

## Non-Financial Reporting

In December 2016, the government published new regulations<sup>1</sup> implementing the European Union Directive on disclosure of non-financial and diversity information (the 'Non-Financial Reporting Directive'). The regulations amend the Companies Act 2006 requirements for the Strategic Report and include diversity requirements in the Disclosure and Transparency Rules (DTR). They apply for financial years beginning on or after 1 January 2017.



### *Non-financial information*

As a first step, companies will need to consider whether they fall within the scope of the new non-financial regulations. The new regulations only apply to a sub-set of companies that are required to provide a Strategic Report. Those companies that are not within the scope of the new regulations will continue to apply the pre-existing non-financial reporting requirements in the Strategic Report.

The new non-financial reporting regulations apply to certain large companies and qualifying partnerships with more than 500 employees. The entities that fall within scope, if they have more than 500 employees, are:

- Traded companies (see box below);
- Banking companies<sup>2</sup>;
- Authorised insurance companies<sup>3</sup>; and
- Companies carrying on insurance market activity<sup>4</sup>.

The information should be provided on a consolidated basis for groups.

Companies within the scope of the new regulations will still be required to meet some of the pre-existing reporting requirements in the Strategic Report (See Table 2 below).

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<sup>1</sup> The regulations are available at [http://www.legislation.gov.uk/uksi/2016/1245/pdfs/ukxi\\_20161245\\_en.pdf](http://www.legislation.gov.uk/uksi/2016/1245/pdfs/ukxi_20161245_en.pdf)

<sup>2</sup> Broadly an entity that has permission under Part 4A of the Financial Services and Markets Act 2000 (c8) to accept deposits. See sections 1164(2) and 1164(3) of the Act for full definition.

<sup>3</sup> An authorised insurance company is an entity who has permission under part 4A of the Financial Services and Markets Act 2000 (c8) to effect or carry out contracts of insurance (section 1165(2)).

<sup>4</sup> Insurance market activity has the meaning given in section 316(3) of the Financial Services and Markets Act 2000 (section 1165(7)).

*Difference between quoted and traded company*

A potential source of confusion in the legislation is that the new regulations apply to ‘traded’ companies, whereas the pre-existing Strategic Report regulations apply to ‘quoted’ companies.

The Companies Act defines traded and quoted companies as follows:

A traded company is a company whose transferable securities are admitted to trading on a regulated market<sup>5</sup> (section 474(1)).

A quoted company is a company whose equity share capital:

(a) has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000, or

(b) is officially listed in an EEA State, or

(c) is admitted to dealing on either the New York Stock Exchange or NASDAQ (section 385(2)).

A key distinction is that ‘traded’ companies includes those with debt securities on a regulated market.

Alternative Investment Market companies are excluded from both as they do not meet the definition of a quoted or traded company.



**What do companies need to disclose?**

*Strategic Report*

The new regulations require companies within scope to disclose, to the extent necessary for an understanding of the company’s development, performance, position and impact of its activity, information relating to environmental, employee, social, respect for human rights, anti-corruption and anti-bribery matters.

This includes a description of:

- the company’s business model;
- the policies pursued by the company in relation to the matters noted, any due diligence processes; implemented by the company in pursuance of those policies;
- the outcome of those policies;
- the principal risks relating to the matters noted arising in connection with the company’s operations;
- how the company manages those principal risks, where relevant and proportionate; and
- the non-financial key performance indicators.

A company is also required to describe, where relevant and proportionate, the business relationships, products and services which are likely to cause adverse impacts relating to the principal risks identified above.

*Corporate Governance Statement*

The European Directive has also led to changes to the Disclosure and Transparency Rules which require listed companies to disclose the following in their corporate governance statement in respect of diversity (DTR 7.2.8AR):

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<sup>5</sup> The Financial Conduct Authority is responsible for maintaining the list of regulated markets. The list is available at [https://register.fca.org.uk/shpo\\_searchresultspage?preDefined=RM&TOKEN=3wq1nht7eg7tr](https://register.fca.org.uk/shpo_searchresultspage?preDefined=RM&TOKEN=3wq1nht7eg7tr)

- the diversity policy applied to the company’s administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds;
- the objectives of the diversity policy;
- how the diversity policy has been implemented; and
- the results in the reporting period.

If no diversity policy is applied by the company, the corporate governance statement must contain an explanation as to why this is the case.

Companies that are required or choose voluntarily to apply the UK Corporate Governance Code may already be meeting many of these requirements (Code Provision B2.4).



**How do the new requirements for the Strategic Report fit within the narrative reporting framework?**

The Companies Act requires all medium and large companies and qualifying partnerships to prepare a Strategic Report. The new regulations require companies to provide non-financial information within their Strategic Report.

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 (duty to promote the success of the company).

The FRC’s Guidance on the Strategic Report<sup>6</sup> provides guidance on the application of the legal requirements in respect of the Strategic Report including non-financial information. The FRC is in the process of updating its Guidance to reflect the new legislative requirements for non-financial reporting and other developments in narrative reporting.

The European Commission has also recently published its Guidelines on non-financial reporting. The Guidelines are non-mandatory and note that companies may use other frameworks such as the FRC’s Guidance on the Strategic Report.



**What are the changes introduced by the regulations?**

For those companies within the scope of the new regulations there are some additional requirements. All quoted companies are already required to provide some information on environmental, employee, social, community and human rights matters in their Strategic Report. Similar to the pre-existing requirements, disclosures relating to most of these requirements are only required when the information would be material.

The additional information required is:

- a requirement for companies to provide information that enables an understanding of the impact of its activity;
- disclosure of anti-bribery and anti-corruption matters;
- a description of any due diligence processes implemented by the company in pursuing the policies relating to non-financial matters; and the outcome of those policies; and

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<sup>6</sup> A copy of the FRC’s Guidance on the Strategic Report <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf>

- a description of the principal risks arising in connection with the company's operations including, where relevant and proportionate, a description of business relationships, products and services which are likely to cause adverse impacts in those areas of risk; and how the company manages those principal risks.

Irrespective of materiality, where a company does not pursue policies in relation to environmental, employee, social, respect for human rights, anti-corruption and anti-bribery matters, the company must provide a clear and reasoned explanation for not doing so.

Whilst the new regulations introduce some new requirements, the companies within the scope of the new regulations are exempt from some of the pre-existing legal requirements. The tables below set out the references to the Companies Act requirements that apply to companies within the scope of the new regulations.

**Table 1**

<b>New disclosure requirements</b>	<b>Related exemptions from existing requirements</b>
414CB(1) environmental, employee, social, respect for human rights, and anti-corruption and anti-bribery matters	414C(7), except community issues
414CB(2) business model, policies, principal risks, KPIs	414C(8)(b) business model, 414C(4)(b) non-financial KPIs
414CB(4) disclosure when a company does not have a policy	
414CB(5) explanations of amounts in financial statements	414C(12) where it relates to provisions in 414CB(7)(a-c)
414CB(6) alternative framework used for disclosing non-financial information	

**Table 2**

<b>Existing Strategic Report disclosure requirements that continue to apply</b>
414C(2) business review, principal risks and uncertainties
414C(4)(a) financial KPIs
414C(8)(a) strategy
414C(8)(c), (9) & (10) gender diversity
414C(12) other provisions