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15 April 2016

Dear Mr Jackson,

The Non-Financial Reporting Directive – A call for views on effective reporting alongside proposals to implement EU requirements

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of EuropeanIssuers, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Corporate Governance and Financial Reporting Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Groups is at Appendix A.

Response

We welcome the opportunity to respond to the Department for Business, Innovation and Skills' consultation on implementing the EU requirements for the Non-Financial Reporting Directive (EU NFR).

We welcome BIS's pragmatic and proportionate commitment to having the best structure for narrative reporting while reducing unnecessary regulations and burdens and not wanting to make unwarranted changes. It is important to highlight that the EU NFR applies to large undertakings that are public interest entities (PIEs) that have an average of 500 employees. Almost our entire constituency, small and mid-size quoted companies, falls outside that definition. Our responses to the questions below reflect the views of our members regarding the issues most likely to affect them, and therefore mostly relate to the issues that fall outside the Government's transposition of the Directive. As a general comment, we firmly believe that the current UK regime should remain in place for companies which are outside of the scope of the Directive. The UK regime is a system which was developed recently following lengthy consultation and engagement and is currently proving its worth.

Responses to specific questions

Q1 Flexibility on where to provide the non-financial statement: What is your view on permitting companies flexibility to place information where they feel most appropriate within the boundaries laid out in the EU NFR Directive? Please explain your reasons.

We agree that there should be flexibility for companies to place information where they feel most appropriate. We believe that regulation should, insofar as possible, allow flexibility with regard to where the information should be placed rather than being prescriptive.

We believe that it can be useful for companies to have the option to disclose non-financial information in a separate report, possibly as a wholly electronic report. It may be more efficient and cost-saving for companies to make non-financial information publicly available on their website. We note that AIM Rule 26 could present a framework regarding how this could be delivered in practice; it stipulates specific information that must be available, free of charge, on a website from the moment of admission. However, we believe that no requirement should be mandatory: provided the company makes the disclosure, the company should be able to determine the manner in which the information is best presented.

If any provision allowing companies to make non-financial information publicly available on their website were extended to small and mid-size quoted companies, this should be on a voluntary basis. It should be ensured that any guidelines/regulation in this regard does not mandate a standardised website template or navigation tools for companies to adopt, but only defines what content should be included in an easily understandable, accessible and searchable way.

Q2 Information that could be placed in a Separate Report: We would welcome suggestions for information, currently required by law that could be placed in the separate report.

We believe that three examples of information currently required by law which could be placed in a separate report are the quantitative information on employee gender diversity (currently required to be disclosed in the strategic report), certain disclosures regarding employment policies in its directors' report for companies with more than 250 UK-based employees as well as information in respect of greenhouse gas emissions (both currently to be included in the directors' report).

In addition, we believe that other examples of information which could be transferred to the separate report are the details of directors (s416 of the Companies Act 2006), indemnity provisions (s418 of the Companies Act 2006), information regarding financial instruments (paragraph 6 of Schedule 7 of SI 2008/410), indications of research and development activities (paragraph 7 (c) of Schedule 7 of SI 2008/410), the existence of branches outside the United Kingdom (paragraph 7 (d) of Schedule 7 of SI 2008/410), and disclosures concerning the details of individuals who hold securities carrying special rights with regard to control of the company and the structure of the company's capital (paragraph 13 of Schedule 7 of SI 2008/410).

We consider that there is merit in locating all of these disclosures in a separate report, as each, whilst being a useful and important reference, does not represent key information on business strategy and performance. Notwithstanding, we would like to highlight that the abovementioned requirements have different scopes to the EU NFR requirements and (in the case of the employee policy disclosures, a different scope to the other suggested disclosures). Therefore, we suggest that harmonisation of the scope of all of these disclosures would be useful to simplify the rules and improve the quality of the disclosures.

Q3 Advantages and Disadvantages of a separate non-financial statement: What do you see as the advantages and disadvantages, for your organisation of the separate statement?

As said above in our response to Q1, we believe that it can be useful for companies to have the option to disclose non-financial information in a separate report, possibly as a wholly electronic report.

At the same time, we recognise that difficulties may arise by allowing companies to present the information in a separate report. There is a risk that the non-financial statement becomes a compliance driven, stand-alone document (in a format more akin to the US form 10-K), which does not provide useful information to investors. It can also lead to the concept of materiality being applied differently in the non-financial statement and the management report.

Currently, the FRC's Guidance on the Strategic Report tries to encourage companies to apply the Strategic Report requirements in such a way that the linkages and interdependencies between the financial and non-financial aspects of the entity's business can be highlighted and explained. This can be more difficult to achieve if the financial and non-financial reports are separate.

At the same time, allowing the option of a separate report can help to ensure that the annual report and accounts does not get cluttered with in-depth or immaterial disclosures that may result from the reporting required by the Directive. It can also allow companies that aspire to best practice to direct more resource to the separate report's preparation, as the production of the Annual Report is already very time-consuming due to the volume of information required to be there.

Q4 Advantages and disadvantages of the Implementation Options: What do you see as the advantages and disadvantages of the various implementation options?

We believe that the UK Government should not seek to goldplate the EU NFR Directive and should only apply the requirements to those entities which fall within the ambit of the Directive. This will still enable companies to voluntarily disclose the information as they see fit, having taken into account the views of shareholders and the interests of the business.

In this regard, we would support the implementation of Option 2 (reduce the scope of the existing UK reporting requirements relating to Non-financial reporting for all quoted companies and limit it to those required by the EU NFR Directive (i.e. generally moving from quoted companies to large PIEs only)). We support the alteration of the scope and nature of the requirements that currently apply to all quoted companies so that they are consistent with the scope and requirements of the EU NFR Directive. This would mean that some quoted companies covered by the currently applicable similar requirements would be removed from the scope of application of the revised EU NFR requirements.

By implementing this option, BIS would be taking the opportunity to simplify the reporting regime and what is currently a complex set of requirements for small and mid-size quoted companies.

Furthermore, we note that there are significant similarities between the existing UK reporting framework and the EU NFR Directive. By choosing for Option 1 (to update the existing UK reporting framework to reflect the new disclosure the Directive for large PIEs that introduces requirements), we believe that BIS could be increasing the risk of adding unnecessary complexity and confusion, for both preparers and users of the reports.

Q5 Preferred option relating to scope: Considering the possible advantages and disadvantages provided by the flexibilities contained within the EU NFR Directive, which would be your preferred options in terms of which companies should be required to disclose non-financial information?

As mentioned above in Q4, we consider that it would be more advantageous for our members, small and mid-size quoted companies, to implement Option 2, reducing the scope of the existing UK reporting requirements for all quoted companies and limiting it to those by the EU NFR Directive. From the point of view of our members, we would see no advantage in complicating the scope of narrative reporting requirements further, which would be the result of the implementation of Option 1.

It is important to highlight that the implementation of Option 2, although it would reduce the scope of application, would not prevent that all companies would still be required to provide information of this nature in their strategic report to the extent that it relates to a principal risk.

Q6 Alternative Options: Are there any other options for implementing the EU NFR Directive the Government should consider?

We believe that the Government should not consider alternative options for implementing the EU NFR Directive. It should implement Option 2 (reduce the scope of the existing UK reporting requirements relating to Non-financial reporting for all quoted companies and limit it to those required by the EU NFR Directive (i.e. generally moving from quoted companies to large PIEs only)), so that the scope and nature of UK reporting requirements are consistent with those of the EU NFR Directive.

Q7 Assurance of Non-Financial Information: Should the Government require that the non-financial statement be verified by an independent assurance service provider?

From the point of view of our members, small and mid-size quoted companies, we believe that these companies should not be required to have their non-financial statement verified by an independent assurance services provider. We agree with the Government's acknowledgement that obtaining independent verification on non-financial information incurs additional costs for companies, and providing information on the type and level of assurance obtained would add excessively time-consuming burdens, both in terms of money and time, to compiling the annual report for small and mid-size quoted companies.

Furthermore, we believe that non-financial information provided by directors should be trusted; they already have liability if they publish untrue information and this should be a sufficient deterrent.

Q8 Advantages and Disadvantages of third-party validation: What do you see as the advantages and disadvantages of requesting third party assurance?

Although we accept that there may be perceived benefits in companies obtaining an independent verification of non-financial information, we believe that a clear disadvantage to requesting third party assurance would be the additional financial and time burden placed on businesses, particularly in the case of small and mid-size quoted companies.

Q9 Other Options: Are there any other options the Government should consider for Third Party Verification?

We do not agree with an obligation to obtain third party verification. Please see our responses to Q7 and Q8 above.

Q10 Advantages and Disadvantages: What do you see as the advantages and disadvantages of preparing or receiving the non-financial statement electronically via a company’s website?

We believe that electronic publication of the non-financial report should be permitted as the default method of distribution.

Allowing the use of a wide range of technologies and formats (not restricted to the use of PDF, for example) would have the advantage to allow companies to be innovative in their approach to the requirements. This would also have the advantage of making the legislation “future-proof”, i.e. not preventing the use of upcoming new technologies and formats.

Q11 Additional Protections: Considering your response to Q7, are there any additional protections that the government should consider?

Directors could benefit from the same level of “safe harbour” protections under s463 of the Companies Act 2006 (applicable to the strategic report, directors’ report and directors’ remuneration report) in respect of the non-financial report.

Q12 Number of Companies Providing an Electronic Report: We are interested in the number of companies that currently send their annual report electronically. Considering your shareholders, how many, as a percentage, opt to receive their annual report as a printed copy?

29% of our members – small and mid-size quoted companies – currently send their annual report electronically. Some of our members estimated that approximately 30% of their shareholders opt to receive their annual report as a printed copy.

Q13 Definition of Senior Manager: BIS would welcome suggestions as to how this definition may be improved to reflect better the intention of this requirement.

We note that one of the major problems with the current definition of a “senior manager” is the inclusion of all directors of all subsidiary companies. This can cause the analysis to be particularly misleading. Therefore, in order to provide companies with a simple and consistent framework, we would recommend using a definition for manager that already exists in the company law or accounting standards.

We suggest that the definition of ‘persons discharging managerial responsibility’ (as already defined in section 96B of the Financial Services and Markets Act 2000 and the FCA Handbook) may be more appropriate. Alternatively, the definition contained in IFRS 8 – Operating Segments or the definition of key management personnel set out in IAS 24 (and FRS 102) could also be used.

Q14 Other Comments on this requirement: BIS would also welcome other comments on this regulation including views on the approach suggested.

As noted in our response to Q2, in our view, the scope of the quantitative gender diversity disclosure requirements should be consistent with the EU NFR Directive’s requirements.

Q15 Reporting Regulations: What other reporting regulations would you suggest that could be repealed?

We agree with the proposed reporting regulations to be repealed which are identified in the consultation document. We believe the following disclosures could be repealed:

- Paragraph 6 (1) of Schedule 7 of SI 2008/410: the requirement in relation to financial instruments that the directors' report must include indications of financial risk management and exposure to price, liquidity and cash flow risks unnecessarily duplicates reporting requirements under IFRS;
- Paragraph 7(1)(a) of Schedule 7 of SI 2008/410: the requirement to disclose post balance sheet events in the directors' report unnecessarily duplicates accounting standards requirements;
- Paragraph 7 (c) of Schedule 7 of SI 2008/410: the requirement to disclose indications of research and development activities adds little value to the content of the strategic report;
- Paragraph 7 (d) of Schedule 7 of SI 2008/410: the requirement to disclose the existence of branches outside the United Kingdom adds little value to the content of the strategic report; and
- Parts 3 and 4 of Schedule 7 of SI 2008/410: the requirement for a company employing more than 250 UK-based employees to provide certain disclosures regarding employment policies in its directors' report is similar to the strategic report that applies to quoted companies.

Furthermore, we believe the following disclosures could be amended:

- Paragraph 7(1)(b) of Schedule 7 of SI 2008/410: the requirement to indicate likely future developments in the business should only be required within the strategic report, not the directors' report. We note that this could represent an opportunity to renew the content of SI 2008/410 so that it corresponds better with the new strategic report regime;
- Paragraph 7(1)(c) of Schedule 7 of SI 2008/410: the requirement of the indication activities in the field of research and development should only be included within the strategic report, not the directors' report; and
- Section 409 of the Companies Act 2016: the requirement for a company to list all subsidiaries in the notes to the financial statements could be overly burdensome for companies with a large number of subsidiaries as, from 1 January 2016, companies have been required to disclose addresses of those subsidiaries' registered offices. We believe that the Government should re-instate the concession formerly included in s410 to allow companies to identify only principal subsidiaries in the annual report and to publish a full list separately. Furthermore, this would seem to overlap (at least in relation to UK subsidiaries) with information already publicly available from Companies House. It should also be noted that the PSC Register regime will further enhance the level of information available regarding corporate structures.

Finally, as an overarching comment, we believe that the Government should undertake a review of the disclosures required of quoted companies under Schedule 8 of SI 2008/410 (Directors' Remuneration Report), which are, in our view, are unnecessarily complex and lengthy.

Q16 Other Information: Is there any information that could be moved outside the Annual Report?

We believe that information in the annual report should only consist of that which is either specifically relevant to the period(s) covered by the financial statements and/or represent an exception. Thus, the corporate governance report, greenhouse gas emissions and gender diversity, could, for example, be moved outside of the annual report.

Q17 Analysis of the Costs and Benefits of implementing the NFR Directive: Type of Organisation

Q17a Are you a company (not a PIE), a company which is a PIE (as described in para 2.6), an NGO, institutional investor or other type of organisation? If you are a PIE please specify whether you are a parent company or a subsidiary company. When considering your answers, we would very much appreciate information on any costs you will incur as a result of the proposals for implementing the EU NFR Directive, both in terms of money and time (e.g. describe which type of staff will be involved, for how long). We would appreciate any information on new systems or practices your organisation may adopt, or existing processes that may change, because of the Directive.

The Quoted Companies Alliance represents small and mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

We asked our members how many staff are generally involved in the preparation of the annual report, and for how long.

- Directors and/or chief executives: Most of our members had between one and two directors and/or chief executives involved in preparing annual reports, typically spending between one and two weeks.
- Accountants: Most of our members have one or two accountants preparing the annual report, with some having between three and four accountants. According to our members, accountants typically spend between three and four weeks on preparing the annual report, although a number of members reported accountants spending up to two months.
- Lawyers: All members had one or two lawyers involved in preparing the annual report. However, the time spent by lawyers varies between a couple of days and a couple of weeks.
- Managers and/or senior officials: Most of our members had between one and four managers and/or senior officials involved in preparing the annual report, on average spending between three and four days preparing the annual report,. In some cases, their involvement can be as short as one or two days or as long as one or two months.
- Administrative and secretarial staff: Most of our members had one or two administrative and secretarial staff involved in preparing the annual report, typically spending between one and two weeks to complete their tasks related to the completion of the annual report.

Our members also mentioned other staff or stakeholders involved in the preparation of annual reports, including nominated advisors (up to three for a couple of days), financial public relation consultants (up to three for up to one week), external designers and publishers (combined for a total of two weeks), company

secretaries (involved for up to two months) and auditors (up to four people for a total of three or four days).

Q17b Do you expect to incur any “one off “or “ongoing costs” as a result of having to comply with the requirements of the EU NFR Directive over and above what you incur currently on your non-financial reporting obligations? Please describe these costs. (One off costs could include staff time to familiarise your organisation with the regulations or updating of internal guidance for staff; ongoing costs could include additional time to review non-financial data in each year subsequent to first year)

We asked our members to provide us with an estimate of costs as a result of currently having to comply with non-financial reporting obligations.

Our members’ estimates of ongoing annual costs resulting from currently having to comply with their non-financial reporting obligations ranged from £5,000 to £500,000; the median estimate cost amounted to £50,000.

Some members pointed out that the annual costs of repeating or updating information each year are low compared to the additional costs which are incurred through new obligations and requirements; the amount of those additional costs depends on the complexity of the changes.

Q17c How would your costs change if you were allowed to provide your non-financial statement separately within six months of the balance sheet date on your financial report?

We asked our members how their costs would change if they were allowed to provide non-financial statements separately within six months of the balance sheet date on the financial report.

The vast majority of our members believe that there would be little to no change in their costs if they were allowed to provide the non-financial statement separately within six months of the balance sheet date of the financial report, since it is the data collection and the report writing that gathers cost.

However, some members pointed out that this effective spread of the workload would ease the burden on their finance teams.

Q17d How would your costs change if you were allowed to provide this report electronically on your website and did not have the obligation to provide hard copies except in exceptional circumstances?

We asked our members how their costs would change if they were allowed to provide this report electronically on their website and did not have the obligation to provide hard copies except in exceptional circumstances.

Some members felt that there would be minimal change, citing the negligible marginal costs of printing and posting hard copies. One member noted that the webpage design costs incurred could offset any savings made from not distributing hard copies.

Nevertheless, some respondents indicated potential savings on printing and postage cost in the range of between £6,000 and £50,000.

Q17e What additional costs would you expect if the government required that an independent assurance services provider verify the non-financial statement? This may be in terms of money or resources costs such as staff time: Benefits to your company of the EU NFR Directive?

We asked our members what additional costs they would expect if the government required that an independent assurance services provider verify the non-financial statement.

There was a unanimous view among our members that it would be costly, both financially and in terms of time. Specific monetary values varied from around £4,000 up to £200,000. At the same time, our members noted the additional burdens in preparing an audit file of verification notes and documents that would satisfy the independent assurance provider at what is already a busy time of year. Some suggested that the quality of information provided would fall due to preparers becoming more risk averse regarding what was included in the report.

One member suggested making it a requirement for statements to be true and fair and not have independent oversight. Please see our responses to Q7 and Q8.

Q17f Please describe any benefits to your company you expect will arise because of the EU NFR Directive (to your organisation or more widely).

We do not have any further comments.

Q17g Any Other Comments: Do you have any other comments about the costs and benefits that will result from the EU NFR Directive?

We do not have any further comments.

Q18 Additional Comments on the Directive: Are there any additional comments that you would wish to make on this Directive

We do not have any further comments.

If you would like to discuss any of the responses in more detail, we would be happy to attend a meeting.

Yours sincerely,



Tim Ward
Chief Executive

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