

Companies need to get ready as more mandatory reporting requirements on non-financial issues take effect

The U.K. Companies Act 2006 has recently been amended to reinforce and expand the requirements on certain large U.K. companies to report on non-financial issues. The amendments require certain companies to provide information on new areas such as anti-bribery and anti-corruption; companies already subject to reporting requirements in relation to social, environmental and human rights matters now face more comprehensive requirements in these areas. This briefing provides an overview of the legislation, explains how this will affect U.K. companies, and briefly considers the broader trend towards mandatory reporting that this measure reflects.

Summary

The U.K. Companies, Partnerships and Groups (Accounting and Non-Financial Reporting) Regulations 2016 (the **Regulations**) amend the Companies Act 2006 (the **Act**) by introducing new sections 414CA and 414CB. These require certain companies and qualifying partnerships to include a non-financial information statement in their strategic report relating to financial years beginning on or after 1 January 2017 (the **Disclosure Requirement**). The disclosure of non-financial information in the strategic report has been a feature of strategic reports for quoted companies since 2013.

However, the Disclosure Requirement expands the scope of such obligations, requiring not only quoted companies but also any other traded, banking, authorised insurance company, or a company carrying on insurance market activity to report on non-financial information in accordance with the Act. The Disclosure Requirement also expressly stipulates that for such companies, the statement should address anti-corruption and anti-bribery issues.

The EU Non-Financial Reporting Directive

The Regulations implement articles 1(1) and (3) of the E.U. Directive 2014/95/EU (the **EU Non-Financial Reporting Directive**) and completes the transposition of article 23 of the

E.U. Accounting Directive 2013/34/EU (the **EU Accounting Directive**) into English law (click [here](#) for further information). Articles 1(1) and (3) of the EU Non-Financial Reporting Directive amend the EU Accounting Directive to introduce a requirement for certain large public interest entities to disclose information on policies, risks and results relating to environmental and social issues, employee matters, respect for human rights, anti-corruption and anti-bribery matters and board diversity issues. The information should appear in a statement (the non-financial information statement or "**NFIS**") that will form part of the entity's management report. The NFIS must disclose such information to the extent necessary for an understanding of the large public interest entity's development, performance and position and of the impact of its activity on such matters.

Who will be affected by the Disclosure Requirement?

The Disclosure Requirement applies to:

- a company which, at any time within a financial year starting on or after 1 January 2017, is a(n) traded, banking, authorised insurance company, or a company carrying on insurance market activity; and

- a qualifying partnership, namely partnerships formed under the law of any part of the U.K. where each of its members is a limited company, or an unlimited company or a Scottish partnership (in each case whose members are a limited company).

The Disclosure Requirement does not apply to any company which, in the relevant financial year is:

- a company subject to the small companies regime in the Act;
- a company qualifying as a medium-sized company under the Act;
- a parent company with 500 employees or less in aggregate in its group; and
- a company with 500 employees or less (where such company is not a parent company).

Companies not subject to the Disclosure Requirement may, however, as a matter of internal governance, elect to prepare the NFIS envisaged by the Regulations.

What will be required under the Disclosure Requirement?

The NFIS in a strategic report must contain information, to the extent necessary for an understanding of a company's development, performance and position, and the impact of its activity, relating to (as a minimum):

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

The information must include a description of:

- the company's business model;
- the policies pursued by the company in relation to the matters listed above and any due diligence processes implemented by the entity in pursuance of those policies;
- the outcome of those policies;
- the principal risks relating to the matters listed above arising in connection with the company's operations and, where relevant and proportionate, a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk and a description of how it manages the principal risks; and

- the non-financial key performance indicators relevant to the company's business.

If policies in relation to one or more of the matters mentioned above are not pursued by the company, the information statement must provide a clear and reasoned explanation for this.

The Disclosure Requirement does not require any disclosure of impending developments or matters in the course of negotiation if the disclosure would (in the opinion of the relevant entity's directors) be seriously prejudicial to the commercial interests of the entity, provided that the non-disclosure does not prevent a fair and balanced understanding of the company's development, performance or position or the impact of the company's activity.

Further, if the information required to be included in the statement is already published by the company under another national, E.U. based or international reporting framework, a company must specify in its strategic report the framework or framework(s) used instead of including that information within the strategic report.

The Regulations also address a gap in the transposition of article 23(1) of the EU Accounting Directive by ensuring that the parent company of a small group cannot benefit from an exemption from the requirement to produce group accounts under Section 399 of the Act if a member of the group is established in an E.E.A. State and is a public interest entity.

Consequences of non-compliance

A strategic report must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the company.

If a strategic report is approved but does not comply with the requirements of the Act, an offence is committed by every director who knew that it did not comply, or was reckless as to whether it complied, and failed to take reasonable steps to secure compliance or to prevent the report from being approved. A director guilty of such an offence is liable to a fine (whether on conviction on indictment or on summary conviction).

Implications for quoted companies

The Regulations do not amend Section 414C of the Act, which continues to apply.

Section 414C of the Companies Act 2006 provides that a quoted company must, to the extent necessary for an understanding of the development, performance or position of the company's business, include in its strategic report:

- (a) the main trends and factors likely to affect the future development, performance and position of the company's business; and
- (b) information about (i) environmental matters (including the impact of the company's business on the environment), (ii) the company's employees, and (iii) social, community and human rights issues,

including information about any policies of the company in relation to those matters and the effectiveness of those policies.

If the report does not contain information of each kind mentioned above, it must state which of those kinds of information it does not contain.

Click [here](#) for further information regarding Section 414C of the Act.

To minimise duplication, the Regulations do provide that if a NFIS complies with the Disclosure Requirement, it will be deemed to fulfil some of the requirements for non-financial information which are set out in Section 414C of the Act.

The continued application of section 414C of the Act results in a situation whereby a quoted company that is also a(n) traded, banking, authorised insurance company or a company carrying on insurance market activity will be subject to additional disclosure requirements. For example:

- **a clear and reasoned explanation** – if the strategic report of a quoted company that is also subject to the Disclosure Requirement does not contain non-financial information, it must provide a clear and reasoned explanation for not pursuing policies in relation to the non-financial matters set out in the Act whereas a quoted company that is not subject to the Disclosure Requirement need only state which of those kinds of information it does not contain;
- **anti-corruption and anti-bribery matters** – the non-financial information to be covered by a quoted company that is subject to the Disclosure Requirement expressly includes anti-corruption and anti-bribery matters; and
- **risks and adverse impacts** – the non-financial information to be covered by a quoted company that is subject to the Disclosure Requirement must include a description of the principal risks relating to the non-financial matters arising in connection with the company's operations and, where relevant and proportionate, a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk and a description of how it manages the principal risks.

Increased mandatory reporting

The Regulations represent the latest in a series of steps taken by governments worldwide which impose disclosure requirements on businesses in an effort to broaden transparency about what companies are doing (if anything) to identify and address non-financial impacts and risks arising from business operations. The intention is to promote better accountability regarding the direct or indirect involvement of businesses in such matters, and exert pressure on businesses to improve the efficacy of their efforts to tackle these issues. It is also intended to increase transparency for investors around the implications of such non-financial risks for the businesses.

In the U.K. alone, under the Modern Slavery Act 2015 (the **MSA**), companies or partnerships (wherever incorporated or formed) with an annual turnover of £36m or more, carrying on a business in the U.K. and engaged in the supply of goods and services are required prepare a yearly slavery and human trafficking statement stating the steps the business has taken to ensure that modern slavery is not taking place in its business and supply chain, or stating that it has taken no such steps (click [here](#) for further information). Such companies will need to consider how best to comply with reporting under both the Act (including, if applicable, the Disclosure Requirement) as well as the MSA. These companies may wish to consider how to reduce any potential crossover or conflict between the various requirements as the Regulations do not address this.

Developments abroad, such as the adoption by the US Securities and Exchange Commission under the Dodd-Frank Act of rules requiring annual disclosures relating to conflict minerals sourced from and around the Democratic Republic of Congo and the requirement under the EU Accounting Directive that European companies in the extractive industries and forestry disclose in their financial statements payments made to governments (click [here](#) for further information) will also need to be considered by certain companies. The burden on business of compiling and reporting relevant information in the face of numerous and sometimes poorly aligned requirements seems set to increase.

In the light of such developments, it would be prudent for companies to develop and implement appropriate internal policies and procedures to address the types of non-financial matters identified by these legislative initiatives. Companies that are able to anticipate the developing trends within their risk management programmes will be a step ahead.

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