Greenwashing is Over!

UK Edition

The New Landscape for Non-Financial Reporting

There is change on the horizon for the UK non-financial reporting landscape. The last few years has seen the introduction of the Corporate Sustainability Reporting Directive (CSRD); a new globalised reporting standard from the International Sustainability Standards Board (ISSB); increased board diversity requirements from the Financial Conduct Authority (FCA), as well as updates to the UK Corporate Governance Code. All of which indicate that there will be a further shift to focus on sustainability reporting. Financial reporting is important, but sustainability reporting is equally important for businesses who want to meet the expectations of investors, customers and wider stakeholders who now expect companies to communicate progress on a range of Environmental, Social & Governance (ESG) factors.

Unified Reporting Standards

There is a theme of unified reporting standards emerging within the landscape of non-financial reporting. Of note, the CSRD, SEC and ISSB have all moved in this direction. The CSRD is the replacement for the EU's Non-Financial Reporting Directive (NFRD) aiming to address its shortcomings and brings higher importance to sustainability reporting. With the call for more sustainable focused businesses the EU Commission believes that current reporting standards allow reports to omit information that investors and stakeholders deem as important. The new legislation helps stakeholders to evaluate organisation's non- financial performance on a more uniform basis.

With the introduction of the CSRD, 49,000 businesses will need to comply. Although this is EU legislation, UK businesses could still be required to report within the scope of CSRD. Non-EU companies which have EU subsidiaries or securities on EU- regulated markets which have a net turnover of over 150m within the EU will be required to align to CSRD. UK companies are considered Non-EU but should consider whether the subsidiary requirements apply to them. The original timeline for businesses to report was presented as follows:

• January 1st 2024 – Large public interest companies (with over 500 employees) already subject to the NFRD, with reports due in 2025.

• January 1st 2025 – Large companies that are not presently subject to the NFRD (with over 750 employees) and/or €40million turnover and/or €20 million in total assets; with reports due in 2026

• January 1st 2026 – Listed SMEs and 'other undertakings', with reports due in 2027. As SMEs have minimal sustainability requirements currently, they can choose to opt out until 2028 should then require more time to gather the correct information and put data collection systems in place.

The new legislation will require reporting on more specific areas opposed to the broader reporting requirements from the NFRD which included items like 'Environmental Protection'. The CSRD also states that third party assurance will now be mandatory. However as of the 24th of January 2024, the Legal Affairs Committee of The European Parliament approved a proposal to delay the full enactment of the CSRD, meaning that adoptions of sector specific sustainability disclosures and obligations for non- EU companies will be delayed until 2026.

When the CSRD was first announced it was praised by some for raising the profile of non-financial issues but was criticised by others for being overcomplicated. On July 31st, 2023, the EU adopted the general reporting requirements of the European Sustainability Reporting Standards, which came into effect from 1st of January 2024. At this time, the European Financial Reporting Advisory Group (EFRAG) has been instructed to focus on developed clearer and more detailed guidance for disclosing against the general standards.

For more information on CSRD, read our EU edition of this paper.

The European Financial Reporting Advisory Group (EFRAG) have confirmed that CSRD will be fully compatible with international initiatives such as the ISSB and SEC but will continue to focus on the EU's objectives and goals, pointing out that the existing initiatives focus on just the needs of investors opposed to broader sustainability issues.

In May 2022, the SEC proposed amendments to ESG Disclosures for Investment Advisors and Investment Companies. The goal of these amendments is to promote consistent, comparable, and reliable information for investors considering ESG factors for businesses operating in the US.

This comes following COP26, during which the International Financial Reporting Standards (IFRS) Foundation announced the plan to form the ISSB. The board will develop a global baseline of sustainability disclosure including a range of ESG topics. It aims to build on the work of existing investor-focused reporting initiatives, supported by the Technical Readiness Working Group (TRWG), created by IFRS Foundation Trustees.

The ISSB have recently issued the first set of standards: IFRS S1 and IFRS S2. IFRS S1 is focused on disclosure of sustainability- related risks and opportunities, that businesses will face over the sort, medium and long-term. IFRS S2 focuses on climate-related disclosures and should be used in conjunction with IFRS S1. Both of these initial standards incorporate the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). Now that these standards have been issued, the ISSB will work with jurisdictions and companies to support the uptake, including development of a Transition Implementation Group and Capacity Building Initiatives.

Climate and Nature Related Disclosures

The UK is the first G20 country to increase the scope of companies which are required to report their climate-related risk in line with the TCFD.

Previously only premium listed companies, under the FCA listing rules, fell under the scope of the mandate, however, the following businesses will be required to report climate-related disclosures for the financial year which begins on or following 6 April 2022. This follows the introduction of regulations by the UK Government, through the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022:

Relevant Public Interest Entities (All UK companies that are currently required to produce a non-financial information statement)

UK registered companies with securities admitted to AIM who also have more than 500 employees.

UK registered companies which do not fall into the above categories and Limited Liability Partnerships which have more than 500 employees and a turnover of more than £500 million.

Although there is not specific format for these new climate-related disclosures it must cover each part of the TCFD with the aim for businesses to disclose all climate-related financial information which consider the risks and opportunities the business may face.

Businesses should report this information at group level where applicable. Where the UK company has an overseas parent which produces a consolidated report, the UK company must comply separately. It is expected that companies will report within the Non-Financial Information and Sustainability Statement which is part of the Strategic report.

Also of note is the new TNFD which published its final recommendations in September 2023. TNFD have confirmed that the recommendations align to those in IFRS S1 and S2 as well as TCFD. It focuses on nature's health and resilience for societies, economies, business and finance across 14 recommended disclosures.

Board Requirements

In addition to these new requirements, the Financial Conduct Authority (FCA) had amended the existing requirements for listing. They have added three new requirements around Board Diversity: at least 40% of the board should be women; at least one of the senior board positions should be a woman; and at least one member of the board should be from an ethnic minority background excluding white minorities. These rules are on a comply or explain basis with the view that this will allow smaller companies some flexibility and more time to comply. However, the FCA have been criticised by some for not having any sanctions in place for existing listed companies not meeting these new requirements.

The UK Corporate Governance Code

After a period of uncertainty as to what changes were going to happen to the Corporate Governance Code, January 2024 saw the Financial Reporting Council (FRC) publish the updated code. Following a consultation in 2023 as part of the FRC's commitment to restoring trust in Audit and Governance, the updated code was released on January 22nd 2024. Many of the updates focus on internal controls alongside smaller changes to streamline the requirements.

Asesoria's comment

Mairead McGuinness the European Commissioner for Stability, Financial Services and the Capital Markets Union, highlights the current environment well, stating that 'Sustainability reporting will now be on an equal footing with financial reporting'. With the numerous changes on the horizon, businesses will need to adapt quickly. Many companies have been focusing on developing their non-financial disclosures for some time but the new frameworks requirements aim to standardise sustainability and climate related disclosures.

These changes demonstrate a new direction for non-financial reporting that will impact a number of UK businesses with the need to report more widely on sustainability issues and have disclosed data externally verified. Companies will need to re-evaluate their non-financial reporting to meet the new globalised standards. Businesses should start by assessing their existing sustainability reporting process. Considering factors such as accessibility to sustainability data from their supply chain, the existing data management process, as well as understanding the processes of industry peers. Gap analysis is a useful tool for assessing the business prior to making fundamental changes. Gap analysis is the process of assessing the current business position, performance, and processes, with the view to identify the changes required between the organisation's current position and where it needs to be. Businesses can begin by asking:

- What do we report on now?
- What do we need to report on and when?
- How do we currently collect and manage non-financial data for reporting?
- Do we need to collect new or revised data?
- How are we going to close the gap?

If you have already started to plan, now is a good time to develop an actionable roadmap with key internal stakeholders, considering how to put your plan into action. This may include training employees on the new regulations, improving data management processes or making changes to your ESG KPIs.