Practical guide to the non-financial and sustainability information statement for group companies

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1. Purpose of this Practical guide

For periods beginning on or after 6 April 2022, climate-related financial disclosures closely aligned with the Taskforce on Climate-related Financial Disclosures (TCFD) framework have been extended to certain public companies other than premium and standard listed companies and also to certain large private companies and limited liability partnerships.

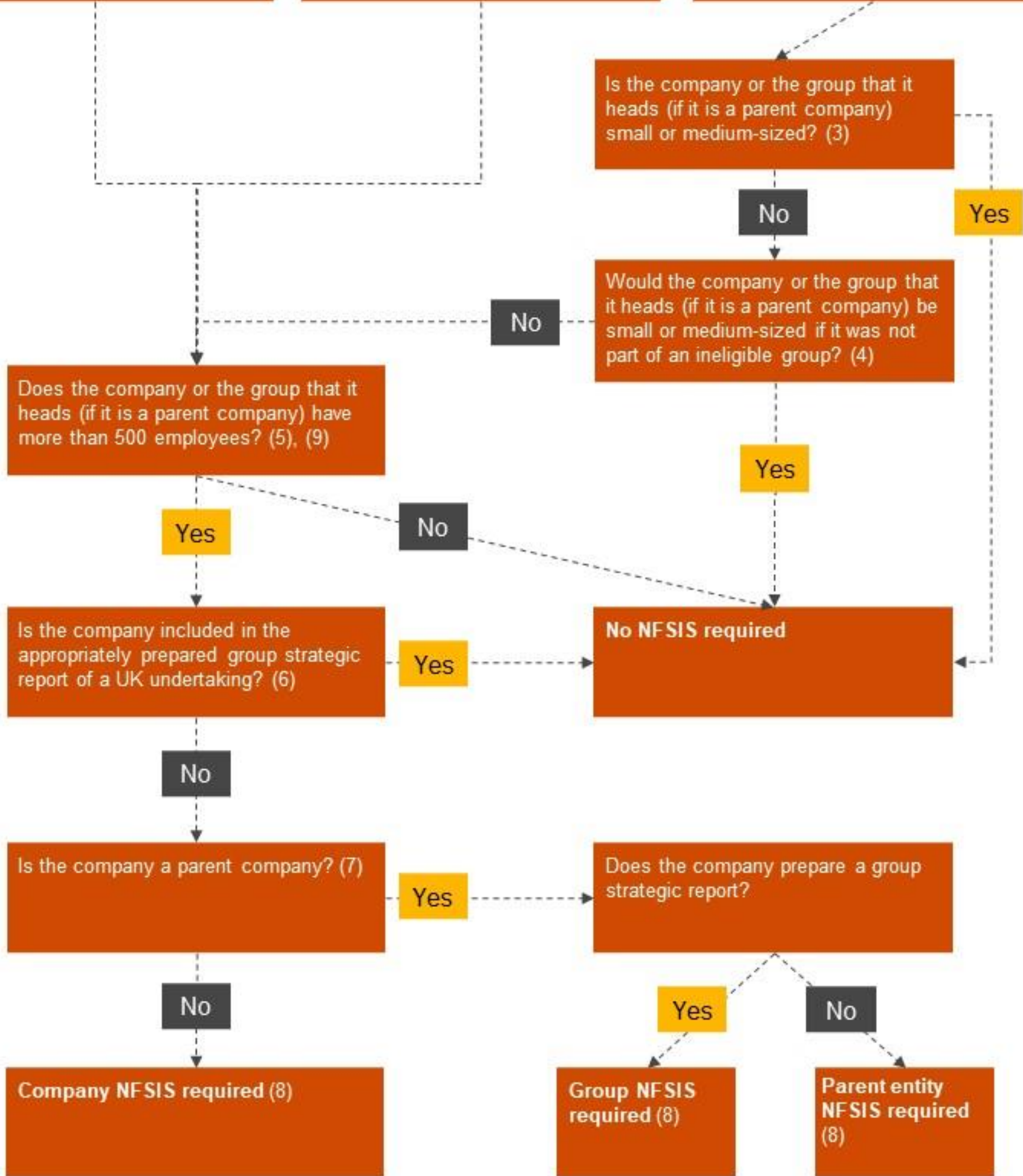
This Practical guide includes a reminder of the scope and applicability of the requirements for companies under sections 414CA and 414CB of the Companies Act 2006. Those sections result in a new non-financial and sustainability information statement (NFSIS) as part of the strategic report, replacing the previous non-financial information statement (NFIS) that was required for UK public interest entities (PIEs) with over 500 employees.

The Practical guide also focuses, in particular, on the implications of the NFSIS for companies that form part of a group, especially intermediate parent companies and subsidiaries.

2. Reminder of the scope and applicability of the new requirements

The flowchart and accompanying notes below are designed to help establish whether a company is within the scope of the new requirements. The requirements apply to three categories of company, and so there are three starting points at the top of the flowchart. As a reminder, the companies required to prepare an NFSIS are as follows:

- UK PIEs: All UK-registered companies that are currently required to produce an NFIS, being UK companies that have more than 500 employees *and* have transferable securities admitted to trading on a UK-regulated market or are banking companies or insurance companies.
- UK AIM companies: UK-registered companies with securities admitted to AIM with more than 500 employees.
- 'High turnover' companies and groups: UK-registered companies, or the groups that they head (where they are parent companies), with turnover of more than £500 million and more than 500 employees.


UK PIE (1)
The company is a UK PIE
• Traded company
• Banking company
• Authorised insurance company
• Company carrying on insurance market activities
AIM company
The company is registered on AIM
High turnover company (2), (9)
The company or the group that it heads (if it is a parent company) has turnover of more than £500 million
Is the company or the group that it heads (if it is a parent company) small or medium-sized? (3)
No
Yes
Would the company or the group that it heads (if it is a parent company) be small or medium-sized if it was not part of an ineligible group? (4)
No
Does the company or the group that it heads (if it is a parent company) have more than 500 employees? (5), (9)
Yes
Yes
No
Is the company included in the appropriately prepared group strategic report of a UK undertaking? (6)
Yes
No NFSIS required
No
Is the company a parent company? (7)
Yes
Does the company prepare a group strategic report?
No
Yes
No
Company NFSIS required (8)
Group NFSIS required (8)
Parent entity NFSIS required (8)

Flowchart notes

1. A 'traded company' for these purposes is defined in section 474 of the Companies Act 2006 as *"a company any of whose transferable securities are admitted to trading on a UK regulated market"*. The main market of the London Stock Exchange will be the most relevant of these in practice (including both premium and standard segments of this), but not AIM. 'Insurance market activity' means a regulated activity relating to contracts of insurance written at Lloyd's.
2. 'Turnover' is defined in section 474 of the Act as *"… the amounts derived from the provision of goods and services ..., after deduction of trade discounts, value added tax, and any other taxes based on the amounts so derived"*. For groups, the thresholds apply on a consolidated (not an aggregate) basis (that is, after the elimination of group transactions). This means that other income-related line items should not be included when applying the thresholds, a point which can be particularly relevant in the financial services sector. (Note that companies exceeding these thresholds are called 'high turnover companies'.)
3. This would not apply in practice to UK PIEs or AIM companies, because those entities are excluded from being small or medium-sized under sections 384 and 467 of the Companies Act. The thresholds for a company to qualify as large under sections 465 and 466 (subject to smoothing provisions) are two out of three of the following: £36 million turnover; £18 million balance sheet total assets; and 250 employees.
4. Entities can be exempt from preparing a strategic report (and therefore an NFSIS) if they are only excluded from being small or medium-sized because they are part of an ineligible group (section 414B).
5. The employee threshold is calculated as the monthly average number including all employees, not only those employed in the UK (section 414CA(5)).
6. The group strategic report must include the company and its subsidiary undertakings (if any); the report must be prepared for a financial year of the parent undertaking that ends at the same time as, or before the end of, the company's financial year, and the report must include a group NFSIS in respect of all of the undertakings included in the consolidation.
7. This would include intermediate parent companies. It would also include premium and standard listed companies that are required to report under the Listing Rules against the TCFD framework – there is no cross-exemption between the two.
8. Companies in scope because they are registered on AIM or are high turnover companies are only required to include the climate change reporting aspects of the NFSIS in their statement, and not the 'non-financial information' requirements (on environmental matters, the company's employees, social matters, respect for human rights, and anti-corruption and anti-bribery matters) from the former NFIS (section 414CB(A1)(1)).
9. There are no smoothing arrangements for the NFSIS, in first or subsequent years, and so exceeding the thresholds once will result in reporting being required. This was also the case for the NFIS.

Further guidance on the requirements is available in:

- BEIS (now Department for Business and Trade) Non-binding guidance
- PwC FAQs on climate-related financial disclosures under the UK Companies Act (Viewpoint subscription required)

3. Implications for reporting by companies that form part of a group

Pragmatic approach

We encourage every organisation to produce high-quality reporting but also recognise that the primary purpose of an annual report is to report to the members of the company. So, in situations where the members already have a good understanding of the company's development, performance and position – as is the case for many wholly-owned subsidiaries, including intermediate parent companies – it can be appropriate to take a pragmatic approach to the nature and extent of what is reported. This can involve, for example, including relatively brief disclosures and/or cross-referring to other reports (such as the annual reports of other group companies or separate sustainability reports) for further information.

The nature of climate-related risks and opportunities is such that they are particularly likely to be managed on a group basis, with the implications for individual subsidiary entities often being secondary.

This is recognised in the NFSIS requirements by the availability of an exemption from reporting for subsidiaries that are included in the group strategic report of a UK parent. But a group strategic report is not always prepared by a UK parent, especially where the ultimate parent is incorporated outside the UK. One or more entities within a group can therefore be required to prepare their own NFSIS, even though climate change is managed on a group basis. In such cases, the group might want to focus the reporting effort on the top UK company in the group, or on the main UK operating company, for instance.

The guidance below expands on the factors that need to be considered when taking such an approach. Two illustrative examples are also included at the end of this document.

Legal considerations

There are two main legal considerations to take into account:

1. Directors' duties under section 172 of the Companies Act

   Although, as noted above, the primary purpose of an annual report is to report to a company's members (generally, its shareholders), section 172(1) requires directors to have regard to a number of other factors, including the interests of a range of other stakeholders, and a specific statement on how this has been done is required under section 414CZA of the Act. This will need to be considered, where applicable, when deciding on the approach to climate change reporting – it is possible that certain stakeholder groups will have an interest in a particular entity's impact on the environment (which is also a factor that needs to be considered by directors under section 172).

2. The requirements of section 414CB

   Under section 414CB, directors must *always* include the following in the NFSIS:

   A. A description of the organisation's governance arrangements in relation to assessing and managing climate-related risks and opportunities.

   B. A description of how the organisation identifies, assesses, and manages climate-related risks and opportunities.

   C. A description of how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management process.

   D. A description of:

      i. the principal climate-related risks and opportunities arising in connection with the organisation's operations, and
      ii. the time periods by reference to which those risks and opportunities are assessed.

The other elements of section 414CB below are not required where the directors *“reasonably believe that having regard to the nature of the organisation’s business, and the manner in which it is carried on”*, they are *“not necessary for an understanding of the organisation’s business”*.

E. A description of the actual and potential impacts of the principal climate-related risks and opportunities on the organisation’s business model and strategy.

F. An analysis of the resilience of the organisation’s business model and strategy, taking into consideration different climate-related scenarios.

G. A description of the targets used by the organisation to manage climate-related risks and to realise climate-related opportunities and of performance against those targets.

H. A description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based.

Where any of these are omitted, the strategic report must provide a clear and reasoned explanation for doing so.

When companies are considering their approach to the NFSIS, they will therefore need to make judgements about the extent to which parts E to H are necessary, based on the governance and risk management processes set out in parts A to D.

Companies might also look for guidance on how to make these judgements, including how much is enough to report in respect of the mandatory parts of section 414CB. The related decisions will need to be made on a case-by-case basis, but some general principles and guidance on how they might be applied by wholly-owned subsidiaries are set out below, starting with intermediate parent companies.

Intermediate parent companies

As shown in the flowchart above, intermediate parent companies can be required to prepare a NFSIS. This is most likely to apply because the group headed by the intermediate parent company exceeds the ‘high turnover’ thresholds (more than £500 million turnover and more than 500 employees) without the subsidiary or other potential exemptions being available to it.

Where an intermediate parent company prepares only an entity strategic report (which is often the case where there is a chain of holding companies in a group), the NFSIS should relate to it as a parent company entity.

Where an intermediate parent company prepares a group strategic report, the NFSIS will also need to cover all of the companies in its group.

Content of the entity-only NFSIS of an intermediate parent

As set out above, the directors would need to have regard to the legal considerations, including their duties under section 172, and show how these have been addressed as part of the section 172 statement, where applicable.

Where a parent company does not prepare a group NFSIS, the Non-binding guidance states that *“the climate-related financial disclosures should … includ[e] how climate-related risks and opportunities may affect the value of the investment in [its] subsidiaries”*. [FAQ 2 in Section 1 C].

Matters that could affect the value of an investment would often need to be very significant, as opposed to the day-to-day management of climate-related risks and opportunities that might be disclosed in an operating subsidiary, for instance.

Similarly, it might not be thought necessary to carry out scenario testing or establish metrics and targets (parts F, G and H in section 414CB) beyond monitoring the overall impact of climate change on the subsidiary. As noted above, the Regulations allow for this, provided that the judgements are explained.

Where there is a chain of intermediate parent companies, group management might decide to include the main disclosure on the basis set out above in the top UK entity and cross-refer to this from the other entities that need to make a statement. A formal NFSIS heading and text explaining what has been done to meet the minimum requirements for compliance (including parts A to D of section 414CB) would still be necessary in the other entities.

Intermediate parents or subsidiaries that are finance companies might have to consider the valuation of inter-company receivables as well as the carrying value of investments, but the same principles apply as those set out above.

Content of the group NFSIS of an intermediate parent

For intermediate parents that prepare a group statement, a range of approaches to the content could be appropriate to reflect the nature of those entities, including the following:

- Disclosures that reflect the climate-related information of the underlying operating business(es) in the group, with much of the information being taken from them.
- Disclosures that largely cross-refer to another group NFSIS of a UK parent further up the group (provided that this will be available from the same time).
- A combination of the two.

The choice would depend on the circumstances of the particular group but, again, a pragmatic approach is possible (subject, as always, to demonstrating compliance with the legal requirements in section 414CB and taking into account the factors in section 172).

Note that it would *not* be appropriate for a parent entity to cross-refer to the climate report of a subsidiary as, by definition, this would not include the climate-related information of its parent.

Wholly-owned operating subsidiaries

Many wholly-owned operating subsidiaries are likely to be able to take the exemption from reporting that results from being included in the group strategic report of a UK parent company.

However, the Non-binding guidance confirms that: *"A subsidiary of a parent company that does not produce consolidated accounts, and that is within scope on an individual basis, should also make climate-related financial disclosures in its individual accounts"*. In practice, as noted above, this will often be because the group annual report is prepared by a non-UK parent.

The climate change disclosures of a wholly-owned operating subsidiary are likely to be more extensive than those of an intermediate parent company entity, but it is still appropriate to consider the nature of the entity and its role in the group to which it belongs. For instance, where there is a single operating subsidiary in a group or several operating subsidiaries that are all subject to similar climate-related considerations, it might be appropriate to provide only minimum disclosures to comply in all but one of the subsidiaries and fuller information in the main UK operating business (with appropriate cross-references to where the additional information can be found).

Cross-references could also be made to the climate-related disclosures of a non-UK subsidiary or parent (again, as long as this additional information is not necessary for minimum compliance purposes).

The following illustrative disclosures are based on the principles set out above, where the circumstances mean that a company might choose to take the 'minimum for compliance' approach to its disclosures. Clearly, the fact patterns represented would need to be adapted to fit the actual situation.

4. Illustrative disclosure for a UK intermediate parent company

Non-financial and sustainability information statement

The directors consider that the climate-related risks and opportunities of the company are integrated with those of the XYZ plc group, and that any climate-related impact on the company itself would originate in the operating businesses of the group. Accordingly, the directors primarily consider climate change in relation to potential changes in the carrying value of the company's assets including its investments in subsidiaries and amounts due from group undertakings, which would be driven by factors arising in the wider group. The assessment of carrying values is carried out at least annually, or when a triggering event occurs, and no impairment charge has resulted to date. [1]

The interests of the company's stakeholders within and outside the group are also considered as part of this assessment, when appropriate. [2] [3]

Accordingly, the climate-related risks and opportunities of the XYZ plc group, and its arrangements for managing them (including the related time periods and potential impacts on the group's business model and strategy), are discussed further on page x of the group's annual report, which does not form part of this report.

As a result of the above, the directors do not consider that it is necessary for an understanding of the company's business to include here a description of the actual or potential impacts on the business model and strategy or their resilience under different climate-related scenarios, or the targets or key performance indicators used. [4]

Notes

[1] The first paragraph addresses parts A to D in the list in section 414CB.

[2] Section 172(1) matters could be addressed as part of the section 172 statement rather than here.

[3] The XYZ plc group report provides further information but minimum compliance is reached through the disclosures within the statement.

[4] The fourth paragraph addresses the need to explain why parts E to H have not been addressed. Further information on these might also be included in the group report.

5. Illustrative disclosure for a wholly-owned UK operating subsidiary of a US ultimate parent

Non-financial and sustainability information statement

The directors consider that the climate-related risks and opportunities of the company, including how they are identified, assessed and managed, are integrated with those of the XYZ Inc. group, because the company is one of the two main operating businesses in the group and a number of UK directors are members of the group executive committee.

The principal climate-related risks and opportunities for the company are the transitional risks associated with future government and regulatory measures and the physical risks connected with predicted rises in sea level at the company's main operating location. [1]

Both of these have been included in the group's scenario analysis and will continue to be monitored by the directors as more information becomes available. The directors do not consider that it is necessary for an understanding of the company's business to establish specific targets or key performance indicators as yet, because of the nature of these risks. [2] [3] [4]

The climate-related risks and opportunities of the XYZ Inc. group (including the related time periods), and its arrangements for managing them, are discussed further on page x of the group's annual financial report, which does not form part of this report.

Notes

[1] The first two paragraphs address parts A to D in the list in section 414CB.

[2] The third paragraph addresses parts E and F and the need to explain why parts G and H have not been addressed.

[3] The XYZ Inc. group report provides further information but minimum compliance is reached through the disclosures within the statement.

[4] Section 172(1) matters would also have to be addressed here if not appropriately covered in the section 172 statement.

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