

Frequently Asked Questions on Non-Financial Reporting

These Frequently Asked Questions have been prepared by FRC staff to assist with the application of the Non-Financial Reporting Regulations (NFR). They are intended to serve as a guide in the interim period whilst the FRC finalises its update to the Guidance on the Strategic Report. Therefore, the content below may be subject to change when we issue our final guidance as we take into account feedback on the application of the Regulations.

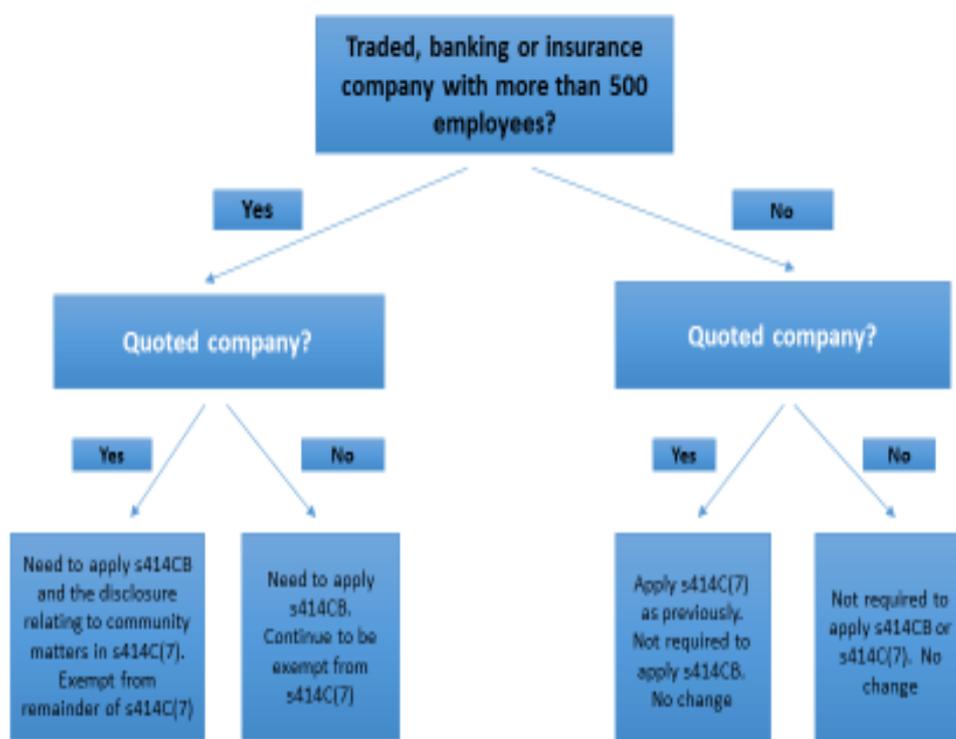
The Non-Financial Reporting Regulations insert sections 414CA and 414CB into the Companies Act 2006, supplementing the existing strategic report requirements as set out in section 414C of the Companies Act 2006.

The frequently asked questions covered in this paper are set out below.

- 1. Who is subject to the NFR requirements?**
- 2. What are the new requirements?**
- 3. If I am a quoted company, what are the new additional disclosures?**
- 4. Is this now a report for stakeholders?**
- 5. Is the non-financial information statement required to be a separate statement headed up 'Non-financial information statement' either outside of or within the strategic report?**
- 6. What is meant by the impact of a company's activities?**
- 7. What do I have to disclose in relation to policies and due diligence?**
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- 9. What do I need to disclose in relation to business relationships, products and services which are likely to cause adverse impacts?**
- 10. If any of the non-financial reporting matters are not material to my business, do I still need to disclose them?**
- 11. What will the auditor's responsibilities be in respect of non-financial information**

1. Who is subject to the NFR requirements?

If they have more than 500 employees, traded, banking and insurance companies¹ are required to comply with the disclosure requirements set out in s414CB. These requirements are similar, but not identical, to those applying to quoted² companies under s414C(7). Companies which are both quoted and subject to the new NFR requirements will be exempt from s414C(7), except for those disclosures in s414C(7) that relate to community issues.



¹ Traded companies are those entities with transferrable securities admitted to trading on a regulated market (474(1)). Banking company is defined by section 1164(2) and (3) of the Companies Act 2006. An insurance company is either an authorised insurance company (1165(2)) or a company carrying on insurance market activity (1165(7)).

² A quoted company is defined in section 385(2) of the Companies Act 2006.

The interplay between s414C(7) and s414CB is complex. The following flow chart will help determine which set of legislative requirements apply depending on the type of company.

2. What are the new requirements?

Section 414CB requires information, to the extent necessary for an understanding of the company's development, performance, and position and the impact of its activity, relating to, as a minimum:

- (a) Environmental matters (including the impact of the company's business on the environment);
- (b) The company's employees;
- (c) Social matters;
- (d) Respect for human rights; and
- (e) Anti-corruption and anti-bribery matters.

The information must include:

- (a) A description of the company's business model;
- (b) A description of the policies pursued by the company in relation to the matters mentioned above and any due diligence processes implemented by the company in pursuance of those policies;
- (c) A description of the outcome of those policies;
- (d) A description of the principal risks relating to the matters above arising in connection with the company's operations and, where relevant and proportionate:
 - (i) A description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk; and
 - (ii) A description of how it manages the principal risks; and
- (e) A description of the non-financial key performance indicators relevant to the company's business.

If the company does not pursue policies in relation to one or more of the matters noted above, a clear and reasoned explanation for not doing so must be disclosed.

3. If I am a quoted company, what are the new additional disclosures?

If you are a quoted company and subject to the new NFR requirements, you previously had to comply with s414C(7), which contains similar, but not identical reporting requirements. The most significant changes in disclosures are:

- Reporting on the impact of the company's activities – this impact should also be considered when disclosing principal risks and KPIs;
- Disclosing information relating to anti-bribery and anti-corruption;
- Disclosure of business relationships, products and services which are likely to cause adverse impacts;
- Different disclosures relating to policies (see question 7 below); and
- Due diligence disclosures.

For those companies, where there is no requirement to disclose non-financial information, the FRC encourages proportionate disclosure as good practice for all reporters where relevant.

4. Is this now a report for stakeholders?

The strategic report remains a report for shareholders. However, in providing information that is material to shareholders, information will also be useful to other stakeholders.

5. Is the non-financial information statement required to be a separate statement headed up 'Non-financial Information Statement' either outside of or within the strategic report?

No. The non-financial reporting requirements are headed up 'Non-financial information statement' in the Companies Act 2006, but the disclosures required do not have to be either a discrete element within the strategic report or a separate statement. Indeed, we would encourage companies to consider how this information relates to other information in the strategic report such as disclosures on strategy, business model, principal risks and uncertainties, key performance indicators.

6. What is meant by impact of a company's activities?

Impact of a company's activities is the effect that it has externally; the impact on the outside world. These impacts may pose threats to and provide opportunities for the success of a company's business. A board should consider the impact of the company's activities on the matters noted in s414CB and then report on those aspects which are material to the long term success of the company.

There was already a requirement in s414C(7) to report on the impact of the company's business on the environment, so the concept is not new to the strategic report. Section 414CB, however, extends the disclosure requirement to include the impact of the company's activities on employees, social matters, human rights and anti-bribery and anti-corruption. Companies are also required to consider and describe the business relationships, products and services which are likely to cause adverse impact, see question 9 below.

Reporting on the impact of activities is an area which will require companies to exercise judgment and we expect best practice to evolve over a period of time. However, we would encourage companies to give particular focus to impact in respect of disclosures relating to the business model, policies, the principal risks and the KPIs of the business. This may also result in the inclusion of KPIs which measure impact.

7. What do I have to disclose in relation to policies and due diligence?

Section 414CB requires the disclosure of a description of the policies pursued by the company in respect of the matters noted in that section together with the due diligence undertaken in pursuance of that policy. The description of the policy should be clear, concise and be proportionate to the risks to the company and the potential impact of its activities. If no policy is disclosed there must be a clear and reasoned explanation as to why the company does not pursue a policy in that area.

The disclosures relating to due diligence should explain the steps taken by the company to ensure that its policies in the stated areas are adhered to and the outcome of that due diligence.

Under s414C(7), a company had to state its policy and disclose the effectiveness of that policy. If no policy was disclosed the company had to state that fact, but no reason was required.

Example

A company may undertake a rolling series of unannounced site visits to suppliers to ensure that no child labour is employed, coupled with a zero-tolerance policy with respect to failures. The due diligence would be disclosing that site visits are undertaken and the outcome would be stating whether any supplier contracts have been terminated as a result of such failures.

It may be that a company has a framework for managing a number of risks rather than specific processes relating to each policy area. In this case, the company should describe its framework, how breaches of policy are identified, the escalation procedures relating to breaches of policy and the outcome of those escalation procedures.

We recognise that providing information relating to due diligence is an area which could result in extensive disclosures. We encourage companies to ensure that disclosures are clear and concise and are proportionate to the underlying risks.

8. Are the principal risk disclosures referred to in s414CB different from the principal risks that I already disclose in my strategic report?

The principal risk assessment carried out by the company in order to determine which risks to disclose in accordance with s414C(2)(b) should already consider both financial and non-financial risks. The existing requirement is to disclose risks facing the company, i.e. those that pose a threat to the long term success of the company.

Section 414CB introduces a requirement to consider the principal risks that the company poses to the outside world more generally. However, in our view, any crystallisation of risk that the company poses externally will also affect its long term success through loss of reputation. Therefore these risks should already have been considered as part of the risks facing the company in a company's assessment of principal risks under S414C(2)(b).

We anticipate that the introduction of the requirement to provide information on the impact of the company's activities will help boards to think more broadly about the consequential effects that those impacts could have on the long term success of the company and that this broader thinking could result in the identification of more risks.

9. What do I need to disclose in relation to business relationships, products and services which are likely to cause adverse impacts?

Companies are required to look beyond their own operations and consider risks arising from business relationships, products and services in relation to the matters noted in s414CB. If these risks are principal risks, or contribute to principal risks, then companies should describe the relevant relationships, products and services.

Example

A company may be reliant on the continuity of supply of products from areas of the world which are experiencing more extreme weather events due to climate change. Where such weather events may disrupt supply of essential materials and this is a principal risk or contributes to a principal risk, a company should describe the business relationship and the products affected. The company should also describe the steps taken to mitigate that risk.

10. If any of the non-financial reporting matters are not material to my business, do I still need to disclose them?

Disclosures are only required when material; the Regulations use the term “to the extent necessary for an understanding of the company’s development, performance and position and the impact of its activity” to serve as a filter to ensure that neither too little nor too much information is disclosed in respect of the five areas noted in the legislation, being environment, employees, social matters, human rights and anti-corruption and anti-bribery. Filters also apply for risk disclosures and performance indicators where disclosures are only required for ‘principal’ risks and ‘key’ performance indicators.

Preparers of annual reports will be accustomed to the application of materiality assessments as a filter for determining what information should be included. In our view, considering materiality as a proxy for the ‘understanding of the company’s development, performance and position and impact of its activity’, ‘principal’ and ‘key’ is a pragmatic approach which will help companies to apply judgement in determining the level of detail to disclose.

In relation to non-financial information, a qualitative assessment may be more important than quantitative factors. When determining whether information is material, a company should consider potential short and medium term effects and also whether the fact or circumstance could affect the ability of the company to generate or preserve value in the long term.

11. What will the auditor’s responsibilities be in respect of non-financial information?

As non-financial information forms part of the strategic report, the auditor is required to read the whole of the strategic report, including the non-financial information, and state in the auditor’s report whether the information given in the strategic report is consistent with the financial statements and whether the strategic report has been prepared in accordance with applicable legal requirements. This means the auditor has to obtain an understanding of the legal requirements that apply in respect of the NFR regulations and the pre-existing requirements of the strategic report. The auditor will also need to report on whether they have identified any material misstatements in the strategic report.