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Need to know

Non-Financial Reporting Regulations

Contents

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In a nutshell

- The Government has enacted Regulations implementing the EU Non-Financial Reporting Directive (EU NFR Directive).
- The EU NFR Directive is broadly similar to the existing UK narrative reporting framework for quoted companies, although there are some differences including the scope (e.g. some unquoted companies are in scope) and the inclusion of some additional matters (e.g. anti-corruption and bribery) for commentary.
- The non-financial statement required by the EU NFR Directive forms part of the strategic report.
- The Regulations apply to financial years beginning on or after 1 January 2017.

Background

Non-financial reporting requirements in the UK have developed substantially in recent years in response to increasing investor interest in those environmental and broader social issues that impact an organisation's ability to create value in the longer term. Non-financial reporting information, including information about a company's strategy and how it responds to risks and opportunities to deliver returns, enables businesses to communicate the contribution they have made to society, thereby strengthening trust with all stakeholders.

The Government has enacted *The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016* (SI 2016/1245) (the Regulations) implementing the EU NFR Directive (Directive 2014/95/EU). The UK is considered to be a world-leader in reporting and governance, and strongly influenced the development of the EU NFR Directive.

Scope

The scope of the Regulations, which mirrors that of the EU NFR Directive, differs from that for the existing strategic report requirements for quoted companies in the UK. It scopes in all public interest entities (PIEs) that have over 500 employees, on average, in the financial year. Where a company is a parent company at any time in the financial year, a non-financial statement is required where the aggregate number of employees for the group headed by that company was more than 500, on average, in the financial year.

A PIE is defined as:

- a traded company (which means a company any of whose transferable securities are admitted to trading on a regulated market in the EEA);
- a banking company;
- an authorised insurance company; or
- a company carrying on insurance market activity.

This means that the scope of the Regulations is both narrower than all quoted companies (for example, because smaller quoted companies are excluded) and wider (in that large unquoted banking and insurance companies are included). Companies with only debt securities traded on a regulated market in the EEA are currently excluded from the definition of a quoted company but will be caught by the new requirements if they have more than 500 employees.

How has this been implemented into UK law?

The requirements of the EU NFR Directive have been implemented into company law with the effect that:

- Large PIEs will apply the requirements of the EU NFR Directive which have been copied into UK law as a new section 414CB in the Companies Act 2006. Large PIEs that are also quoted companies will also apply any existing requirements for the strategic report which are similar but not identical. There are, however, exemptions from some of the existing requirements for companies that are required to apply the new ones.
- Quoted companies that are not large PIEs (due to having fewer than 500 employees) will continue to apply the existing requirements for the strategic report as applicable to quoted companies.
- All other companies and qualifying partnerships will continue to apply the other applicable disclosure requirements for the strategic report.

Observation

This means that there are two similar, but different, sets of requirements operating in parallel. Companies may have to comply with one or other or both sets of requirements. This leads to regrettable complexity and a simpler approach was suggested by many commentators on the earlier proposals. However, the Government rejected the simpler approach of applying the same requirements to quoted companies and large PIEs because it would be "gold plating" of the Directive.

Groups

When the company is a parent and prepares consolidated accounts, it prepares a group strategic report. In this case, the non-financial information statement must be a consolidated statement relating to the undertakings included in the consolidation. References to information about the company should therefore be read as encompassing the undertakings included in the consolidation.

There are exemptions available from the requirement to prepare a non-financial reporting statement when the company is a subsidiary at the end of the financial year and is included in a group strategic report for a larger group (or the equivalent in another EEA state).

The requirements

Those within scope of the Regulations are required to include a non-financial statement in their strategic report disclosing, as a minimum, information about:

- environmental matters (including the impact of the company's business on the environment);
- the company's employees;
- social matters;
- respect for human rights; and
- anti-corruption and anti-bribery matters.

If the company does not pursue policies in relation to one or more of these matters, the statement must provide a clear and reasoned explanation for not doing so.

This information is required only to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity.

Observation

This relaxation is similar to the existing one for quoted companies but disclosure is required where information is necessary for an understanding of the impact of the company's activities in respect of these matters.

The content of the non-financial statement should also include a description of:

- the company's business model;
- the policies pursued in relation to those matters listed above, including due diligence processes implemented;
- the outcome of those policies;
- the principal risks relating to those matters arising in connection with the company's operations;
- where relevant and proportionate, the business relationships, products and services which are likely to cause adverse impacts in those areas of risk;
- how the company manages the principal risks; and
- the non-financial key performance indicators relevant to the company's business.

The statement must also, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.

How does this differ from existing UK requirements?

The key areas of difference between the EU NFR Directive and the existing UK requirements for the strategic report as applicable to quoted companies relate to:

- the scope of companies required to disclose the non-financial information;
- the matters which are required to be reported on;
- principal risks specifically related to those matters (including anti-corruption and bribery); and
- diversity information disclosures.

The additional matters to be reported

In addition to the UK's existing requirements for information on environmental, social and community, employee and human rights matters, the EU NFR Directive requires disclosures in respect of anti-corruption and anti-bribery matters. The required information with respect to anti-corruption and anti-bribery matters should include information about any policies in relation to those matters and the outcome of those policies.

Principal risks

The existing UK framework requires companies to describe the principal risks and uncertainties facing the business. The EU NFR Directive states that the non-financial statement should include principal risks relating, as a minimum, to the specified matters (i.e. environmental, social and employee matters, respect for human rights and anti-corruption and anti-bribery matters). These disclosures must include, where relevant and proportionate, the company's business relationships, products or services which are likely to cause an adverse impact in those matters. The company must also disclose how it manages those risks.

Observation

While the existing requirement for companies to consider all principal risks should mean that these areas have been disclosed where relevant previously, the Regulations should encourage companies to review and refresh their principal risks in respect of the matters specified in the Regulations. This may result in companies including additional disclosure in respect of non-financial information.

Diversity information in the Corporate Governance Statement

The EU NFR Directive also requires diversity disclosures but the scope of this requirement is different from the others described above. The requirement applies to traded companies (i.e. those with transferable securities admitted to trading on regulated market in the EEA) but it does not apply to issuers which do not have shares admitted to trading on an EU regulated market, unless the issuer has issued shares which are traded on an EU multilateral facility (i.e. companies with listed debt will usually be exempt). Companies that meet the size criteria to qualify as small or medium-sized under company law are exempt from the diversity disclosures.

Such companies are required to describe their diversity policy including aspects such as age, gender, geographical diversity and educational and professional background. As well as describing the policy, they must explain the objectives of the policy, how it has been implemented and the results of the policy in the reporting period. The EU NFR Directive states that this information should be included as part of the corporate governance statement although UK companies often incorporate that statement into the directors' report or strategic report by cross reference. Consistent with other corporate governance reporting requirements, these requirements of the EU NFR Directive have been implemented in the UK through the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA). The FCA has introduced a new rule DTR 7.2.8AR to do this.

Observation

The current UK requirements for the strategic report already require companies to provide numerical disclosures on gender diversity. However, the EU NFR Directive goes further and requires a broader discussion of diversity in the corporate governance statement.

At a glance – a high level overview of the differences and which companies they affect

Existing non-financial information (Existing) requirements and EU NFR Directive (NFRD) non-financal information requirements for UK companies

Company type	Principal risks		Environmental, social and employee matters		Human rights matters		Anti-corruption and bribery matters		Diversity matters	
	Existing	NFRD	Existing	NFRD	Existing	NFRD	Existing	NFRD	Existing	NFRD
Listed equity (> 500 employees)	✓**	✓	✓	✓	✓	✓	X	✓	✓*	✓***
Listed equity (≤ 500 employees)	✓**	X	✓	X	✓	X	X	X	✓*	✓***
Listed debt (> 500 employees)	✓**	✓	X	✓	X	✓	X	✓	X	X***
Listed debt (≤ 500 employees)	✓**	X	X	X	X	X	X	X	X	X***
Unlisted credit institutions (> 500 employees)	✓**	✓	X	✓	X	✓	X	✓	X	X
Unlisted credit institutions (≤ 500 employees)	✓**	X	X	X	X	X	X	X	X	X
Unlisted insurance undertakings (> 500 employees)	✓**	✓	X	✓	X	✓	X	✓	X	X
Unlisted insurance undertakings (≤ 500 employees)	✓**	X	X	X	X	X	X	X	X	X

* Whilst some disclosures regarding diversity are already required in the existing UK framework, these differ from those in the EU NFR Directive.

** Whilst the disclosure of principal risks is a requirement of all UK companies within the scope of the strategic report requirements, the EU NFR Directive explicity refers to principal risks relating to the non-financial information matters (i.e. environmental, social, employee, human rights, anti-corruption and bribery matters).

*** The diversity disclosures do not apply to issuers which do not have shares admitted to trading on an EU regulated market, unless the issuer has issued shares which are traded on an EU multilateral facility. Companies that meet the size criteria to qualify as small or medium-sized under company law are exempt from the diversity disclosures.

Further information

If you have any questions about the subjects raised in this publication, please speak to your usual Deloitte contact.
The Regulations can be accessed at: **http://www.legislation.gov.uk/uksi/2016/1245/contents/made**
More information on UK accounting, reporting and corporate governance news and publications, can be found at **www.ukaccountingplus.co.uk**

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Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000
Fax: +44 (0) 20 7583 1198.

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