ICAEW
REPRESENTATION 83/23

SMARTER REGULATION: CALL FOR EVIDENCE NON-FINANCIAL REPORTING

Issued 30 August 2023

ICAEW welcomes the opportunity to comment on *Smarter Regulation: Call for Evidence Non-Financial Reporting* published by Department for Business and Trade in June 2023, a copy of which is available from this link.

For questions on this response please contact us at frf@icaew.com quoting REP 83/23.

This response of 30 August 2023 has been prepared by the ICAEW Corporate Reporting Faculty. Recognised internationally as a leading authority on corporate reporting, the faculty, through its Financial Reporting and Non-Financial Reporting committees, is responsible for formulating ICAEW policy on financial and non-financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The faculty provides an extensive range of services to its members including providing practical assistance with common corporate reporting problems.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

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KEY POINTS

A COMPREHENSIVE AND TIMELY REVIEW

1. We congratulate the Department for Business and Trade (DBT) for publishing this comprehensive and timely call for evidence on UK non-financial reporting. For a number of years, the UK has stood at the forefront of non-financial reporting developments, with the overall quality of non-financial reporting improving as a result. In particular, the introduction of the strategic report in 2013 was a crucial step towards UK companies providing a broader and more integrated narrative on their position, performance, and development, alongside their financial statements. Ten years on, the strategic report has become a highly regarded and valued document that underpins the UK's reputation for corporate transparency.
2. While the quality of reporting has improved over time, the underlying legislative framework has become complex. New requirements have been added in a piecemeal way rather than being integrated effectively, and scoping requirements have become difficult to navigate. As a result, there are now numerous duplicative and overlapping requirements. We believe that this complexity has reached a tipping point, and risks compromising both progress made to date and the UK's position as a global leader in this space.
3. We therefore welcome this call for evidence as an initiative necessary to ensure that the UK legislative framework is both fit for purpose and sufficiently clear and robust to allow for future developments. The review is also timely, falling at a time when the UK Government is in a position to amend the legislative framework and when the proposed adoption of IFRS Sustainability Disclosure Standards is on the horizon. This may provide an opportunity to align investor-focused reporting requirements with the objectives and terminology used by the IFRS Foundation in relation to both the International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB).
4. We are aware that this is the first stage of DBT's deliberations, with further consultations planned in 2024 and beyond. ICAEW stands ready to assist in this journey and to provide further input as appropriate. ICAEW's Better Regulation work, as described in our response to Question 24, is very relevant to this review and we would be happy to engage with DBT on our work in this area.

SHORT TERM CHANGES, BIGGER PICTURE THINKING

5. We have made numerous recommendations throughout our response. Some relate to urgent issues which we believe should be addressed in the shorter term and have the potential to significantly improve to the quality of the non-financial reporting framework. We have also made recommendations which require a broader review of the non-financial reporting legislative framework over the longer-term. We encourage DBT to move ahead with short-term changes, where possible, but to keep in mind the bigger picture thinking we set out in this response where it might helpfully inform government decision-making.

STREAMLINE, ALIGN, REFINE

6. While our recommendations are wide-ranging, they broadly fall under three categories, which we have described as *streamline*, *align*, and *refine*. We set out key recommendations under these three categories below.

Streamline

7. **Scope and thresholds:** the existing thresholds for non-financial reporting information should be simplified and streamlined. It is also necessary to review the size categories used to determine the type of accounts that need to be prepared and filed with Companies House. We have highlighted a number of practical challenges with the existing thresholds within our responses to questions 22 and 23, and have suggested a simplified model which would require just four categories of company. We also strongly encourage DBT to bring all the size

criteria and threshold requirements together into one location to allow preparers to identify clearly the category or categories into which they fall.

8. **Duplication of non-financial reporting requirements**: changes are required to eliminate the duplication and overlap of non-financial reporting requirements across the different components of the annual report that has built up over time. The legislative drive to introduce new requirements has not always been matched by a commensurate drive to remove or amend redundant requirements. There is a need to rationalise certain reporting requirements, particularly with regards to the directors' remuneration report. We highlight specific examples of each in response to question 19 and within the Appendix.
9. **Group reporting:** we urge DBT to review how non-financial reporting requirements are applied within groups of companies. In response to question 19, we highlight a number of reporting requirements which result in unusual outcomes within group situations. While we encourage DBT to address the specific issues raised in this response, we also urge government to undertake a more holistic review of non-financial reporting within groups, to ensure that reporting requirements are matched to the appropriate level of reporting within groups more generally.
10. These streamlining activities are urgent issues that should be pursued by DBT in the short term as they are required to make the current legislative framework function as intended. Consideration should also be given to some of the bigger picture matters to help inform decision-making in the short term, for example, applying principles for introducing new non-financial reporting requirements.

Align

11. **Align with ISSB standards:** ICAEW is a strong supporter of the ISSB and encourages government to move swiftly to endorse IFRS Sustainability Disclosures Standards for use in the UK. There should be one source of sustainability disclosure requirements in the UK ie, UK-adopted ISSB standards. Companies which are, in time, required by law or regulation to report under the ISSB standards will refer to the disclosure requirements as set out in those standards. The legislation for companies not required to apply ISSB standards should, as soon as practicable, be aligned to the ISSB baseline to the extent proportionate unless there are strong reasons to deviate from the requirements of those standards.
12. **An ISSB for SMEs:** in the longer term, DBT should discuss with the ISSB the possibility of an 'ISSB for SMEs' type of framework being developed in the UK, perhaps by the Auditing, Reporting and Governance Authority (ARGA). This would not only simplify the underlying legislation, but also enable reporting requirements for companies not in-scope of the full ISSB standards to remain proportionate and updated to reflect changes in reporting best practice.
13. We note that work is underway by the UK Sustainability Disclosure Technical Advisory Committee to consider whether the ISSB's first two standards are suitable for use in the UK, as part of the wider endorsement process. We acknowledge that alignment with the ISSB standards will evolve and will be linked to decisions around scope and timetable.

Refine

14. **Radical reform in the longer-term:** as noted, we believe that DBT could pursue a number of urgent issues while developing its vision for a future framework, even if that vision would be implemented over a longer period of time. We encourage DBT to be bold in this respect, taking the time necessary to discuss and develop the bigger picture for UK non-financial reporting. This is an historic opportunity for the UK to develop a truly streamlined and world-leading legislative framework which not only accommodates developments in sustainability reporting but minimises the risk of complexity and confusion re-emerging over time.
15. **Purpose-led regulation:** we believe that the purpose of the annual report is to provide material information about a reporting entity that is useful to existing and potential investors, creditors and other lenders in making decisions relating to the provision of resources to the

entity.[1] Clarifying the purpose of the annual report provides an organising principle which can be applied when taking decisions over the need for and subsequent location of non-financial information, and the associated scoping requirements. We have observed that the drafting of questions 9, 20 and 21 appears to suggest that the purpose of requiring non-financial reporting is to direct management in the running of the business. We do not agree that this is the purpose of non-financial reporting requirements and have answered the questions in the call for evidence on that basis.

16. **Information outside of the annual report:** following on from above, if the purpose of requiring certain non-financial information is not to provide material information to the primary users, but rather to meet a broader public policy objective, that information should be presented outside of the annual report. Accepting that certain non-financial information is better located outside of the annual report also provides DBT with an excellent platform to explore ways to improve the mechanism by which such information is provided and to support other organisations which require this information to produce their own reporting. We believe that there is a real opportunity for innovative thinking in this respect, with a particular focus on the role that technology might play with regards to reporting developments more broadly.

17. **Principles for requiring non-financial information:** we encourage DBT to develop a clear set of principles to help determine whether and how non-financial reporting requirements are introduced into the regulatory framework. Clearly identifying the purpose of information at the outset is critical. We set out some examples in our introductory comments below to provide a starting point for developing a set of core principles. Agreeing a set of principles would provide a helpful framework for DBT when reviewing the UK non-financial reporting framework.

18. **High-level regulatory framework:** ICAEW is a longstanding advocate of a legislative framework which contains minimal or very high-level non-financial reporting requirements, with the majority - if not all- detailed reporting requirements for the annual report located outside the legislative framework. We would support efforts to achieve this in the UK. To operate effectively, this approach would need to be backed by the devolution of sufficient powers to the relevant regulatory body or bodies, for example, through the delegation of detailed reporting requirements to a body such as ARGA. There are many benefits of adopting this approach, including greater flexibility in making any amendments on a timely basis to reflect developments and best practice. It would also facilitate greater alignment of other legislative regimes, for example, those applying to charities, LLPs and qualifying partnerships, all of which are in need of updating.

OTHER GENERAL COMMENTS

OUR APPROACH TO RESPONDING

19. The call for evidence covers a complex and expanding area of corporate reporting, with developments in some areas occurring at pace. In the following paragraphs we outline our approach to responding to the call for evidence, including how we have defined the terms ‘non-financial information’ and ‘non-financial reporting framework’. Our responses to the individual questions within the survey should be read with our overall approach in mind.

DEFINING THE PARAMETERS OF NON-FINANCIAL INFORMATION

20. While the call for evidence is seeking views on a broad range of non-financial information requirements, we have confined most of our detailed comments to non-financial information that is (or should be) required within the boundaries of the annual report. That is, the non-financial reporting requirements as set out in Part 15 of the Companies Act 2006 and the

[1] This is consistent with the objective of general-purpose financial reporting as set out in 1.2 of the IFRS Accounting Standards Conceptual Framework for Financial Reporting and with the objective IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information.*

associated relevant Statutory Instruments[2]. In effect, this includes the legislative framework for the strategic report, directors' report and directors' remuneration report. This group of legislative requirements, which encompasses a range of non-financial information from explanation of financial performance through to sustainability-related matters, is referred to in our response as the 'non-financial reporting framework'.

21. Where we have considered non-financial reporting requirements beyond the annual report, it has principally been in the context of encouraging DBT to establish an organising principle to determine when information should be included outside of the annual report, and in providing suggestions on how or where that information might be better presented.

22. We emphasise that we do not consider the presentation of information outside of the annual report, or that is required to meet a public policy objective or wider stakeholder needs, to be intrinsically of less value or importance than information included within the annual report. Simply, we have focussed our attention within this response on the information needs of the primary users of an annual report.

23. Similarly, while not the primary focus of our response, we also consider in response to question 9(a) the value of non-financial information more generally to preparers, and the extent to which non-financial information produced for reporting purposes has the potential to positively inform and shape strategic decision-making and governance.

REBUILDING THE LEGISLATIVE FRAMEWORK

24. We believe that it is important for DBT to set out a vision of a future non-financial reporting framework. It is important to clarify how the various components of the annual report are intended to fit together and to re-build the legislative foundations in such a way that it achieves this vision. To determine this vision, there are fundamental questions that first need to be considered by DBT. These include:

    - Is an investor-focused annual report the most effective vehicle for reporting information to meet public policy objectives and wider stakeholder needs? For example, a review could consider whether the directors' report is or is not the most effective location for public policy disclosures.
    - Can the objective of investor-focused information be more clearly and consistently stated to support the preparer's understanding of the requirements, and an objective test of whether all material information relevant to the company's circumstances has been provided? For example, a review might consider whether the objectives of the strategic report could be aligned with the objective of providing information to support assessments of valuation and stewardship set out in the IFRS Conceptual Framework (1.2-1.3).
    - What is the purpose of the individual components within the annual report? Are all the existing reports still required, and if so, how should information be organised between them? For example, a review might consider how reporting requirements could be specified in a manner that supports a more integrated and coherent narrative across the different types of information to be reported.
    - To what extent do detailed non-financial reporting requirements need to sit within legislation? Should detailed non-financial reporting requirements be delegated to standard setters and regulatory bodies such as ARGA?
    - What principles should be followed when developing non-financial reporting requirements for the annual report? How can we ensure that these are applied to future requirements?
    - What types of company should be required to provide non-financial information and how can the framework be made sufficiently proportionate to accommodate different types and sizes of company? For example, a review might consider principles for

[2] SI 2008/409 The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 SI 2008/410 The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

setting proportionate but aligned disclosures for those companies that do not have independent providers of long-term capital.

- How will future developments in non-financial reporting fit within the existing framework?

25. Establishing this broader vision would lead to a more coherent and comprehensible approach to changes in non-financial reporting requirements, and reduce the likelihood of the current complexity, inconsistency and duplication recurring as the framework develops in the future.

PRINCIPLES FOR INTRODUCING NON-FINANCIAL REPORTING REQUIREMENTS

26. As noted above, we believe it is necessary to develop a set of principles to help determine whether and how new non-financial reporting requirements are introduced into the legislative framework. Clearly identifying the purpose of information at the outset is critical. Other key principles might include:
    - Avoiding duplication and overlap with existing requirements.
    - Using existing thresholds when introducing new reporting requirements (unless there is highly persuasive reason not to do so).
    - Adopting a proportionate approach, and considering different information needs for different categories of company.
    - Ensuring principles-based reporting requirements, with more detailed reporting requirements or guidance located outside the legislative framework.
    - Presenting data required for purposes other than investment (even when the entity requiring this is an investor) in an appropriate location outside the annual report.
    - Aligning with relevant reporting frameworks or requirements.

27. This is not intended as a definitive or exhaustive list of principles. Instead, we highlight these as being key factors to be considered by DBT, both when reviewing existing requirements, but also when producing future reporting requirements. Agreeing a set of key principles would provide a helpful framework for DBT when reviewing the UK non-financial reporting framework. ICAEW would be happy to assist in any future efforts to determine such a set of key principles.

ANSWERS TO SPECIFIC QUESTIONS

Administrative questions

Question 1

What type of respondent are you?

28. ICAEW is a representative body.

☐ Individual
☐ Investor
☐ Shareholder
☐ Academic
☐ Business
☒ Representative Body
☐ Charity
☐ Other (please specify)

Question 2

What is your name?

29. Sarah Dunn, Nigel Sleigh-Johnson

Question 3

What size is your business?

30. ICAEW is a large business.

☐ Micro (1-9 employees)

☐ Small (10-49) employees)

☐ Medium (50-249 employees)

☒ Large (250 or more employees)

Question 4

And are you an accountancy firm?

31. ICAEW is not an accountancy firm.

☐ Yes

☒ No

Question 5

What is your organisation's name?

32. ICAEW

Question 6

What is your email address?

33. nigel.sleigh-johnson@icaew.com

Question 7

How did you hear about this consultation?

34. Email from the Department for Business and Trade

☒ Email from the Department for Business and Trade
☐ Email from elsewhere
☐ GOV.UK/GOV.UK alert
☐ Newsletter
☐ Twitter
☐ LinkedIn
☐ Other (please specify)

Question 8

Are you a preparer or a user of non-financial information?

35. ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

☐ Preparer
☐ User
☒ Other (please specify)

Questions primarily aimed at the preparers of non-financial information.

Question 9

How valuable, if at all, is the preparation and/or disclosure of non-financial information for the effective running of your company?

☒ Highly valuable

☐ Moderately valuable

☐ Somewhat valuable

☐ Not valuable

☐ Don't know

Question 9(a)

And why do you say that? Please consider whether the information:

- ***Helps to attract investment;***
- ***Supports setting of strategy, understanding and improving the long-term value creation of the company and;***
- ***Your transition to net-zero.***

36. To run any organisation effectively, non-financial information needs to be captured, measured and monitored. For example, information on a company's business model, strategy, workforce, product lines and supplier arrangements are all crucial to the day to day running of a business, regardless of any associated external reporting requirements.

37. The extent to which the information that is produced and disclosed in accordance with specific non-financial reporting requirements is 'valuable' to preparers will vary. Generally speaking, if non-financial reporting is seen as a compliance exercise, then its value to the company is likely to be reduced. However, where an integrated approach is adopted, non-financial information produced for reporting purposes has the potential to positively inform and shape strategic decision-making and governance. For this reason, we have answered 'highly valuable' to question 9, although as already noted this will vary between companies depending on the nature of the information and the way in which it is used internally.

38. While we agree that the preparation and disclosure of non-financial information has the potential to help in the effective running of a company, this is not the primary purpose of requiring such information. As previously noted, we believe the objective of requiring non-financial information within the annual report is to meet the information needs of investors, lenders and other creditors in these roles. It is through this lens and this lens only that the legislative framework for non-financial information should be considered. We discuss this idea further in response to questions 14–19.

Question 10

What challenges, or costs, if any, does the preparation, disclosure and distribution of non-financial information create for your company? Please consider the aspects which are difficult to comply with, the cost related to compliance or the production of information.

39. A key challenge for preparers is the complexity in the non-financial reporting framework. In particular, there are challenges in relation to scoping requirements, the duplication of requirements across the annual report, and how non-financial reporting requirements are applied within group situations. These challenges are discussed further in response to question 19. This complexity increases the cost for preparers by way of time spent identifying the relevant requirements and understanding the legislation. Another challenge can be the collation of data to fulfil reporting requirements. This challenge is not uniform and will clearly depend on the nature of the item being captured and the maturity of an individual company's systems.

40. In relation to cost, we would also distinguish between the cost of information that is already being collated for the running of the business and information that is not (at least currently)

being used for decision-making purposes. Where data are already being used by the company, the incremental cost of requiring this information within the annual report will be less than when compared to data that are not currently being collated, meaning that new systems are required to capture the information. Information that is derived from that used to manage the business is typically both the most useful type of information and the least costly to report.

Question 11

What, if any, are the key drivers of cost when having to comply with non-financial reporting requirements? Please respond in line with the following considerations listed below:

- ***Staff costs;***
- ***Time costs;***
- ***Production costs;***
- ***IT infrastructure costs;***
- ***Any other relevant costs.***

41. Broadly speaking, we agree that all the costs outlined in this question could be relevant when identifying the costs of complying with non-financial reporting requirements. There may also be other costs to consider, for example, assurance-related costs or when external advisors are needed. However, as noted in question 10, linking specific costs to individual non-financial reporting requirements is complex. Not only is the nature of the individual requirement relevant, but also the size and nature of a company including the maturity of its systems in capturing non-financial data. To understand the costs of complying with non-financial reporting requirements would require a more targeted level of research and evidence-gathering. We would be happy to discuss this further.

Question 12

Please select the most applicable statement:

☒ The benefits of preparing and disclosing non-financial reporting information outweigh the costs
☐ The costs of preparing and disclosing non-financial reporting information outweigh the benefits
☐ The benefits of preparing and disclosing non-financial reporting information are proportionate to the costs
☐ Don't know

Question 12(a)

Please explain your above answer.

42. While this question is directed at preparers, it is worth noting that many of the benefits from the preparation and disclosure of non-financial information will accrue to those outside of the company, for example future and current investors. We have considered the benefits accruing from non-financial information in this broader sense.

43. The overall benefits of preparing and disclosing non-financial information outweigh the costs. While there is clearly room for improvement across the non-financial reporting framework, the Management Discussion and Analysis (MD&A) component of the annual report is, in our experience, a highly regarded and useful package of information.

44. However, it is not always the case that the benefits of preparing and disclosing non-financial information will outweigh the associated costs for each individual disclosure requirement. This will vary in accordance with the type of information being requested and also the nature of the company. For example, information provided under the Streamlined Energy and Carbon Reporting (SECR) requirements is not subject to a materiality filter and is disclosed primarily to meet a public policy objective rather than to meet the needs of investors. This information can be costly to collate but arguably has limited benefit to the company, or indeed the primary users of the annual report.

45. We have also highlighted in our response to question 19 various issues relating to intermediate parent companies where the ultimate parent company is an overseas entity. We do not repeat the specifics of these issues here, but note that these are examples where existing thresholds can result in information not being reported at the right level within the group which clearly limits the benefits to users of that information.

Question 13
To what extent do the Companies Act non-financial reporting requirements align with other regulatory requirements your company might be in scope of? For example these might include requirements that are set by the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA) (or other regulators).

46. We are not aware of significant conflicts between non-financial information required within the annual report and other non-financial reporting regulatory requirements. However, there are some areas where there is a degree of inconsistency which might helpfully be addressed, as follows:
    - While the requirements of the strategic report and Corporate Governance Code are broadly consistent, there is some inconsistency with regards to the requirements to disclose details on diversity, such as the definition of senior managers. There is also some inconsistency with the Listing Rules in relation to diversity.
    - The climate-related financial disclosure requirements within the strategic report have been adapted from, and aligned with, the Task Force on Climate-Related Financial Disclosures (TCFD), whereas the FCA Listing Rules and accompanying guidance directly refer to the TCFD's published guidance materials. Furthermore, FCA Listing Rules are applied on a 'comply or explain' basis, whereas the strategic report requirements are mandatory. Companies subject to the Listing Rules are also permitted to make TCFD disclosures outside of the annual report, which is not the case for the similar requirements within the Companies Act.

Questions primarily aimed at the users of non-financial information to complete.

Question 14

To what extent do you agree or disagree that non-financial information prepared by companies is useful?

☒ Strongly Agree

☐ Agree

☐ Neither agree nor disagree

☐ Disagree

☐ Strongly disagree

☐ Don't know

Question 14(a)

Please explain your answer.

47. The disclosure of non-financial information by listed and AIM entities is particularly valued when it provides material information that helps the primary users to make decisions, as set out in paragraph 1.2 of the IFRS Conceptual Framework for Financial Reporting. The provision of non-financial information also has an important role in ensuring the effective stewardship of the company. It provides vital information on how management have taken account of broader stakeholder considerations and to enable accountability of these actions. The evidence for use of this information and the quality of disclosure outside those companies without shares in public hands is, in most cases, much more limited.

Question 15

How, if at all, do you use non-financial information?

48. Even amongst the primary users, there are a number of uses for non-financial information included in the annual report. We refer DBT to Figure 2 of the Financial Reporting Council's Future of Corporate Reporting: Conclusions from an Online Survey of FRC Stakeholders. This highlights how users may use information in the annual report to: judge the performance of the company, make comparisons, confirm existing information, understand how the board is making decisions, and much more. It may be that some users have a very narrow and specific need, whereas others will use the annual report for multiple purposes.
49. We also refer DBT to the 2018 CFA Institute Member Survey Report, which provides some useful insights and analysis on how non-financial information is used both within and outside of the annual report.
50. As noted elsewhere in this response, investors, asset owners, banks and insurers rely heavily on information reported on emissions to enable them to provide their own Scope 3 carbon emission disclosures.

Question 16

Which types of non-financial information are the most useful and/or which are the least useful?

☐ Most useful – see our response below

☐ Least useful – see our response below

51. In our view, the extent to which non-financial information included in the annual report is 'useful' depends on whether it meets the needs of the primary users. As noted elsewhere in our response, it is critical to understand the purpose of requiring a particular item of non-financial information and for this to then determine the location and scope of that information.
52. We emphasise this point again here as it may be that information categorised as 'least useful' within the annual report may in fact serve an important purpose for another audience and/or may be necessary for the purpose of meeting a wider public policy objective. It may, therefore, not be a case of no longer requiring that information, but rather finding a more effective way to present that information to the intended audience. Potential options for reporting outside of the annual report are discussed further in our response to question 19
53. Clarity of purpose aside, there are other factors which could render information of more or less useful to users of the annual report. These have been explored further in our responses to questions 17 to 19 below.

Question 17

How easy or difficult is it to interpret non-financial reporting disclosures?

☐ Very easy
☐ Easy
☐ Neither easy nor difficult
☐ Difficult
☐ Very difficult
☒ Don't know

Question 17(a)

Please explain your answer

54. We have answered 'Don't know' to question 17 as the answer to this question is dependent on various factors. That is, the extent to which non-financial reporting disclosures are easy or difficult to interpret will vary between companies and depends on the quality of the

information provided. That said, there are some key factors which enable non-financial information to be more easily interpreted. These include:

- When the information is specific to the entity and there is a clear context supporting the disclosure.
- When the information disclosed is material.
- When the information reflects the management's view of the business.
- When the basis and methodology used to prepare non-financial information is explained alongside that information.
- When there are clear linkages between information, for example, when management clearly explains the business model, strategy, the risks faced by the company and how they are mitigated, how performance is measured in financial and non-financial terms, and how directors' have fulfilled their duties in accordance with s172.
- Where the information provided is fair, balanced and understandable.

55. In our view, these factors help improve the relevance and ease of interpretation of non-financial information.

56. We acknowledge that there can be a tension between underlying reporting requirements which enable more relevant information about the company to be disclosed and requirements that enable easier comparisons to be made between companies within the same industry or to explain trends over time. We generally favour requirements which provide more relevant information to be disclosed as that is more likely to provide useful information to the primary users of the annual report.

57. As discussed under question 19, there are certain investors that require data on an aggregated basis to enable large scale comparisons. However, this is generally intended for a purpose other than provision of material information on the performance of an individual company, and therefore such data might be more usefully located outside of the annual report.

Question 18

How does non-financial information support your judgement in the following areas?

- ***How the directors of the company have fulfilled their duties;***

58. We assume that this question is primarily directed at the s172 statement within the strategic report. In our view, the s172 statement best supports judgements on how directors of the company have fulfilled their duties when there is a genuine attempt at explaining both positive and negative matters faced by the company in the year, how this information is escalated to the board, and how the business has or will respond in the year and beyond. Information on how the directors have engaged with stakeholders and run the business, including how they have considered the risks faced and the opportunities encountered, and how they have affected decision-making, are also particularly valuable.

59. We also understand that s172 statements are increasingly being integrated within strategic and governance reports, which has prompted some to question the need for a standalone statement. We have heard suggestions that it might be more appropriate to require companies to report against s172 throughout the annual report, as appropriate, rather than having a specific format or location. Currently, taking this approach is at odds with the legislation. We recognise that this would also have implications for the review of this information.

- ***The performance of the company;***

60. Non-financial information is essential for understanding the matters affecting the company's past financial performance and in supporting investors' assessments of its prospects, including over the long-term. For example, non-financial information provides insight into the progress in implementing the company's strategy and the potential performance implications of the strategy.

61. Other aspects which are also important include the extent to which management has focused on the material matters relating to the performance of the company, where linkages and proper explanations have been made throughout the annual report. It is also particularly helpful when it is clear how market context has determined strategy and business model, strategic progress is measured by relevant financial and non-financial KPIs, and KPIs are used to determine remuneration outcomes.

- ***The company's future strategy, opportunities and risk;***

62. Non-financial information relating to risks and opportunities is of most value when it is specific, so that the primary users understand why it is material to the entity. For example, this might include a description of the likelihood of the risk, an indication of the circumstances under which the risk might be most relevant to the entity and its possible impact. It is also more valuable when explanations of how the risks are managed or mitigated are included, as this enables users to assess the impact on the future prospects of the entity. Where relevant, the description of the risks and opportunities facing the entity should include linkage to and discussion of the entity's strategy and/or business model. It is also particularly helpful when disclosures show the relative likelihood and impact of each principal risk rather than an unquantified and unprioritized list of risks. It is also helpful to see how the risk profile has changed year on year, and any emerging risks, including when they could occur and the likely impact.

- ***The company's approach to societal issues such as modern slavery and the gender pay gap;***

63. We have understood this question to be referring to the existing requirements for certain companies to provide information, outside of the annual report, on gender pay gaps and modern slavery. As noted elsewhere, we have not focused on these reporting requirements as part of this report as they fall outside of the annual report. However, we would be happy to engage separately with DBT on these additional reporting requirements.

- ***Whether or not to invest in a company - please consider the types of non-financial information that is most and least useful, and how it compares to other factors or information in your response.***

64. The provision of relevant non-financial information is essential for investors' assessments of a company's prospects. The extent to which non-financial information supports judgements on whether to invest in a company will depend on the various factors discussed in response to questions 16 and 17 and to the points immediately above.

The following questions are aimed at <u>all</u> respondents

Question 19

What changes, if any, would you like the UK Government to make to the current legal requirements for companies to prepare non-financial information, and why? You may wish to consider: The merits and disadvantages of individual requirements; The level of difficulty in using or preparing certain types of non-financial information; Whether there are opportunities to rationalise or simplify reporting requirements.

65. In addition to our comments below, reference should be made to the Appendix, which sets out further detail on current reporting requirements, including recommendations on whether they might be rationalised, removed, or whether the required information would be better located outside of the annual report.

Clarifying the purpose of the annual report

66. We believe the purpose of the annual report is to provide material information about the reporting entity that is useful to existing and potential investors, creditors and other lenders in

making decisions relating to providing resources to the entity.[3] Information on how a company is progressing in implementing its strategy is a particularly good example of useful non-financial information which would meet this purpose.

67. There is an opportunity as part of this review to not only consider the purpose of the annual report but to also consider how the purpose of requiring non-financial information, as described in the UK legislative framework, might be better aligned with the objective of general-purpose financial reporting as described in the IFRS Accounting Standards Conceptual Framework for Financial Reporting and IFRS Sustainability Disclosure Standards.

68. Clarifying purpose will help frame DBT's review of existing non-financial reporting requirements, both in the short term and when considering longer term changes. It provides an organising principle which can be applied when making decisions on the need for and subsequent location of non-financial information. If the purpose of requiring certain non-financial information is not to provide material information to the primary users, but rather to meet a broader public policy objective, that information should be presented outside the annual report.

69. We recognise that there are certain investors or investment managers that require information from companies for the purpose of aggregating data on a large scale, for example, to present information about portfolios or investment products on a weighted average basis and potentially for screening out investments from certain portfolios. In our view, such data serves a different purpose from that set out above and generally would be better located outside the annual report.

70. It is important for government to also consider this separate need for the aggregation of data, particularly with regards to those investors, asset owners, banks and insurers that are currently required to provide Scope 3 carbon emission disclosures. There is a need to develop an appropriate mechanism to allow companies across the economy to disclose information on their emissions, outside of the annual report, and in such a way that the data can be collated and aggregated by those companies required to disclose Scope 3 emissions.

71. Examples of existing reporting requirements which are currently required within the annual report but could be presented elsewhere as they do not meet the needs of the primary users include:

SECR

- Detailed information on GHG emissions, energy consumption and energy efficiency currently required in the directors' report (or carbon and energy report for LLPs) ie, the SECR requirements. Some thought will be needed as to how the current SECR requirements will interrelate with the future integration of ISSB standards, particularly IFRS S2 *Climate-related Disclosures*. Companies within the scope of ISSB standards will be required to disclose details of emissions, which may be included within the annual report. While the information required in accordance with ISSB standards will be subject to materiality (whereas SECR has no materiality filter), there will be some overlap of their respective requirements.
- There are a number of issues at stake here. Firstly, we have highlighted passim issues around thresholds and scope of SECR which could usefully be addressed, particularly for groups of companies. Secondly, the extent to which SECR can be aligned with ISSB standards, which might allow companies within scope of ISSB standards to be exempt from certain SECR requirements, will need to be considered. Thirdly, it will be necessary to consider whether there is further information required, over and above that required in the ISSB standards, for example, to meet a wider public policy objective, and the location of that information. Finally, the disclosure requirements for companies not in scope of the ISSB standards and the location of such information (for example, whether an external database might be appropriate) will need to be addressed.

[3] This is consistent with the objective of general purpose financial reporting as set out in 1.2 of the IFRS Accounting Standards Conceptual Framework for Financial Reporting.

Directors' remuneration disclosures and report

- While information on directors' remuneration is very important to provide transparency, and serves a wider public interest point, the content of the directors' remuneration report could be rationalised significantly. It is our understanding that there are now some 43 separate provisions, with different measurement bases, and often several years of comparatives required. Each of these requirements aims to deal with a particular incident or concern, but each new requirement is not considered in the context of the whole, resulting in a long, complex component of the annual report that is expensive to prepare and difficult to understand.
- It may be that some 'standing information' such as disclosure around the components of pay and the purpose of pay could be located elsewhere. Other aspects could benefit from general rationalisation, for example, the percentage pay increase in each director's pay across 10 years and the relative importance of the pay chart. The various disclosures required in relation to pension funds would also benefit from being revisited to assess whether they are still relevant and the extent to which they could rationalised and located elsewhere. This would then enable DBT to consider what information would be of most interest to the users of the annual report and propose a more streamlined and useful set of disclosures.
- Another issue with the directors' remuneration report is that the basis on which it is prepared is not the same as the basis required for the financial statements. One option to explore might be whether the requirement to disclose information on directors' remuneration in the financial statements could be removed if a company is producing a statutory directors' remuneration report.

Other

- The requirement for medium-sized and large companies to disclose details of related undertakings in the annual report[4].
- For LLPs, the requirement to produce a list of all members of the LLP within the carbon and energy report.

Standing information

72. Having considered what information would be better located outside the annual report with reference to the annual report's primary purpose, we suggest DBT also explores options for the location of 'standing information', ie, information that while considered relevant for the primary users, need not be included in the annual report each year. This is often the case for information that does not change frequently. One approach might be for such information to be required in the annual report only if it has changed in the year, otherwise it could be located outside of the annual report, with appropriate cross references. This might be accompanied by a statement in the annual report, explaining that standing information has been checked and updated where necessary.
73. Any developments which would require cross referencing from the annual report, either in relation to standing information or other areas, would in itself require a broader review by DBT, considering whether the annual report remains coherent for investors, and whether reference is needed to other documents to provide a complete picture necessary for a true and fair view.

Encouraging reporting requirements outside of the annual report

74. It is important to make clear that we do not consider the presentation of information outside of the annual report to be intrinsically of less value or importance than information included within the annual report. The issue here is finding a way of matching the primary objective of requiring certain non-financial information with the intended audience. We strongly believe that introducing this organising principle to the legislative framework would improve both the

[4] CA 2006 s409 SI 2008/409 Schedule 2 and SI 2008/410 Schedule 4

quality and accessibility of non-financial information, both within and outside the annual report.

75. We also note that where non-financial information presented outside of the annual report is material to understanding the performance of the company, it would also be required to be included within the annual report in accordance with current requirements.

76. Accepting that certain non-financial information would be better located outside of the annual report also provides DBT with a platform to explore ways to improve the mechanism by which such information is presented. There is a real opportunity for innovative thinking in this respect. For example, consideration might be given to information being provided in an annual return-style document, perhaps filed at Companies House each year. Other options could be to include information on corporate websites, or a consolidated government reporting mechanism as used under the gender pay reporting regulations.

77. Another option might be to explore whether certain information could be published alongside, but separately from the annual report. For example, when DBT comes to consider how to incorporate reporting on net-zero transition plans into UK legislation, it may be that the detailed analysis of transition plans is reported outside of the annual report, with the annual report reserved for the material aspects of the plan and/or an update on the company's progress against the plan.

78. Technology must also be a consideration, and thought is needed on how the information reported will be used. For example, detailed information on emissions might usefully be included on an external database in such a way that enables easy access of the information by third parties. This would be particularly helpful for companies, for example, in the asset management, banking or insurance sectors, that need to collate information in relation to their investments and/or for companies seeking to report on information across their supply chains.

79. We are aware that there are various departments within UK government which may have an interest in requiring companies to provide non-financial information to meet a particular user need, as well as other regulators such as the FCA. We strongly encourage government to ensure a joined-up approach across departments and other regulators when it comes to developing regulation in relation to non-financial information, both for requirements relating to the annual report and for those that are required to be disclosed elsewhere.

80. Adopting a joined-up approach will be particularly important should DBT decide to explore new mechanisms for reporting outside the annual report. The situation whereby different mechanisms or approaches for capturing information outside of the annual report are developed by each individual department should be avoided. Similarly, it would be important to develop consistent and well understood criteria which can be applied across government to assess which mechanisms or approaches should be used to meet various objectives of reporting requirements.

81. Exploring new ways of reporting outside of the annual report would also require consideration of how such information is monitored, and its provision enforced to ensure compliance and quality of the reported information.

Objective of individual reports

82. Having clarified the overall purpose of the annual report, whether the directors' report and strategic report themselves have a specific objective needs to be considered. In our view, the objective of the directors' report could be helpfully clarified. Many of our recommendations focus on existing directors' report requirements that could be rationalised, removed or located outside of the annual report (for example as part of an annual return-type document filed at Companies House).

83. We suggest examining whether a clear objective can be established and determine what reporting requirements would still fall to be included in the directors' report. We also acknowledge that the directors' report is the only opportunity for small companies to provide non-financial information within their annual report, although it might be that alternative

options could be explored, for example, a directors' statement that provides an overview of the principal activities and performance in the year.

Eliminate duplication and overlapping requirements

84. Changes are required to eliminate unnecessary duplication and overlap of existing requirements across the different components of the annual report. For example:
    - Currently, there are requirements for certain companies to report on engagement with stakeholders in the directors' report, including the employee engagement statement and the statement of engagement with suppliers, customers and others[5]. This directly overlaps with the requirements of the s172 statement[6] within the strategic report for directors to explain how they have had regard to the interests of the company's employees, and the need to foster the company's business relationships with suppliers, customers and others. There are also separate requirements for quoted companies[7], as part as the general strategic report requirements and Non-Financial and Sustainability Information Statement. Though cross-referring is possible and explicitly provided for in some areas, this still results in confusion.
    - There is duplication of requirements between the contents of the Non-Financial and Sustainability Information statement and the strategic report, and other requirements elsewhere in the strategic report. These requirements encompass different but overlapping categories of company, which means that some companies are subject to both sets of requirements. Examples of where the requirements overlap include the provision of information on the company's business model, environmental matters, company employees, social matters and human rights matters.

Address reporting within groups

85. We strongly encourage DBT to review how non-financial reporting requirements are applied within groups. We are aware of several reporting requirements which result in unusual outcomes within group situations. While we encourage DBT to address the specific issues raised below, we also urge a more holistic review of non-financial reporting within groups of companies ie, to ensure that requirements are matched to the appropriate level of reporting within a group and to recognise, where possible, the reality that groups are generally managed as a whole rather than as single companies.
86. We are particularly aware of issues for intermediate UK holding companies that do not produce consolidated accounts (taking the s401 exemption). When the ultimate parent company is an overseas entity, and the top UK parent does not produce consolidated accounts, it is not then required to produce a group strategic report or directors' report. This becomes problematic as subsidiary undertakings can only take an exemption from certain non-financial reporting requirements when they are included within the group report of the parent company, for example the SECR within the directors' report, and climate-related financial disclosures in the strategic report. The result is that the non-financial reporting information is then required at an individual subsidiary level, rather than on a group basis by the parent company. Also, the information reported by the parent will be on its own activities, rather than across the group of which it is parent which, depending on the nature of the group, may provide minimal information of use.
87. A further complexity regarding the climate-related financial disclosures is that parent companies that do not prepare group accounts must nevertheless apply the scope criteria to the aggregated turnover and employee figures of the group headed by that parent, although the statement need relate only to the parent company and not its group. We understand that this aggregation process can be complex, particularly in the absence of any consolidated accounts.

[5] SI 2008/410 Sch 7, para 11 and 11B
[6] CA 2006 s414CZA
[7] CA 2006 s414C

88. An additional issue relates to thresholds based on meeting certain turnover and employee number criteria only. It is common for groups to be structured so that the employees are included within one subsidiary (ie, the service company), operating activities in another, and, sometimes, assets in another. We also note that in some cases, the employees within a group might be located in a service company which is not directly within the sub-group. This can be problematic for UK intermediate holding companies that have an overseas parent company as, although the parent company might be in scope of certain requirements such as climate-related financial disclosures, it is not required to produce a group report and need only report on its own activities, which might be minimal. The subsidiaries within the group may not be captured as turnover and employees do not fall into a single entity or a single UK group. In these situations, valuable information is not reported within the group.

89. DBT might give consideration to enabling or requiring the highest UK intermediate holding company within the group to be permitted or required to produce a group directors' report and strategic report even if they are not preparing consolidated accounts, as this would enable UK subsidiaries to take advantage of the exemption and enable more efficient reporting across groups.

90. As a more general point, consideration might also be given to the value of UK intermediate holding companies disclosing certain non-financial information, for example, the s172 statement and corporate governance reporting requirements, and whether exemptions might be appropriate in these situations.

91. We also note that there are some instances where thresholds are determined on an individual company basis, rather than on a group basis. For example, the requirement for certain large companies to produce a statement of corporate governance arrangements[8] within their directors' report is determined at an individual company level. This is inconsistent with almost all other thresholds which require consideration of the size of the group headed by the parent company. As a result of this, the resulting disclosures are not necessarily applied at the right level or at all. For example, it might be that an individual subsidiary meets the individual threshold and reports on its corporate governance arrangements, but the parent company does not meet the threshold and therefore does not report this information. We believe the threshold should be set on a group basis, with exemptions provided for subsidiaries included within a consolidated report by the parent company unless subject to a different governance structure.

Other entities

92. The non-financial reporting requirements set out in the Companies Act, other than the climate-related financial disclosures, do not apply to Limited Liability Partnerships (LLPs). The strategic report is founded on the directors' duty as set out in s172, which does not apply to LLPs. However, many environmental, social and governance matters are equally relevant to large LLPs and their stakeholders. It would be helpful if there was more joined up thinking when determining reporting requirements of companies and LLPs.

93. More generally, we note that reporting requirements as set out in company law are replicated for other entities. While this is often appropriate, it is important to note that some tailoring might be necessary in order to avoid creating onerous requirements that do not necessary provide useful information to the users of those entities' reports.

Rationalise company thresholds

94. We believe considerable rationalisation of the existing scope and thresholds associated with the directors' report and strategic report is needed. This is explored in more detail in response to questions 22-23.

Question 20

Thinking about the future of your organisation and the UK's transition to a net zero economy, what changes, if any, do you think may be required to the type of non-financial

[8] SI 2008/410 Sch 7, paragraph 26

information produced to guide decision making, and why? You may wish to consider whether additional information is required to support decision making (such as Transition Plans and Green Taxonomy disclosures covered by the recently published Error! Hyperlink reference not valid.).

95. ICAEW strongly supports efforts to encourage meaningful action towards a net-zero economy, including ongoing initiatives to support companies in planning for their transition towards a low carbon economy. Indeed, in our recent response to the Transition Plan Taskforce (TPT) Disclosure Framework and Implementation Guidance we encouraged TPT to focus its immediate efforts on finalising guidance on the preparation of a transition plan, which we believe will be of most use to companies at this stage and will drive improvements to disclosures.

96. Guidance to help companies prepare for their transition to a low carbon economy is a separate matter to any guidance or requirements on how companies report against that plan, for the purpose of providing useful information to users of the annual report. We are aware that TPT is also preparing guidance on disclosing a transition plan. However, it is not yet clear how this guidance might be referred to and/or integrated into regulatory requirements, such as the FCA Listing Rules, or future amendments to ISSB standards.

97. That said, we believe there are some general matters that need to be considered when DBT reviews whether and how the reporting on transition plans, for the purpose of providing useful information to users of the annual report, might be incorporated into the non-financial reporting framework. These are discussed in the following paragraphs.

Transition plans go beyond net zero

98. While the current focus is on companies preparing for transition to a low carbon economy, we believe this will evolve over time so that transition plans are also associated with how a company plans to achieve a wider range of sustainability ambitions, for example, in relation to addressing bio-diversity loss. The legislative framework should avoid introducing requirements which narrowly define transitions plans as relating to net zero targets so that a single integrated plan can cover all material issues. This will provide longevity to any specific reporting requirements. Detailed reporting guidance can then be developed outside of the legislative framework, allowing greater flexibility to respond to emerging issues and adapt to reflect best practice.

Interrelation with ISSB standards

99. DBT will also need to consider how any future UK legislation interacts with the ISSB's standards, which include requirements for companies to provide information on plans relating to the transition to a low carbon economy. If DBT intends to base future requirements on the framework and guidance being produced by the TPT, we suggest that TPT is encouraged to ensure that the final framework aligns with, but does not duplicate, ISSB requirements.

Detailed roadmap as a separate report

100. We support the inclusion of information on transition plans, particularly the reporting of progress against transition plans, to the extent that they provide material information to the primary users of the annual report. In our response to TPT's recent draft disclosure and implementation guidance, we also supported the production of a standalone transition plan, outside of the annual report, which could usefully set out a more detailed roadmap of long-term ambitions for ongoing reference.

101. If an entity chooses to make a net zero commitment in its annual report, this should be supported by reference to a transition plan, proportionate to the size and complexity of their business and the action needed to meet net zero targets. This is an example of the potential value of permitting cross-referencing from the annual report to information that is reported elsewhere to meet a wider public policy purpose.

International companies

102. If any regulatory requirements relating to transition plans are introduced, care will be needed to ensure that this does not require only UK-based information. That is, we would question the value of a UK domiciled company operating across multiple jurisdictions being required to disclose UK-only information on transition plans. If there is specific UK information that is required to meet a wider public policy goal, there should be consideration of how this information can be presented outside of the annual report.

Liability and safe harbour

103. There continues to be significant uncertainty for companies when setting targets for transition plans, and the measurement of progress against those targets. DBT might want to consider how to best encourage companies to disclose information, including commitments to sustainability targets such as net zero, while addressing concerns relating to potential liability claims arising in relation to those commitments.

Question 21

How should the standards being prepared by the International Sustainability Standards board (ISSB) be incorporated into the UK's non-financial reporting framework? You may wish to consider:

- ***The role that reporting against any of these standards could have in simplifying the UK's legal framework;***
- ***The role that reporting against any of these standards could have in guiding the transition to a net zero economy;***
- ***The Exposure Drafts for IFRS S1 General Sustainability-related Disclosures and IFRS S2 Climate-related Disclosures first two standards issued by the ISSB.***

104. We note that the Financial Reporting Council has issued the UK Sustainability Disclosure Technical Advisory Committee's call for evidence to seek UK views on IFRS S1 *General Sustainability-related Disclosures* and IFRS S2 *Climate-related Disclosures.* It is our intention to respond to the FRC's call for evidence and for this reason we reserve some of our more detailed comments for that separate consultation. That said, we do have some general comments about how to incorporate the ISSB's standards into UK legislation. These are set out in the following paragraphs.

Mechanism for introducing standards

105. In the first instance, we do not believe it is helpful to include the full text of the two standards into the legislative framework. Doing so risks making the legislation unwieldy and could result in complications in the long run. For example, if changes are made to the ISSB standards then the underlying legislation would also need to be updated for every change, subject to UK endorsement. Unless the legislation can be updated in a timely way, the legislative requirements could very easily become out of sync with the ISSB's standards and compromise attempts to achieve a global baseline in sustainability reporting.
106. In terms of location, information reported under the ISSB's standards would naturally fit within the strategic report, although consideration would be needed on how to avoid duplication with existing requirements, as discussed below.

Transition

107. It would be helpful for DBT to encourage voluntary adoption of the ISSB's standards by in-scope UK companies. This will create a period of transition and learning for companies prior to mandatory adoption. We also stress the importance of companies being given sufficient lead time to prepare for first time adoption, and that, depending on decisions related to scope, a phased approach is considered.

Integration with existing requirements

108. The extent to which existing UK reporting requirements need to amended will be very dependent on the scope of company that is ultimately required to apply the ISSB standards in the UK, as well as separate considerations about how best to streamline company thresholds more broadly (as discussed in response to question 22). Nevertheless, in our view, the best approach would be to have one source of sustainability disclosure requirements ie, UK-adopted ISSB standards. Decisions would then need to be made as to the scope of companies required to report under those standards. The legislation for companies not required to apply the standards should be aligned to the ISSB baseline, subject to proportionality, unless there are strong reasons to deviate from the ISSB's requirements.

Companies outside the scope of ISSB standards

109. In the longer term, we recommend that DBT discusses with the ISSB the possibility of an 'ISSB for SMEs' type framework being developed in the UK, perhaps by ARGA. Alternatively, it might seek to encourage any efforts for the development of a global set of ISSB standards for SMEs.
110. Developing a simplified framework would enable reporting requirements for companies not in-scope of the full ISSB standards to remain proportionate and updated to reflect changes in reporting best practice.

Interoperability

111. It is also important to recognise other sustainability reporting developments, in particular, the EU Corporate Sustainability Reporting Directive (CSRD), which has extra-territorial implications. DBT might consider how best it can work to gain acceptance for 'equivalent' standards of non-financial reporting, at least by companies incorporated outside the EU which are subject to the CSRD. This might best be achieved by contributing to international efforts to establish ISSB standards as a global baseline. Otherwise, there is a risk that multinational companies are required to comply with one set of standards (ie, ISSB standards) for non-EU reporting and European Sustainability Reporting Standards (ESRS) for EU reporting.

Question 22

To what extent do you agree or disagree that current size and company type thresholds for non-financial reporting information could benefit from simplification?

☒ Strongly agree
☐ Agree
☐ Neither agree nor disagree
☐ Disagree
☐ Strongly disagree
☐ Don't know

Question 22(a)

Please explain your answer. You may wish to consider:

- ***The different scope requirements and the ease or difficulty of following these;***
- ***Whether there are any size and/or type thresholds that are particularly well targeted, or by contrast, inappropriate or no longer fit for purpose;***
- ***Application of exemptions and ease of use;***
  How thresholds interact with requirements set by other regulators (for example the Financial Conduct Authority and Prudential Regulation Authority).

112. We strongly agree that the existing company size and company type thresholds for non-financial reporting information should be simplified. The number of different thresholds has

increased steadily over time, and this has become an extremely complicated aspect of the non-financial reporting framework to navigate. To demonstrate this, in the Appendix to this response we set out the various thresholds that are relevant for the purpose of preparing the directors' report and strategic report. Confusingly, some companies fall into multiple different categories. There are also a variety of different ways to determine when a company falls into a particular threshold, for example, some depend on meeting certain criteria during the year whereas others are calculated on a 2 (or more)-year rolling basis. Some thresholds depend on meeting size criteria only, for example SECR, whereas others take into account ineligibility for small and medium-sized regimes. There are also differences around how to determine thresholds for groups.

113. We have set out some general comments below on key areas where simplifications and improvements are needed. We assume that DBT will be considering this further with a view to proposing revisions to the existing thresholds for non-financial reporting and company size thresholds as discussed in question 23. As well as taking account of the practical challenges outlined in our responses below, we urge DBT to consider the broader picture when revising thresholds. In particular, consideration should be given to the purpose of the annual report, and how the information needs of the primary users of those accounts might differ according to the size and nature of the entity. There should be a clear rationale behind how thresholds have been determined, and this should then be joined up with decisions on information requirements for companies falling into the various categories.

114. ICAEW would be happy to provide further input to assist the development of proposed revised thresholds.

Large companies and public-interest entities

115. A particular area of confusion relates to the different types of 'very large' and 'public-interest' companies that have emerged in recent years. The Appendix to this response sets out the various different thresholds that we have identified as being relevant for the directors' report and strategic report. There is a confusing array of thresholds, with various distinctions based on the nature of a company, for example, quoted, traded companies (of which there are two definitions[9]) and public interest entities. Not only does this create confusion, but we have heard anecdotally of some companies 'over-reporting' to avoid the risk of inadvertently not complying with reporting requirements.

116. There is now an urgent need for DBT to considerably streamline these thresholds. In our opinion, there should ideally be one single category to encompass what might be referred to as 'very large' and/or 'public-interest entities'. This could reduce significantly some of the existing complexity within the non-financial reporting framework.

UK and non-UK employees

117. We also note that certain thresholds are based on employees located in the UK-only ie, the directors' report requirement to provide an employee engagement statement[10] and disclosures on the employment of disabled persons[11]. In our opinion, thresholds should include worldwide employees of the company, or group. The exception to this would be where the nature of the required non-financial information is such that worldwide employees are clearly not appropriate or relevant. In this instance we suggest that the purpose of such information might be intended to meet a wider UK public policy objective and might, therefore, be better presented outside of the annual report.

Location of threshold requirements

118. Currently, many of the existing thresholds relevant to non-financial reporting appear alongside the individual reporting requirements within the legislation. Some thresholds are self-contained whereas others require reference back to the company size thresholds set out in the Companies Act. We strongly encourage DBT to bring all the size criteria and threshold

[9] CA2015 s360C and s474
[10] SI 2008/410 Sch 7, para 11A
[11] SI 2008/409 Sch 5, para 5 & SI 2008/410 Sch 7, para 10

requirements together into one location to allow preparers to see clearly into which category(ies) they fall. This section could create a set of clearly named size thresholds which could then be referred to from elsewhere in the legislation, as required. Furthermore, if new reporting requirements are added in the future, they can then simply refer back to these clearly defined thresholds without the need to add in scoping requirements throughout the legislative framework.

Other

119. We have some further comments regarding thresholds based on size, for example, in relation to the definition of turnover and employee numbers. Please see question 24 for further details. Furthermore, we have highlighted some issues relating to the determination of scope and thresholds within groups in response to question 19.

Question 23

The Companies Act 2006 sets out size categories for UK companies that determine the type of accounts that need to be prepared and filed with Companies House. Do these size thresholds remain appropriate?

☐ Yes
☒ No
☐ Don't know

Question 23(a)

Please explain your answer and what, if any, changes you would like to see.

120. It is necessary to review the size categories used to determine the type of accounts that need to be prepared and filed with Companies House. It has been some time since these size categories have been reviewed and it would be helpful to consider whether changes are needed in light of developments in business practice and corporate reporting more broadly.
121. As a longer-term project, DBT might also consider whether there are alternative ways to determine company thresholds, for example, a system whereby shareholders external to management and long-term creditors are able to vote on the category within which a should company fall. However, we would not expect such longer-term thinking to replace the need to consider the existing size categories and thresholds in the shorter term.
122. As noted above, ICAEW stands ready to assist DBT in any efforts to establish the detail of any revised thresholds in preparation for future public consultation. In the meantime, we have set out some broader comments below.

Size categories and other thresholds

123. DBT should, with the exception of the micro-entities' regime, consider increasing the existing company size reporting thresholds. The level to which these size thresholds should be increased will require further evidence-gathering by DBT, with any subsequent proposals subject to public consultation. This would require, amongst other things, consideration of the impact of inflation and other changes in circumstances, as well as the cost-benefit of a change in thresholds.
124. We have set out below an example of how we would envisage an improved set of streamlined size categories and thresholds, covering both the preparation and filing of accounts and non-financial reporting requirements:
    - Micro-entities (maintained at current level).
    - Small companies (potentially with a higher size threshold and incorporating the existing medium-sized category).
    - Large companies (potentially with a higher size threshold).
    - 'Public-interest entities' and/or 'very large companies' (as discussed in question 22).

125. In our view, adopting the above model could significantly streamline and improve the understandability of the overall reporting framework. As discussed under question 22, we would also recommend consistency in the way companies transition between thresholds, and with regards to group reporting.

Review definitions

126. As part of the review of the existing size categories, we suggest DBT also revisits the existing definitions of ‘turnover’ and ‘employee numbers’ that are used for the purpose of determining the size of companies.

127. The definition of ‘employee’ needs to be reconsidered to capture the entire workforce, rather than just the employees of the company. For example, it is becoming increasingly important to explore ways for reporting to extend to contractors and self-employed workers and employees of sister service companies ‘lent’ to an operating company where the holding company of both is outside the UK. We recognise that this is an area that has the potential to be complex and that any revisions to the definition would need to be sufficiently straightforward to understand and apply.

128. The definition of ‘turnover’ is also problematic for the purposes of categorising companies by size in sectors such as banking and insurance. This has been an issue for a number of years (see above for issues relating to groups with service companies, and thresholds based turnover and employee numbers) and is something that could be usefully reviewed as part of any plans to revise the existing size categories. We see that an attempt to address this has been made in the recent draft *The Companies (Strategic Report and Directors’ Report) (Amendment) Regulations 2023*. We are surprised to see that a ‘net’ approach to measuring turnover has been used there as this may allow international insurers, particularly, to in effect, opt out of the new regulations by reinsuring within the group.

129. Other areas where DBT might consider providing guidance include:

- How the aggregation process works when calculating thresholds, as this is not the same as a consolidation, ie, the treatment of subsidiary undertakings joining or leaving the group during the year, non-conterminous year ends, and non-12-month periods of subsidiaries. It would also be helpful to provide guidance on the GAAPs to be applied, connected to financial statement definitions as necessary.
- The definition of ‘balance sheet total’, which we understand often is often misinterpreted in practice.

130. We encourage DBT to work towards the adoption of standardised explanations and definitions of terms used in calculating size, for example with regards to the number of employees and how turnover is calculated, when calculations are carried out, and how these apply across groups. This would simplify matters and lead to greater consistency. This process would need to be managed carefully to avoid the risk that the definitions are extended to meet diverse wishes of regulators or other stakeholders.

Question 24

Do you have any other comments that might aid the consultation process as a whole? Please use this space for any general comments that you may have, comments on the layout of this call for evidence would also be welcomed.

131. We welcome the ambition of this consultation exercise to gather evidence from stakeholders on reporting requirements more generally so they can be considered in a holistic way. This approach is particularly important given that similar sorts of issue can arise in other contexts. For example, we are aware of significant concerns in the charity and pensions sectors, including where reports are of doubtful use to the supposed audience; a plethora of size thresholds results in complexity, with resultant risk of error; and overlapping requirements lead to duplication of effort. DBT could usefully extend this exercise to those sectors.

132. Indeed, it may be that similar issues arise throughout the UK’s regulatory regime. Over the longer term, we would encourage DBT to continue with and broaden this initiative, as it could lead to a substantial improvement to the UK’s overall regulatory regime. This would of course

take time and require further consultation and discussion with a variety of stakeholders. We would be happy to engage in relevant consultations as part of our Better Regulation work, designed to help improve the UK's regulatory regime.

133. We do not propose commenting extensively here but have the following general observations for consideration in relation to possible future initiatives on this topic.

Better regulation – the regulatory framework

134. We believe that the Principles of Good Regulation should be applied effectively throughout the regulatory regime. For the purpose of this call for evidence, we have identified specific areas where improvements could be made to the UK non-financial reporting legislative framework, for example, improving consistency and understandability, and to ensure purpose-led legislative reporting requirements.

135. In general, we support a regulatory approach in which legislation sets out the principal rules, and the power to make more detailed rules (if required for implementation) are conferred on relevant regulators. However, this approach makes it especially important that regulators adhere to the Principles of Good Regulation (and the Regulators' Code) and that they are held to account for doing so (by Parliament, which is the ultimate responsible body).

136. The impact of proposed and ongoing regulation needs to be assessed in an objective way, based on evidence, so that new regulation is made only when necessary and that regulation that is not meeting its objectives or is disproportionately burdensome can be removed or amended, or the objectives changed if necessary.

Practical matters

137. It might be helpful to develop a guiding principle to help government and regulators assess when requirements would apply to all legal forms of business (eg companies, LLPs, partnerships) or only some.

138. The question of where information required for regulatory purposes is to be kept or disclosed is an important one. In general, any information should only be required to be disclosed once. If it is publicly available, then all regulators will have access to it and should avoid seeking materially the same information without a very good reason. As we have said elsewhere in this response (and in other contexts), there are specific circumstances when information should be included within the annual report and we would like to see government develop a consistent approach to alternatives. Timing is also an important practical consideration ie, those imposing regulatory requirements should be mindful of other relevant requirements and the practical pressures that might result (including possible work overload at a given time of the year, for example at year ends).

APPENDIX: DIRECTORS' REPORT AND STRATEGIC REPORT – SCOPE AND CONTENT

We outline below the main categories of company that we have identified as being relevant for the purpose of preparing a directors' report and strategic report, cross referring to the various disclosure elements. These tables are primarily included here to highlight the complexity in scope and thresholds that has arisen for each report rather than as a detailed and exhaustive guide to the underlying legislation. Instead, we refer to the ICAEW Corporate Reporting Faculty's factsheet *Strategic Report and Directors' Report* from which these tables are drawn and which outlines further details of the qualifying criteria and thresholds associated with each category. We also note that the names of the different categories of company included in the tables below are not all defined terms in legislation but are rather our own descriptions of a particular scoping requirement. We also note that references to the specific underlying legislative requirements relevant to each category and associated reporting requirement are included within our factsheet, which we would be happy to provide to DBT.

Directors' Report

Table 1: Overview of content requirements for the directors' report

	All companies [12]	Not a wholly owned subsidiary of a UK company	Company not entitled to the SCR	Company not entitled to the SCE	Limited company that is not entitled to the SCR	Publicly traded company with securities carrying voting rights	Public company	Company > 250 UK employees in the year	Company > 250 employees on 2-year rolling basis	Large company based on size	Very large company	Unquoted large company based on size and >40,000 kWh	Quoted company and > 40,000 kWh
Directors' names, qualifying indemnity provisions & audit	✓												
Political donations		✓											
Financial instrument risks, post-balance sheet events, likely future developments and R&D activities			✓										
Dividends				✓									
Overseas branches					✓								
Share capital & securities						✓							

[12] This category does not include micro-entities as such entities are not required to produce a directors' report.

	All companies [12]	Not a wholly owned subsidiary of a UK company	Company not entitled to the SCR	Company not entitled to the SCE	Limited company that is not entitled to the SCR	Publicly traded company with securities carrying voting rights	Public company	Company > 250 UK employees in the year	Company > 250 employees on 2-year rolling basis	Large company based on size	Very large company	Unquoted large company based on size and >40,000 kWh	Quoted company and > 40,000 kWh
Acquisition of own shares							✓						
Employment of disabled persons								✓					
Employee engagement statement									✓				
Statement of engagement with suppliers, customers & others										✓			
Corporate governance											✓		
GHG emissions, energy consumption & energy efficiency –												✓	
GHG emissions, energy consumption & energy efficiency –													✓

Key: SCR – Small companies regime; SCE – Small companies exemption

S – Relevant to companies applying the small companies regulations.; ML – Relevant to companies applying the medium-sized and large companies regulation

We recommend that DBT reviews the various disclosure requirements set out above and considers the removal of requirements which duplicate information provided elsewhere. In particular, this would be relevant for the requirements relating to financial instrument risk, post-balance sheet events, the employee engagement statement, and the statement of engagement with suppliers, customers and others, all of which either directly overlap with requirements in the strategic report or would be expected in the strategic report if material.

We also suggest that DBT considers the purpose of the various information requirements and assesses whether there is still a need for that particular information, and if so, whether the annual report is the right location. It may be that some information could be moved to the company's website or an external database. We suggest that information on the employment of disabled persons would fall into this category as we consider it information that is likely to serve a wider public policy objective that could be located outside of the annual report.

Other information, for example, details of corporate governance arrangements might be better suited to the strategic report, alongside over disclosures relating to governance. Similarly, consideration could also be given to the location of the additional information that will be required once the draft *The*

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Companies (Strategic Report and Directors' Report) (Amendment) Regulations 2023, are finalised (eg, Audit and Assurance Policy Statement, Resilience Statement, and disclosures on distributions).

As discussed in response to question 19, we also believe that detailed information on emissions is better suited outside of the annual report, to the extent that it is not material to the primary users. However, we appreciate that there is some complexity here. We have set out some matters to consider on this point in response to question 19 and would be happy to engage with DBT on this matter further if that would be helpful.

Strategic Report

Table 2: Different categories of company relevant for the strategic report

	All companies[13]	Large company	Quoted company	Public interest entities (PIEs) with > 500 employees[14]	AIM companies and high turnover companies[15] with > 500 employees
Fair review of the business including principal risks and uncertainties	✓				
Key performance indicators – financial	✓				
Reference to and explanations of amounts included in the annual accounts	✓				
Key performance indicators – non-financial		✓			
Section 172(1) statement		✓			
Information on trends, company strategy and business model.			✓		
Gender split			✓		
Information on environmental matters, the company's employees, and social, community and human rights issues			✓		

[13] This category does not include companies within the small companies exemption (including micro-entities) as such companies are not required to produce a strategic report.
[14] UK companies that have either transferable securities admitted to trading on a UK regulated market or are banking companies or insurance companies.
[15] Companies or groups with turnover of > £500m.

	All companies[13]	Large company	Quoted company	Public interest entities (PIEs) with > 500 employees[14]	AIM companies and high turnover companies[15] with > 500 employees
Non-financial information statement[16] – information on environmental matters, the company's employees, social matters, respect for human rights and anti-corruption & anti-bribery matters				✓	
Non-financial and sustainability information statement – additional climate-related disclosures[17]				✓	✓

As discussed in our response to question 19, there is an overlap in the information required in order to meet the reporting requirements relating to:

- Information on trends, company strategy and business model.
- Information on environmental matters, the company's employees, and social, community and human rights issues.
- Non-financial information statement – information on environmental matters, the company's employees, social matters, respect for human rights and anti-corruption & anti-bribery matters.
- Non-financial and sustainability information statement – additional climate-related disclosures.

The scoping for each of these various overlapping disclosure requirements all vary, which also confuses matters. Therefore, any efforts to eliminate duplication of reporting requirements within the strategic report will need to take into account the attached scoping requirements and any ongoing plans to streamline company thresholds more broadly.

We also note that for listed companies, there is also some overlap between the requirements of the strategic report, the requirements of the FCA's Listing Rules and Disclosure Guidance and Transparency Rules, which might also need to be considered when considering the extent to which the reporting requirements might be streamlined.

[16] The existing non-financial information statement was expanded to include additional climate-related disclosures and renamed the non-financial and sustainability information statement for financial years starting on or after 6 April 2022.
[17] These requirements are in addition to those in column D for PIEs and apply for financial years starting on or after 6 April 2022.