether survey evidence or monitoring data could be used to assess the impact on users' investment decisions, given it is acknowledged that the evidence is "less well-developed" in this area.

The IRN also stated that, to improve the quality of future evaluations, the PIR should have a clearer statement of what data will be collected before then to provide a much-improved analysis. The RPC is pleased to see that the revised PIR sets out more explicitly the questions that the next PIR will attempt to answer to evaluate the success of the policy, and the methods that will be used to gather the evidence required to achieve this.

Evaluation

The use of several sources of evidence and primary research is proportionate for evaluating a policy of this scale. While the results of the stakeholder surveys may not show compellingly that the respondents were strongly in favour of the regulations, the PIR holds that the objectives of the policy have largely been met. Meanwhile, the PwC research shows that 60 per cent of companies surveyed thought that the regulations had provided some benefit to them, and stakeholders understood that it will take time for impacts to be seen.

The IRN suggested that the PIR should provide some break-even analysis to show what monetary benefits investors would need to gain in order to justify the initial, and ongoing, costs to business. This analysis has now been provided and suggests that profits would need to rise by 0.1-0.2 per cent to offset the costs of non-financial reporting.

Other comments

The IRN also stated that the PIR should discuss further any unintended consequences of the policy.

The PIR has now identified one unintended consequence, which is that guidance developed by the *Financial Reporting Council* in 2013 has become a *de facto* reporting standard, which was not required. There may be other unintended consequences that need examining, such as whether requirements on publicly-quoted companies distort choices made between public and private company status.

Regulatory Policy Committee

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