UK Government:

Non-Financial Reporting Consultation

Mark Jackson
Business Environment
Department for Business, Innovation and Skills

Dear Mr Jackson,

ABOUT THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. PRI has 1500 signatories globally with £42 trillion ($60 trillion USD) in assets under management. Over 200 of these Signatories are based in the UK[1].

We welcome the opportunity to comment on the UK Government's consultation on transposition of the Non-Financial Reporting Directive.

ABOUT THE DIRECTIVE

The Non-Financial Reporting Directive *(Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups)* seeks to ensure that large public interest entities in Europe provide a comprehensive and meaningful view of their position and performance. As part of their management report, companies should provide relevant and useful information on their policies, main risks and outcomes relating to at least

- environmental matters,
- social and employee aspects,
- respect for human rights,
- anticorruption and bribery issues, and
- diversity in their board of directors.

For consistency with the Directive, PRI has adopted the terminology "non-financial reporting" for this response. We take this to include environmental, social and governance issues, which are increasingly understood to be financially material[2].

---

[1] See www.unpri.org/signatory-directory

[2] Gunnar Friede, Timo Busch & Alexander Bassen (2015) *ESG and financial performance: aggregated evidence from more than 2000 empirical studies* & Smith School of Enterprise and the Environment, Arabesque Asset Management (2014): *From the stockholder to the stakeholder: how sustainability can drive financial outperformance*

SUMMARY OF PRI'S POSITION

Considering both financial and non-financial factors is fast becoming mainstream investment practice. PRI investment manager signatories represent around 63% of all professionally managed assets globally – and of these, over 98% consider environmental, social and governance issues in investment decision making and engagement and voting[3].

A comprehensive, meaningful picture of a company's position and performance must include both financial and non-financial factors[4]. We welcome the Non-Financial Disclosure Directive, which will substantially increase the availability of relevant information to investors. Throughout this consultation, we encourage the Government to recognise material non-financial disclosures as vital to a holistic, useful picture of a company, and treat them in line with financial information.

PRI is providing a response to questions 1-8 which directly relate to transposition of the Non-Financial Reporting Directive.

NEXT STEPS

The PRI has experience in ESG regulation in a number of international investment markets, and has developed a wealth of practical guidance on incorporating ESG factors into investment decision making, reflecting the operational experiences of signatories. PRI offers its expertise to support the UK Government to ensure the outcomes of this consultation are well-implemented, reflect existing good practice and remain current.

Yours sincerely,

Fiona Reynolds

Managing Director, Principles for Responsible Investment

[3] PRI Report on Progress 2015 p.9, 13. Available at unpri.org

[4] Gunnar Friede, Timo Busch & Alexander Bassen (2015) *ESG and financial performance: aggregated evidence from more than 2000 empirical studies &* Smith School of Enterprise and the Environment, Arabesque Asset Management (2014): *From the stockholder to the stakeholder: how sustainability can drive financial outperformance*

CONSULTATION QUESTIONS

Contact name: Alyssa Heath (Senior Manager, Policy - Alyssa.heath@unpri.org)

Organisation: Principles for Responsible Investment

Address: 25 Camperdown Street, London, E1 8DZ

Organisation type: Business representative organisation/trade body

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 by the EU NFR Directive? Please explain your reasons.

PRI's view is that the disclosures required under the Non-Financial Reporting Directive should be embedded within the Strategic Report.

The purpose of the Strategic Report is to provide shareholders with "a holistic and meaningful picture of an entity's business model, strategy, development, performance, position and future prospects"[5]. An increasing body of evidence demonstrates that non-financial factors influence a company's performance and prospects[6]. Disclosure of material non-financial factors is therefore necessary to provide this holistic and meaningful view.

Furthermore, including this information in the strategic report will;

- Encourage companies to assess the materiality of non-financial factors to their business model and strategy;
- Increase the level of scrutiny of these factors by the Board and Senior Management, and;
- Ensure that material financial and non-financial data are made available to investors at the same time.

We elaborate further on this in our response to Q3 (advantages and disadvantages of a separate non-financial statement).

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

As noted in our response to Q1, we believe that material non-financial disclosures should be incorporated into the Strategic Report.

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?

The key disadvantages are:

---

[5] FRC (2014): Guidance on preparing a strategic report

[6] Metastudy, arabesque study

- Siting non-financial disclosures in a separate report will result in these issues being perceived – by report preparers, the company's Board and report users - as separate and distinct from the company's business model, strategy, development, performance, position and future prospects. This is an important failing of current reporting. Research from PRI, the UN Global Compact[7], Eurosif and ACCA[8] finds that investors do not believe corporate reporting makes strong links between non-financial factors and business strategy and risk. Furthermore, it found that corporates and investors disagree on the extent to which current reporting is addressing this (57% of company CEOs believe they can set out their strategy for seizing opportunities presented by sustainability – just 9% of investors surveyed agree). This Directive gives an opportunity to address this issue.
- The Directive gives flexibility for a non-financial statement to be produced up to six months after the annual report and accounts. This is a concern, as it would result in investment-relevant, material information being delivered at a substantial delay to financial data.

We note from the consultation documents that companies have concerns about the additional burden of reporting financial and non-financial data concurrently. However, if a non-financial factor is being considered and managed as a core part of business operations, then presenting the figures at the same time as the financial reporting should not present substantive additional burden.

We are also aware of concerns that siting material non-financial disclosures in the Strategic Report could introduce duplication between the Strategic Report and any sustainability reports the company chooses to produce. We note that many companies see substantive business value in producing a sustainability report, which also helps with their transparency to a much wider audience of stakeholders. However, the Strategic Report is mandatory and serves a defined purpose - to provide a holistic and relevant summary of performance to Shareholders. We believe that the benefits of providing this holistic and relevant summary outweigh the disadvantages of duplication.

Q4) ADVANTAGES AND DISADVANTAGES OF THE IMPLEMENTATION OPTIONS.

What do you see as the advantages and disadvantages of the various implementation options?

PRI encourages the UK to consider options to enhance transparency without increasing complexity for reporters and data users.

Option 1 (*separate requirements for large PIEs within the scope of the EU NFR Directive and for quoted companies within scope for the UK CA 2006 requirements*) will add an additional tier to the existing reporting requirements, with the potential for companies to move between the boundaries year on year. PRI encourages the Government to ensure that data made available to Investors is consistent and comparable year on year.

Option 2 (*Ensure strategic report requirements only apply to companies within the scope of Article 19a and 29a of the EU Accounting Directive*) would reduce the quality of reporting from some UK companies on non-financial factors. We encourage the Government to ensure that existing reporting requirements are maintained.

[7] UN Global Compact, PRI and Accenture (2014): The Investor Study: Insights from PRI Signatories

[8] Eurosif and ACCA (2013): What do investors want from non-financial reporting?

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 option in terms of which companies should be required to disclose non-financial information?

As noted in our response to Q4, we encourage the UK to review alternative options that would enhance transparency without increasing complexity for reporters and data users.

Q6) ALTERNATIVE OPTIONS

Are there any other options for implementing the EU NFR Directive the Government should consider?

Please see our responses to Q4 and Q5.

Q7) ASSURANCE OF NON-FINANCIAL INFORMATION

Should the Government require that the non-financial statement be verified by an independent assurance service provider'?

PRI encourages BIS to require independent assurance, consistent with audits performed on financial results. This requirement could be phased in to give companies time to prepare – we elaborate further in our discussion of practicalities in Q8.

We note that for Strategic Reports, the existing ISA 720 audit standard requires an auditor to assess whether narrative provided is consistent with financial statements. However, we do not believe that these requirements ensure that auditors directly assess the risk of material misstatement in non-financial KPIs. For non-financial information to be usable by investors, steps should be taken to ensure accuracy and veracity. According to a recent CFA Institute ESG survey 69% of financial analysts agree that it is important that ESG disclosure is subject to independent verification[9].

Q8) ADVANTAGES AND DISADVANTAGES OF THIRD-PARTY VALIDATION

What do you see as the advantages and disadvantages of requesting third party assurance?

The key advantage of third party assurance is that it reduces the risk of material misstatement. This means that investors can be confident that the information they are using is fair and accurate.

We do not consider there to be substantive disadvantages, but note that there are several practical issues which make assurance challenging. These are:

1) Resources: assurance involves a direct cost (hiring an assurance provider) and indirect costs (staff time). However, the cost of audit is not unique to non-financial information, and may be small compared to the sums spent on financial audit.

2) Equivalence of audit standards – several different frameworks exist for providing assurance of non-financial information. We would encourage the Government to consider standards which reduce the risk of material misstatement in non-financial data to equivalent levels required for financial data.

9 CFA ESG Survey 2015

3) Assurance of non-financial data has increased substantially in the recent past[10], reflecting the fact that companies see it as a value-adding activity. However, it is not yet a mainstream practice. For this reason, the Government may wish to consider a transition phase, giving companies time to prepare for assurance of non-financial data.

WORKSHOPS

BIS also intends to hold a series of workshops to discuss the issues in this consultation in more depth. We anticipate holding these in Spring 2016. If you would like to send a representative, pleased tick the box below and we will contact you in due course with further details.

☒ Yes, I would like to register interest to attend the BIS NFR Workshops

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☒

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

☒Yes ☐No

[10] For example, in 2015, CDP analysed 232 responses from FTSE 350 companies and found that 66% had their carbon emissions data assured, up from 42% in 2010. Source: CDP (2015) UK Edition Climate Change Report