



NON-FINANCIAL REPORTING REVIEW: MEDIUM-SIZED COMPANIES PROPOSALS

Issued 26 June 2024

ICAEW welcomes the opportunity to comment on the Non-financial Reporting Review: medium-sized companies proposals published by Department for Business and Trade (DBT) on 16 May 2024, a copy of which is available from this [link](#).

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KEY POINTS

INITIAL STEPS ARE ENCOURAGING

1. We appreciate the opportunity to comment on the proposals set out in this consultation. We strongly support the overall intention of the non-financial reporting review: for the UK Government to seek out opportunities to refresh and rationalise current reporting requirements so that the UK's non-financial reporting framework is fit for purpose and delivers decision-useful information to the market.
2. We also commend the ongoing efforts of DBT officials to advance this process. The previously announced plans to increase the monetary company size thresholds as well as the intention to remove certain Directors' Report requirements are welcome as important first steps towards a refreshed and improved non-financial reporting framework.

SUPPORT THE DIRECTION BUT WIDER THINKING NEEDED

3. We believe there is merit in the proposals presented in the consultation document. In particular, we are fairly supportive of the provision of a strategic report exemption for qualifying medium-sized companies. This support centres around our position that reporting requirements should be purpose-driven and if done properly, it has the potential to ensure more proportionate reporting requirements for medium-sized companies.
4. We are concerned, however, that the proposals represent further piecemeal amendments that risk adding complexity and uncertainty rather than clarity and consistency. We strongly encourage DBT to present the proposals as part of a full set of plans that covers wider and connected elements of the non-financial reporting framework.
5. When we [responded to the 2023 Non-financial Reporting Call for Evidence](#), we encouraged DBT to consider some short term changes as well as some bigger picture thinking. We explained that there are some issues that are more urgent and require addressing in the short term (for example, a company size threshold review), but there are also many issues that require a more comprehensive and holistic approach and strategy (for example, a review of the purpose of the annual report and its users).
6. It is clear that DBT believes that the current proposals can provide some 'quick fixes' to the non-financial reporting framework, given the timetable attached to the proposals and the fact that they are made in isolation from other potential changes. However, our firm conclusion is that these further proposals would be better suited as part of a broader, more complete set of recommendations that consider the consequences of making the changes in the context of other current and future reporting requirements and developments.
7. Specifically, we are referring to the UK's plans regarding the introduction of UK Sustainability Reporting Standards (UK SRS). We believe it would make more sense to put the current proposals on pause and use the comments received to feed into the development of a holistic plan and set of proposals that could be implemented over a timeframe that corresponds with developments around sustainability reporting requirements. As explained in our previous response, we encourage DBT to be bold in this respect, while taking the time necessary to discuss and develop the bigger picture for UK non-financial reporting and to futureproof the framework.
8. We have responded to each of the questions below in a way that focusses on our views of the specific proposal set out. Our responses should however be read together with the overarching comments above.

ANSWERS TO SPECIFIC QUESTIONS

Question 1: Do you agree or disagree with the uplift of the employee threshold from 250 to 500 employees for 'medium-sized' companies? Please explain your answer.

Questionable benefits

9. We can see some logic to this proposal. It makes sense to align the employee threshold with that set out in the Climate-related Financial Disclosure (CRFD) regulations 2022. The proposed threshold also aligns well with the considerations included in the Better Regulation framework as well as with other reporting thresholds.
10. However, there does not seem to be any significant benefit in doing so given the relatively modest number of UK companies (some 2,000) likely to be impacted by such an uplift. In order to have a more significant effect on the reporting landscape, we think it would make more sense to review all of the employee thresholds at the same time. With such a marginal benefit, alongside the costs of understanding the impact and implementing the associated changes, we are not convinced that this is worth doing as proposed.

Introducing new inconsistencies

11. We have a concern about introducing inconsistency between the medium-sized company threshold and other thresholds applicable for non-financial reporting purposes, in particular the UK Streamlined Energy and Carbon Reporting (SECR) regulations. While consistency with the employee threshold set out in the CRFD regulations is welcome, it is unhelpful and confusing to have thresholds which are inconsistent with other UK reporting requirements relevant to this population.
12. We understand that further analysis of the impact on carbon budgets is needed before making any change to the SECR regulations. This serves to emphasise that DBT needs to allow sufficient time to perform a full and thorough assessment of all the potential consequences of amending thresholds. It is not helpful to change one threshold and subsequently change another that affects the same population of companies.
13. We note that if the increase in turnover and total asset thresholds goes ahead as planned, this will also create new inconsistencies. To a certain extent this is an unavoidable consequence of making progress on these matters. However, if there was a clear roadmap of how DBT plans to review and update the entirety of the non-financial reporting framework in the UK, this would enable stakeholders to understand how incremental proposals and announcements fit into the longer-term plan.
14. While not a primary issue for annual reporting, we believe DBT should also consider alignment of thresholds (turnover, total assets and employee numbers) for non-financial reporting requirements outside of the annual report, such as gender pay gap reporting and modern slavery reporting. These have been aligned in the past and should remain so in order to prevent confusion for companies and others.

Connected considerations

15. As expressed in our previous response, we also strongly encourage DBT to bring all the size criteria and threshold requirements together in one location to allow preparers to identify clearly the category or categories into which they fall. The company size thresholds are defined in Part 15 of the Companies Act 2006, in Chapters 1 and 12, whereas many of the specific reporting requirements have separate reporting thresholds attached (for example, CRFD and SECR regulations), making it difficult for preparers to navigate.
16. Another issue that we have raised previously is the definition of 'employee'. We think this needs 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, self-employed workers and employees of group service companies that perform work in another 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. For this reason, the matter would need careful consideration and consultation.

17. It should be noted that if the employee threshold is uplifted as proposed, then the LLP regulations (SI 2008/1911) will require a similar amendment for consistency.

Joined-up decisions

18. In summary, while we have no strong objections to this proposal, we continue to urge DBT to consider the broader picture when revising thresholds generally. In particular, consideration should be given to the purpose of the annual report, and the information needs of primary users. 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. We consider this in more detail as part of our answer to Question 2.

Question 2: Do you agree or disagree with exempting medium-sized private companies from having to prepare a Strategic Report? Please explain your answer.

Purpose-driven reporting

19. We continue to believe that the primary purpose of disclosure in 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. It is critical to consider how the information needs of the primary users of accounts might differ according to the size and nature of the entity. It is with this primary purpose in mind that we have considered this proposal.
20. While we agree that for many companies, 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.
21. Broadly, those we have spoken to that work for or with medium-sized companies, support the proposal to introduce a strategic report exemption for qualifying medium-sized companies. This support centres around the purpose of disclosures in the annual report, as described above, and can be explained in more detail when we consider the types of companies that fall into the medium-sized threshold.

Types of medium-sized companies

22. The types of business within the medium-sized threshold generally fall into one of three broad categories. We have described each of these categories below alongside how such companies typically approach the strategic report requirements. It is not to say that there aren't some companies that fall outside of these categories, and we encourage DBT to undertake its own research to understand the demographic of medium-sized companies more fully.
- a. **Owner managed/family companies** – those that invest or provide credit to this category of medium-sized company generally have access to information about the company in better, more efficient ways than via the annual report. These companies tend to be reluctant to disclose publicly, information that they perceive to be 'sensitive'. As such, it is common for this category of company to provide 'bare minimum' disclosures, in order to comply with the strategic report requirements. Given the closer relationship of investors, creditors and other lenders to these companies, and consequently, the more efficient ways to access relevant information, we can see a strong argument for allowing such companies a strategic report exemption.
 - b. **Private equity-backed companies** – directors of this type of medium-sized company generally engage more with the requirements of the strategic report because the information and insight it provides can help to secure investment. These companies are less likely to view the strategic report requirements as a compliance exercise, but rather a solid framework to maintain rigour and discipline internally, as well as truly

serving the purpose of providing material information to its existing and potential investors. For this reason, we believe that even with the option of an exemption, these entities may well continue to produce a strategic report voluntarily.

- c. **Subsidiary companies** – for most medium-sized subsidiaries, the parent company will already produce extensive reports. With an ownership structure like this, we understand that little value tends to be placed on information disclosed in the subsidiary's strategic report, as again, the parent company will very often have direct, more immediate access to information about the company. As a result, the reporting produced often ends up as 'boiler plate' and of little value. We can therefore see that a strategic report exemption for these companies would be welcome.
23. If (in the cases described in (a) and (c) above) companies cannot connect reporting requirements with an outcome that creates value for themselves or their users, then we believe it is unlikely they will invest sufficient time and attention to the exercise. This would explain why such entities view the strategic report as a burden.
24. It is worth noting that the Financial Reporting Council's (FRC) recent [thematic review of reporting by the UK's largest private companies](#) focussed on companies far larger than those within the medium-sized threshold (revenue starting at £1.5 billion), yet still acknowledged that the shareholders of these companies are often fewer and are more likely to be involved in the business to some degree and have greater access to internal information.

Understanding the consequences

25. Given the analysis above, we see merit in the provision of an exemption as proposed, however our strong preference is for the proposal to be included within a holistic and comprehensive strategy that considers all of the interlinked elements of the non-financial reporting framework in the UK. This plan should include a thorough mapping of all and any potential consequences such that they are well understood and can be justified accordingly.
26. Set out below are some of the relevant matters that require proper consideration before the proposed strategic report exemption for medium-sized companies is taken forward.

Consider the individual elements of the strategic report

27. Over the years, narrative reporting requirements have evolved substantially, and elements of the current strategic report requirements have been around for some time - albeit not necessarily in their current form. We believe that the approach of no longer requiring medium-sized companies to provide *any* of the current strategic report requirements is a rather blunt solution to an issue that requires more extensive thinking.
28. If we consider the constituent parts of the strategic report requirements for medium-sized companies, some are fairly basic and may still provide some value for this population of reporting entities:
- a. Fair review of the business including principal risks and uncertainties
 - b. Financial Key Performance Indicators (KPIs)
 - c. Reference to and explanations of amounts included in the annual accounts
29. We are not convinced that it has been possible for this level of consideration to be given to the proposal set out in the consultation document or for the cost-benefit analysis to be sufficiently granular.

Sustainability reporting in the UK

30. It appears that, this consultation has not taken into consideration the likely increase in sustainability reporting requirements in the UK. We understand that subject to future consultation, UK SRSs are likely to be introduced on a mandatory basis for some companies that are not listed companies. As this consultation has not yet taken place, it is difficult to predict what size and type of entity will be within scope of these new sustainability reporting requirements.

31. It is widely agreed that the strategic report is the natural mechanism by which to report a company's material sustainability-related information. Given this, and the associated uncertainty over the scale and extent of future sustainability reporting requirements, it seems premature to remove the likely mechanism for reporting such information for medium-sized companies.
32. It might be that DBT has already given consideration to this particular point and concluded that companies below the large threshold will not be required to report against UK SRSs. If this is the case, we encourage some transparency and communication about this conclusion, to provide certainty for reporters and their stakeholders. If this is not the case, we feel it is not helpful to remove the reporting mechanism at this stage. Either way, the sequence of events does not appear ideal.

Fundamental questions

33. The proposal presented in this consultation re-opens fundamental questions about who the users of 'medium-sized' company accounts are and how their information needs may differ from the users of large company accounts. To make an informed decision about the exemption as proposed, we feel that these questions need to be thoroughly explored through extensive outreach over an adequate timeframe.
34. The consultation document explains that 'shareholders of private medium-sized companies are often close to the business (such as family, friends, or sophisticated outside investors who enjoy a direct relationship with company management) and may therefore get limited benefit from the Strategic Report'. While we agree with this assertion, we think this justification is too simplistic and fails to consider the wider benefits of the requirements such as providing management with a framework for disciplined thinking and effective stewardship of the business.

Question 3: Please provide any evidence you have regarding the usefulness of the information medium-sized private companies provide to their shareholders or other stakeholders in their Strategic Reports.

35. We have no specific evidence to provide regarding the usefulness of the information medium-sized private companies provide to their shareholders other than the comments shared above, based on discussions with our members. We would be happy to explore this issue further if time permits.
36. We would, however, encourage DBT to perform further research to help direct the ongoing activities connected to the non-financial reporting review that could seek to answer some of the following questions:
 - a. Impact of the micro-entity regime:
 - i. what has the uptake been since it was introduced?
 - ii. has the regime had a positive impact on business growth?
 - b. Primary users:
 - i. in what way do the primary users of annual reports change according to size/type of company?
 - ii. how do the information needs of different users change?
 - c. Other countries:
 - i. how do narrative reporting requirements differ in other jurisdictions?
 - ii. how do any such differences impact the users/reporters?