Invested in a better future

Narrative reporting technical briefing

November 2023 (Updated)

Subject	Narrative reporting developments for private equity firms and their portfolio companies.
Effective date	The latest developments come into force on for accounting periods beginning on or after 1 January 2022. Others include reporting in future periods that will be relevant for members.
Impact	Large UK private companies and non-EU companies operating in the EU (subsidiaries) will need to assess which narrative reporting requirements they must comply with and start preparing for them.

Summary

The last number of years has seen the introduction of a number of the reporting requirements, especially related to sustainability and increased corporate governance.

Strategic and directors' reports

All companies (except micro entities) are required to prepare a directors' report containing certain basic information. Additionally, all companies, except Small companies are required to prepare a strategic report. A company will be considered Small, Medium or Large under CA 06, if it meets two of the three thresholds below. Further analysis is required where a company moves between categories in two consecutive financial years.

	Small Company	*Medium Company*	*Large Company*
Turnover	Not more than £10.2m	Not more than £36m	More than £36m
Balance sheet total	Not more than £5.1m	Not more than £18m	More than £18m
Number of employees	Not more than 50	Not more than 250	More than 250

Some companies will be treated as Large regardless of the above thresholds, including public companies; companies that carry out insurance market activities; authorised insurance or banking companies; e-money issuers; MiFID or UCITS management companies; or companies with transferable securities trading on a regulated market in the EEA.

Narrative reporting requirements

The narrative reporting requirements for private equity and venture capital-backed companies varies in terms of what needs to be reported, when it comes into force, which companies they apply to, and where they must be reported. The table overleaf seeks to identify all these different requirements to help our members.

It is non-exhaustive, covers narrative reporting by private companies only (although aspects may be relevant for public companies) and focuses on the reporting to be found in companies' strategic and directors' reports, as well as any similar reporting requirements.

Date Introduced	Requirement	Effective date	Which companies does this apply to?	What needs to be reported? *This is an overview only. Please refer to the relevant act or regulation for full requirements.*	Where does it need to be reported?
November 2006 (updated in August 2013)	Strategic Report disclosures (CA 06)	In effect	All UK companies except Small companies per CA 06.	The strategic report must include: • A balanced and comprehensive analysis of development and performance during the year and position at the year-end • Principal risks and uncertainties facing the company • Financial key performance indicators (KPIs) • Non-financial KPIs (Medium-sized companies per CA 06 are exempt from providing this information)	In the strategic report.
November 2007 (updated in July 2014)	Walker Guidelines	In effect	Buyout of a portfolio company with an enterprise value at acquisition of £350m (or £210m if public to private) AND a significant presence in the UK - either: • more than 50% of revenues derived in the UK ; OR • more than 1,000 full time equivalent employees).	Besides the strategic report requirements above, companies must also report on the following (typically applicable to quoted companies): • Strategy • Business model • Trends and factors affecting future development, performance or position • Environmental matters • Employees • Social, community and human rights issues • Gender diversity Companies must also report on certain Walker Guidelines-specific disclosures: • Identity of private equity firm • Details on board composition • Financial review – position and financial risks • Statement of conformity with the Guidelines	In the strategic report (or directors' report for a non-UK company).
June 2014	Energy Savings Opportunity Scheme (ESOS)	In effect Participants do not need to submit notification of compliance until 5 June 2024.	Large UK undertakings and their corporate groups. For the third phase of the compliance period (31 December 2022), a large undertaking is defined as a UK company that either: • Has annual turnover in excess of £44 million and an annual balance sheet total in excess of £38 million or • Employs 250 or more people A corporate group is in scope of the requirements if at least one UK group member meets the ESOS definition of large undertaking. The highest UK parent will act as a 'responsible undertaking' and have responsibility for ensuring compliance across the whole group.	Companies will be required to: • Calculate total energy consumption (used by assets held or the activities undertaken by organisation or group). This includes industrial processes, buildings and transport. The UK Government will update guidance on compliance with ESIS once phase 3 requirements have been enacted into legislation. • Identify areas of significant energy consumption (as a result of activities undertaken by your organisation or by assets held), accounting for at least 95% of total consumption. Companies will need to establish: 1. If ISO 50001, DECs or GDAs cover any of the areas of significant energy consumption 2. If ESOS compliant energy audits have been undertaken or need to be carried out. This would be on areas of significant energy consumption not covered by DECs, GDAs or ISO 50001. A combination of approaches can be used if 95% of the total energy consumption is covered. • Appoint an ESOS lead assessor to validate their ESOS assessment. Employees or external contractors can be appointed lead assessors if they are members of an approved professional body register. • Notify the Environment Agency once the ESOS assessment has been completed. Companies will be required to outline details of the organisation, its compliance, information on its energy consumption and opportunities where energy can be saved. • Maintain a record of how it has complied with ESOS. There is no set format for this.	A notification of compliance should be submitted through the UK Government website.
March 2015	Modern Slavery Act 2015	In effect	Organisations with UK operations and turnover in excess of £36m.	A statement detailing all steps taken during the financial year to ensure that slavery and human trafficking are not taking place in any of the company's supply chains or any part of the business. This must be approved by the board of directors and signed by a director (or equivalent).	On the company's website with a prominent link on the homepage.
December 2016	Non-financial reporting (CA 06 amendment)	In effect	With respect to private companies, any group of companies that has more than 500 employees on average in the financial year, AND either has transferable securities trading on a regulated market in the EEA or is a banking or insurance company.	A non-financial statement must be produced disclosing, as a minimum, information on: • the company's business model; • non-financial KPIs; and • policies on the matters listed below, including due diligence processes implemented, the outcome of those policies, the principal risks relating to those matters, and how the company manages the principal risks. The matters to be covered are: o environmental matters (including company's impact on the environment); o the company's employees, and social matters, and respect for human rights; and o anti-corruption, and anti-bribery matters. If the company does not pursue policies in relation to any of these matters, a clear and reasoned explanation for not doing so must be disclosed. The statement should also refer to amounts included in the company's annual accounts, where appropriate.	In the strategic report.
February 2017	Gender Pay Gap Information	In effect	Employers with 250 or more relevant employees. A relevant employee is someone who ordinarily works in the UK	Each year on 5 April, employers must publish: • the percentage difference in mean pay between male and female employees; • the percentage difference in median pay between male and female employees; • the percentage difference in the average bonuses received by male and female employees;	On the company's website. Employers must also upload evidence of compliance on a

	Regulations 2017		and whose contract is governed by UK legislation.	• the proportion of men and women who receive bonuses; and • the number of men and women in each quartile of pay within the workforce.	government-sponsored website.
July 2018	Section 172 reporting (CA 06 amendment)	In effect	Large companies per CA 06.	Companies must include a statement describing how directors have complied with their duty to have regard to the matters set out in s.172 CA 06.	In the strategic report and on the company's website.
				Companies must also report on directors' engagement with suppliers, customers and others in a business relationship with the company. This will comprise of a statement summarising how directors have had regard to foster such relationships and the effect of that regard on the principal decisions taken by the company during the financial year.	In the directors' report. Companies can report this in their strategic report as part of their s.172 statement (see above) and should signpost this in the directors' report.
			All companies employing on average more than 250 employees in the UK.	Companies must build on the current directors' report requirement to discuss employee involvement matters by summarising how directors have engaged with employees, had regard to their interests, and the effect of that regard on the principal decisions taken by the company during the financial year.	
	Corporate Governance arrangements reporting (CA 06 amendment)		UK companies that are not already required to report on their corporate governance arrangements with either: • 2,000 or more global employees; or • A turnover over £200m globally and a balance sheet over £2bn globally	Companies will have to include a statement stating which corporate governance code (defined as a code of practice on corporate governance), if any, has been applied and how. If the company has departed from any aspect of the code, it must set out where it did so, and the reasons. If the company has not applied any corporate governance code, the statement must explain why that is the case and what arrangements for corporate governance were applied. To aid large private companies in disclosing how corporate governance processes operate within the businesses, a coalition (including the BVCA) has been developing a set of corporate governance principles for companies to report against (see the Wates Principles overleaf).	In the directors' report and on the company's website.
November 2018	Streamlined energy and carbon reporting (CA 06 amendment)	In effect	All quoted UK companies and all Large (per Companies Act 2006) UK incorporated unquoted companies. Very low energy users are exempt from reporting.	Unquoted companies will be required to report their UK energy use and associated intensity scope 1 and 2 emissions. As a minimum, this should include electricity, gas and transport. An intensity metric will be required, but metrics used will be left to individual sectors and existing best practice and guidance. An exemption to not report where it is not practical to do so has also been provided. Narrative commentary on energy efficiency action taken will be required, but will not require disclosure of ESOS recommendations and how they have been taken forward.	In the directors' report.
December 2021	Taskforce for Climate Related Financial Disclosures (TCFD)	In effect. First required disclosure date for large asset managers is 30 June 2023. First required disclosure date for small asset managers (with less than £50 bn in AUM) is 30 June 2024 First required disclosure date for a large company is on or after 6 April 2023. (Applicable to financial years starting on or after 6 April 2022).	Largest Asset Managers (>£50bn; 3 year rolling average). Smaller Asset Managers (between £5bn & £50bn). Managers below £5bn (3 year rolling average) are currently out of scope. Large company: >500 employees and £500 million in turnover.	TCFD reporting provides consistent, decision-useful and forward-looking information on the material financial impacts of climate change. The in scope company is required to include information under four headings: • Governance - The organization's governance around climate-related risks and opportunities; • Strategy - The organization's governance around climate-related risks and opportunities; • Risk Management - The processes used by the organization to identify, assess, and manage climate-related risks; and • Metrics and Targets - The metrics and targets used to assess and manage relevant climate-related risks and opportunities.	In the front half of the annual report (strategic report section) and on the company website.

June 2023	ISSB Sustainability Standards (IFRS S1 & S2)	The standards are not yet mandatory. Will apply for financial reporting periods beginning on or after 1/1/24	The Standards will apply to corporate entities that are required or choose to prepare general purpose financial statements and build upon existing market standards, such as those issued by the Task Force for Climate Related Financial-Disclosures and the Sustainability Accounting Standards Board. However, the ISSB does not have the right to mandate the application of the Standards. Adoption is currently being considered in the UK.	Companies who adhere to IFRS S1 and IFRS S2 will supposedly be compliant with the TCFD recommendations. This has not been tested. IFRS S1 provides a list of requirements to communicate with a company's investors. It requires an entity to disclose information about all sustainability-related risks and opportunities that affect the entity's cash flows, access to finance or cost of capital over the short, medium or long term. IFRS S1 consists of four core content areas (similarly to TCFD) that enable understanding of: • Governance - processes, controls and procedures used to, manage and oversee sustainability-related risks and opportunities; • Strategy - for managing sustainability-related risks and opportunities; • Risk Management - processes to identify, assess, prioritise and monitor sustainability-related risks and opportunities; and • Metrics and Targets - performance in relation to a company's sustainability-related risks and opportunities, including progress towards any targets the company has set, or any targets it is required to meet by law or regulation. IFRS S2 sets out the specific climate-related disclosures and requires the disclosure of information about both cross-industry and industry specific climate-related matters. IFRS S2 is closely linked to IFRS S1, as any company applying IFRS S1 is obligated to apply IFRS S2 to identify and disclose material information about its climate-related risks and opportunities. As for IFRS S1, a company is required to disclose information about its governance, strategy, risk management and metrics and targets related to the climate. They can be applied in accordance with IFRS Accounting Standards or other generally accepted accounting principles or practices ("GAAP"). Corporate disclosures on sustainability related opportunities and risks will be set out in the UK Sustainability Disclosure Standards (SDS), based on the IFRS S1 and IFRS S2. The UK SDS will only diverge from on IFRS S1 and IFRS S2 on UK specific matters, if is necessary. A decision on whether the UK Government will endorse the IFRS Sustainability Disclosure Standards and establish UK SDS will be made by July 2024.	In general purpose financial reports. Does not specify a location however it is most likely it will be found in the front half.
June 2023	Corporate Sustainability Reporting Directive (CSRD)	Member states must have incorporated CSRD into national law by July 2024. Will apply to large, unlisted EU companies (including EU subsidiaries of non-EU parent companies) which exceed two of the following criteria: • Net turnover of more than €40 million; • More than 250 employees • Balance sheet total of €20 million EU companies with a non-EU parent company will be in scope from 2028	Large EU companies (including with non-EU parent company), which exceed two of the three criteria; 250 employees, €40 million revenue and €20 million in total assets, will be in scope. This applies from 1 January 2025 (first reporting due 2026). These thresholds are likely to increase by 25% in the near future. Non-EU companies with net turnover exceeding €150 million in the EU in each of the previous two years with either: i. A subsidiary considered a 'large undertaking' (an entity that meets two of the three criteria as noted above) in the EU or that has EU listed securities; or ii. A significant EU subsidiary/branch (EU subsidiary must be large and/or its EU branch must have at least €40 million turnover in the EU). Sustainability impact report at group level of non-EU company will apply from financial year 2028 (to be published in 2029). Sector-specific standards to be adopted by the European Commission by 30 June 2024	Companies in the scope of CSRD are required to report in accordance with a detailed set of standards, the European Sustainability Reporting Standards (ESRS). The ESRS aims to increase the consistency, accuracy, and comparability of sustainability reporting. Private equity sponsors in scope should: i. <u>Identify entities in scope and consider the reporting required</u> – firms will apply the "double materiality" (financial and impact) assessment. While the climate change standards are closely aligned to TCFD, ESRS requirements include disclosing material information on the sustainability-related impacts, risks and opportunities on a double materiality basis and may require disclosures beyond these other requirements. The ISSB, European Commission and European Financial Reporting Advisory Group (EFRAG) have ensured alignment and interoperability between the ISSB Standards and ESRS, and guidance will be published to assist firms (publication date not yet known). However, it is clear that there are very material differences between the standards. ii. <u>Consider the scope of the value chain and reporting required</u> – reporting is required on environmental and social matters in a value chain (where specified in the ESRS) broadly defined as its supply, marketing and distribution channels, with customers also treated as part of the value chain. iii. <u>Concept of value chain in private equity context</u> – applying the concept of a value chain in private equity could broaden the reporting required. Private equity managers are required to report on GHG emissions in their portfolios as set out in ESRS climate change reporting standard. Further clarity is needed on the reporting requirements for firms who as delegated portfolio managers or sub-advisors to entities (defined as "customers" and are thus part of the value chain). Sector specific standards are not expected until 2024. The position of structures governed by nominated directors of the fund sponsor (i.e., holding companies for portfolio company groups and co-investment vehicles) will also need to be considered. The sustainability standards do not provide the same exemptions for consolidation between funds and portfolio companies, as those developed under financial reporting standards. iv. <u>Identify an external assurance provider</u> – private equity sponsors will need to consider the terms of engagement and scope of the work that will be provided as part of the "limited" assurance exercise to provide significant judgement on the nature of checks. For portfolio companies, sponsors should identify those who will be in scope and assist with the preparation of reporting, through: • Identifying important value chains • Enhance understanding of the standards and the internal operational framework to help with compliance • Identifying gaps in the data currently collected against the requirements under the standards • Preparing questionnaire for companies in distribution and supply chains There are a number of exemptions included in the Directive, including due to consolidation and on financial products referenced in SFDR.	Dedicated section in management report – companies will be required to digitally tag reported sustainability information as per digital taxonomy. Further detail remains to be seen. Machine readable format to a central European access point.

				The ESRS will permit the omission of sensitive information about a company's strategy, plans and actions, when it is connected with intellectual property, results of innovation and know-how.	
January 2023	Corporate Sustainability Due Diligence Directive (CS3D)	Adoption expected in 2024 (Trilog stage) but the European legislators currently have different views on the text. All details are therefore subject to change. For large EU and EU-listed companies, rules are expected to be phased in from 1 January 2024. Rules are expected to be applicable to all in-scope companies by 1 January 2028.	EU companies with more than 500 employees and €150 million in turnover. EU companies operating in high-impact sectors, with more than 250 employees and €40 million turnover. Non-EU companies operating in the EU with more than 500 employees and €150 million turnover, of which €40 million is generated in the EU. SMEs and micro companies are not in scope (but will be affected indirectly where they deal with companies in scope).	CS3D requires in-scope companies to identify, prevent, mitigate and account for negative environmental and human rights impact in their operations, subsidiaries and value chains. Business strategies will also need to align with the Paris Agreement (limiting global warming to 1.5 degrees). Companies will be required to consider six components: • Integration of due diligence into company policies; • Identifying actual or potential adverse environmental and human rights impacts; • Prevent, mitigate or end actual and potential adverse environmental and human rights impacts; • Establish and maintain complaints procedures; • Monitor the effectiveness of the company's due diligence policies and measures; • Publicly communicate on due diligence. Companies will be required to outline the measures they have taken to meet these six components in their annual report. Note: The broad scope of CS3D on subsidiaries and value chains will impact on private equity structures if the current provisions remain. A private equity fund may be deemed a "parent" of the portfolio companies it invests in, if the fund takes a majority equity share in a company for investment purposes. Invest Europe has set out industry's considerations on the applicability of CS3D on subsidiaries and value chains: • Private equity funds which hold a majority share in a portfolio company do not influence the day-to-day operations of the firms. • Portfolio companies remain within a fund for a few years, rather than in perpetuity. The manager's objective is to sell the equity stake after the defined period. • Portfolio companies operate independently, with independent management. • Regulation to identify and manage sustainability risks in investment management is already provided by SFDR and AIFMD/MiFID II	In annual report. Does not specify a location however it is most likely it will be found in the front half.

Further guidance on any of the requirements to be disclosed in the strategic report can be found in the FRC's revised Guidance on the Strategic Report, available on its website (www.frc.org.uk).

The Wates Corporate Governance Principles for Large Private Companies

A coalition group, chaired by James Wates CBE, and including the BVCA, FRC, CBI and IoD, published a set of corporate governance principles, known as the Wates Principles, in December 2018 and may be utilised by large private companies to aid in the reporting of their corporate governance arrangements. The principles cover:

- Purpose and Leadership
- Board Composition
- Director Responsibilities
- Opportunity and Risk
- Remuneration
- Stakeholder Relationships and Engagement

Other Considerations

Those private equity firms and portfolio companies that fall within the scope of AIFMD are required to provide additional transparency disclosures. Please refer to the 2014 Walker Guidelines for a gap analysis between the AIFMD requirements and the Walker Guidelines.

Additionally, portfolio companies should also be aware of two other relevant reporting requirements:

<u>Tax strategy reporting</u>

Companies in scope are required to disclose on an annual basis on their website the board approved tax strategy, including the level of UK tax risk the company is prepared to accept, how the tax risk is managed, its attitude to tax planning, and the company's relationship with HMRC. This requirement is in effect.

This requirement applies to UK companies with more than £200m turnover OR a balance sheet exceeding £2bn. Multinationals with UK activity and UK subsidiaries may also be in scope.

<u>Payment practices and performance</u>

Companies in scope are required to report on their payment practices and performance. This includes the company's payment terms, process for dispute resolution related to payment, average time taken to pay invoices, percentage of invoices paid and not paid within the agreed terms in the reporting period, whether services like e-invoicing and supply chain finance are offered, and if the company is a member of a payment code. This information must be reported twice per year, in line with the company's financial reporting timetable, on a government-sponsored website. This requirement is also in effect.

This requirement applies to individual UK companies that are considered large under CA 06. Each individual company will need to report (i.e. not in consolidated group report).

If you have any questions on the topics raised in this note, please contact Ciaran Harris, charris@bvca.co.uk.