

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Eighth Delegated Legislation Committee

DRAFT COMPANIES, PARTNERSHIPS AND
GROUPS (ACCOUNTS AND NON-FINANCIAL
REPORTING) REGULATIONS 2016

Thursday 8 December 2016

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Monday 12 December 2016

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The Committee consisted of the following Members:

Chair: Ms KAREN BUCK

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| † Burt, Alistair (<i>North East Bedfordshire</i>) (Con) | Mullin, Roger (<i>Kirkcaldy and Cowdenbeath</i>) (SNP) |
| † Crabb, Stephen (<i>Preseli Pembrokeshire</i>) (Con) | Perkins, Toby (<i>Chesterfield</i>) (Lab) |
| † Debbonaire, Thangam (<i>Bristol West</i>) (Lab) | † Raab, Mr Dominic (<i>Esher and Walton</i>) (Con) |
| † Doyle-Price, Jackie (<i>Thurrock</i>) (Con) | † Redwood, John (<i>Wokingham</i>) (Con) |
| † Efford, Clive (<i>Eltham</i>) (Lab) | † Smeeth, Ruth (<i>Stoke-on-Trent North</i>) (Lab) |
| † Esterson, Bill (<i>Sefton Central</i>) (Lab) | † Tugendhat, Tom (<i>Tonbridge and Malling</i>) (Con) |
| † James, Margot (<i>Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy</i>) | † Vickers, Martin (<i>Cleethorpes</i>) (Con) |
| † Johnson, Gareth (<i>Dartford</i>) (Con) | Katy Stout, <i>Committee Clerk</i> |
| Lynch, Holly (<i>Halifax</i>) (Lab) | |
| † Morton, Wendy (<i>Aldridge-Brownhills</i>) (Con) | † attended the Committee |

Eighth Delegated Legislation Committee

Thursday 8 December 2016

[Ms KAREN BUCK *in the Chair*]

Draft Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016

11.30 am

The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Margot James): I beg to move,

That the Committee has considered the draft Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016.

It is a pleasure to serve under your chairmanship this morning, Ms Buck. The main purpose of the draft regulations is to fulfil our obligation to transpose into law the non-financial reporting directive, or NFRD. While we remain a full member of the European Union, we will continue to implement EU legislation in a positive and cost-effective fashion. That is why we are in Committee today.

The NFRD builds on provisions in the EU accounting directive, which requires certain business entities to disclose a range of non-financial information alongside their accounts. The accounting directive applies only to certain types of business undertaking that have limited liability, including certain types of partnerships known as qualifying partnerships, as well as groups of business entities. I will generally refer to companies for simplicity's sake, but the Committee should please bear in mind that my remarks apply also to qualifying partnerships and groups.

The NFRD applies only to large companies that are defined as public interest entities and that have more than 500 employees, or to groups with a public interest entity parent, which are large groups having more than 500 employees within the group. Public interest entities are entities whose activities are of major interest to the public and include banks, insurance companies and quoted companies. We estimate that the total number of UK companies impacted by the NFRD will be about 260 such public interest entities. However, some 15,000 subsidiaries of public interest entities will also be impacted by the need for reporting across the corporate group.

The requirements of the directive were strongly influenced by the UK's existing regime for non-financial reporting. Consequently, the new framework broadly mirrors the requirements that apply to all the UK's quoted companies, regardless of their size, so the regulations will not significantly change company reporting. In one change, the regulations will cover all large public interest companies, not only those quoted on the stock exchange. Companies do not have to be quoted for their activities to have far-reaching consequences.

At present, all companies except those eligible for the small companies regime must publish strategic reports. Within the strategic report, companies that do not qualify

as medium-sized are required to provide analysis about the company's development and performance using non-financial information, which includes employee and environmental matters. Quoted companies must also publish information about social, community and human rights issues, including information about any company policies in relation to those matters. They must also give specific disclosure on gender diversity for directors, senior managers and employees.

The strategic report is the narrative element of a company's annual report. It should provide colour and context for the accounts and be forward looking to provide reassurance on the company's direction of travel for investors and suppliers. The report should contain a fair review of the company's position, as well as risks and uncertainties that are not easily quantified. Issues such as cyber-security and employee matters can be as significant as the fiscal issues covered in company balance sheets.

The draft regulations build on that by requiring eligible companies to disclose, to the extent necessary for an understanding of the company's position, information on environmental, employee, social and human rights matters. That is already required by the UK's existing regime for some of those companies, but the regulations also require disclosure of anti-corruption and anti-bribery matters.

Companies must also describe any policies they pursue in relation to any of these matters and identify the principal risks relating to them. These disclosures will provide companies with an opportunity to bring discussions on these issues to the boardroom and to demonstrate to shareholders and other parties that they are considering issues in their proper context and addressing potential risks.

The regulations strengthen the current regime by requiring companies that do not have policies in these areas to provide an explanation for not doing so. I stress that companies are not required to make policies in order to have something on which to report, but they will have to consider whether they should have policies on such matters. Furthermore, if they decide they should not, they will have to explain their reason for the omission.

The regulations also bring benefits by providing shareholders and investors with a greater level of consistency and conformity with EU counterparts in relation to non-financial information. This is important. Bringing entities of a certain size and type up to the same level will mean that UK companies within the scope of NFRD that currently provide such information will not face greater reporting requirements than EU counterparts.

The regulations are sufficiently flexible to enable disclosure to be specific to the company. This balance between specifying categories and allowing companies flexibility to provide relevant information should ensure that reporting is meaningful and cost-effective. Disclosure is important to ensure that shareholders can act as a critical friend to directors.

It is worth mentioning by way of reassurance that the regulations will not require disclosure of information about impending developments if the disclosure would be seriously prejudicial to the company's commercial interests. However, non-disclosure should not prevent a fair and balanced understanding of its position or the impact of its activity.

In our consultation earlier this year, stakeholders recognised the need to transpose the NFRD. During the consultation, stakeholders raised concerns about how the requirements would interact with the UK's existing regime. The regulations provide that a company that reports under the NFRD framework qualifies as having complied with overlapping elements of the UK's domestic regime. They also permit voluntary compliance with the NFRD disclosure requirements, so that companies can avoid the complexities of moving between reporting obligations during their life cycle as their size, in financial terms or staff numbers, increases or decreases year by year. I acknowledge the contribution from representatives of business, professional bodies and national regulatory bodies throughout the development of the regulations, including KPMG and PwC. I am grateful to them for their engagement.

Another aspect that I must mention briefly is that regulation 3 contains a minor correction to the transposition of the accounting directive. This ensures that the parent company of a small group cannot benefit from an exemption from the requirement to produce group accounts just because that member is established under the law of a European economic area state and not in the UK. If a member of a group is a public interest entity in any EEA state, the exemption should not be available.

I am aware that some businesses struggle with regulatory change to financial reporting. The regulations do not fundamentally change the UK's regime for annual reports. Many companies within the scope of the regulations will have to adapt their reporting only slightly. Although the changes are not substantial, I believe they will add value to company reporting in the UK.

Bill Esterson (Sefton Central) (Lab): This statutory instrument and the non-financial reporting that the Minister is describing follow the recent announcement about a change in corporate governance. I wonder whether she could tell us how the regulations fit in with the Government's plans for corporate governance.

Margot James: The regulations complement our framework in the corporate governance Green Paper but they do not touch directly on the main thrust of its proposals, which are mainly about the voice of workers and other stakeholders on boards and about executive pay. They are definitely in the same terrain, but I would not put them any closer than that.

It is greatly to our advantage for the UK to maintain its reputation as a hub of global transparency. However, as our future relationship with the EU becomes clearer, it may lead us to examine whether certain aspects of company law are cost-effective. In the meantime, I am sure Members will agree that building on the reputation of UK governance and the reliability of annual reports can contribute to making the UK an attractive place to invest. I commend the regulations to the Committee.

11.41 am

Bill Esterson: I am grateful to the Minister for her summary of the regulations. As she said, while we remain members of the EU, we continue to implement its directives. Some members of this Committee may be considering the irony of that situation, but that is where we are.

I raised the question of corporate governance because it struck me on reading the regulations and the Government's response to the consultation that this was an opportunity to pick up on many of the points considered in the Green Paper at an early stage, including, but not exclusively, worker representation on boards. At one point the Prime Minister was very keen on having elected representatives, but we seem to have gone into reverse on that. Perhaps the Minister will correct me if I am wrong, but my understanding is that a director will now represent workers, small businesses/suppliers and customers, and presumably that director will be appointed by the board.

A number of aspects of the regulations seem worthy of further debate. If we are to make the most of the opportunities afforded by non-financial reporting, matters such as how companies deal with worker representation and their relationships with suppliers and customers will fit directly with that approach.

John Redwood (Wokingham) (Con): Does the hon. Gentleman not think that this sums up the EU perfectly: no financial benefits, plenty of financial costs and we cannot do anything about it?

Bill Esterson: Just when we thought we had escaped the debate about the EU this morning.

There are opportunities, regardless of whether we are part of the EU. I happen to think it a very good thing for companies to report on their approach and attitude to wider stakeholders, because I think companies should behave responsibly. I hope hon. Members on both sides of the Committee agree with that. Section 172 of the Companies Act 2006 has provisions, which have never been enforced, about directors' long-term responsibilities to have regard to employees, suppliers and customers, to the community and the environment, to standards of business conduct and the importance of the company's reputation, and to the way they treat fellow directors and shareholders. Those matters would fit very well with duties to report non-financial matters. Do the Government intend to consider section 172 as part of this statutory instrument? What does the Minister think will be contained in the reports after it passes? We have no intention of dividing the Committee, because this instrument is a thoroughly good move, but perhaps she could tell us what she thinks will be in the reports.

The Minister mentioned gender reporting. Again, the diversity of company boards is exactly the sort of thing that should be seen in company reports, but is it also an opportunity to consider gender equality in terms of pay, or the difference between the top pay and the pay of everybody else in companies? Is it an opportunity to examine pay policy and have it clearly set out in the non-financial as well as the financial part of company reports? She mentioned that there will be omissions. Can she explain what those omissions will be and why things will be omitted, as well as whether she agrees about the areas that I would like to be included?

The Minister discussed the importance of employees. She also said that because of their security implications, cyber matters—I think that was the phrase she used—were as important in reports as financial matters. I agree, but that led me to think about electronic reporting. She can correct me if I am wrong, but I think the Government

[*Bill Esterson*]

are still considering requiring small firms, which are clearly outside the scope of the legislation—[*Interruption*]—she is confirming that to me by nodding—to undertake significant additional bureaucratic responsibilities by reporting quarterly using digital reporting. The feedback that I get—we have discussed this before, and I am sure we will discuss it again—is that that is time-consuming and expensive for many small firms that simply do not have the resources in-house to address them. Does she consider it ironic that, although she made it clear that she did not want to extend the responsibilities in these regulations any further than necessary beyond the largest firms, when it comes to electronic reporting, she is making small firms comply with time-consuming additional responsibilities?

I mentioned the importance that I think we should attach to the wider stakeholders when it comes to the responsibility of business to society. These regulations are a move in the right direction. Non-financial reporting is extremely important, and I hope that the Minister will take on board the opportunity that the regulations present, alongside the corporate governance Green Paper, to partner with business to develop the relationships and arrangements with the wider community and society that are the hallmarks of a successful business environment and a prosperous economy and country.

11.49 am

Margot James: I thank the hon. Gentleman for his thoughtful comments and questions. He mentioned the Green Paper on corporate governance again and asked whether we were going backwards on certain of the commitments made, particularly in relation to the voice of workers, suppliers and other stakeholders on boards. He mentioned one particular proposition in the Green Paper to have a non-executive director responsible for ensuring that those voices are heard, but that is just one of several options. The Green Paper is not prescriptive at all. We are consulting at this stage, and he is welcome to contribute his thoughts. We will be collecting the thoughts of many other stakeholders with a view to reaching conclusions in future, but it is certainly not prescriptive at this stage.

I agree with the hon. Gentleman when he points to section 172 of the Companies Act 2006. Since the Act came into being there has perhaps been an over-emphasis on the undoubtedly vital subject of ensuring that the board of directors ensures a return for investors. However, inadequate attention has been paid to the other requirements on a board of directors that contribute in their entirety to the long-term future of the company and to the responsibility of directors to secure that long-term future by their decision making. I very much hope that the outcome of our consultation on the Green Paper and the steps taken as a result will up-weight those other requirements on directors. That is an aspiration and not in any way prescriptive, because at this stage it is all a consultation.

The hon. Gentleman talked about gender reporting and the gender pay gap.

Bill Esterson: I want to work with the Minister on these points, so just to be clear and in no doubt, can she say whether she and the Secretary of State—and, as far

as she knows, the Prime Minister—are open to all the elements of section 172 being implemented in full? [*Interruption.*] That is obviously a call from the Prime Minister to answer my question. This is an important issue for the wider stakeholders, so will the Minister please clarify whether the Government are open to that?

Margot James: I am sorry to disappoint the hon. Gentleman, but I have said all I can say about that particular matter.

The hon. Gentleman also asked about gender reporting and the gender pay gap. Gender pay reporting is in legislation at the moment. We intend for that to lead over time to a closure of the gender pay gap. It may not be adequate to the task in and of itself, but it has to be given a chance. I very much share the hon. Gentleman's concerns about the unacceptable level of the current gender pay gap.

The hon. Gentleman mentioned the subject of omissions in the context of this directive being—

Bill Esterson: Before the Minister moves on, I have a question about gender reporting. The Government's response referred to senior managers in gender reporting. Is the Minister saying that it applies to all employees, not just senior management?

Margot James: I am so sorry; I do not think I can answer that at this point. It is actually in relation to boards of directors, senior management and the entire workforce, I believe. If I am incorrect about that, I will write to the hon. Gentleman.

To continue answering the hon. Gentleman's point about omissions, the directive places the obligations on companies on a "comply or explain" basis. He mentioned the quarterly reporting of financial information and the pressures that that bears on small and medium-sized enterprises, particularly the very small companies.

I have met the Federation of Small Businesses and listened to its concerns. This is a Treasury matter—it is not actually my or my Department's area of responsibility—but I have also met the relevant Treasury Minister to raise the concerns expressed to me by the FSB. The Treasury is consulting on the matter of quarterly reporting and is prepared to make certain changes that the FSB has told me will be of benefit to its members. There is a move. It will not fundamentally alter the requirement for quarterly reporting, but it raises the threshold for a company's turnover before it qualifies as being required to comply with the regime and in certain cases the requirement will be delayed. However, that is really a question that the hon. Gentleman should raise with Treasury Ministers.

I thank hon. Members, in particular the hon. Member for Sefton Central, for their valuable comments during this debate. The regulations strike the right balance between offering flexibility for companies to report on those issues of risk that relate to their activities and provide a structure that makes the disclosures meaningful. The regulations should help to increase the transparency of how our companies behave and better equip shareholders to be active stewards of the companies they own.

Question put and agreed to.

11.55 am

Committee rose.