UK Sustainability Reporting Standards:

Alignment with section 172 (director duty) of the Companies Act 2006.

December 2024

ESG Risk Viewer

Executive summary

Many companies are required to prepare strategic reports as part of their annual report and accounts. With the introduction of the UK Sustainability Reporting Standards in 2025, there could be a significant change in the content elements of strategic reports.

Key changes may include requirements on “***what to report***” (*materiality assessment*), “***how report it***” (*disclosure requirements*), and “***how to measure the reported information***” (*metrics and targets*).

Under the current regulatory regime, when presenting information on the “*business environment*” category as part of their duty under section 172 of the Companies Act 2006, directors are required to have regard to information about

- environmental matters (including the impact of the company’s business on the environment),
- the company’s employees, and
- social, community and human rights issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies.

However, the drive to create UK Sustainability Reporting Standards (UK SRS) by assessing and endorsing the global corporate reporting baseline of IFRS Sustainability Disclosure Standards (IFRS SDS) may change the current regulatory regime on sustainability-related information. These changes will be required in order to simplify and streamline existing rules in the UK and to support interoperability and international comparability.

Moreover, UK-based companies with supply chains in the EU, especially those which are required to disclose information in accordance with the EU’s CSRD will benefit from this simplification of the existing rules in the UK to minimise duplication. In this way, they will be adequately prepared to respond to (or receive responses to) information requests from (to) their EU partners.

Introduction

With the introduction of the UK Sustainability Reporting Standards in 2025, there could be a marked change in how UK companies prepare strategic reports. The Companies Act 2006 specifies the requirements for companies to prepare a strategic report as part of their annual report and accounts.

To keep pace with the growing needs to standardise sustainability reporting around the world, the UK Government published information on its framework to create UK Sustainability Reporting Standards (UK SRSs) by assessing and endorsing the global corporate reporting baseline of IFRS Sustainability Disclosure Standards (IFRS SDSs).

In this article, we review the content elements of the strategic report for companies[1]. We also review the work of the Technical Advisory Committee (TAC), a committee whose operations are supported by the Financial Reporting Council (FRC) to assess IFRS Sustainability Disclosure Standards on a technical basis and provide independent recommendations on endorsement to the UK Business and Trade Secretary. Finally, we highlight the salient points from the TAC recommendations that may shape new requirements in the content elements of strategic reports.

> ***"The TAC agrees that all material information should be included in the strategic report. Over the years the length of the strategic report has increased significantly as entities provide more information than is strictly necessary, which can result in difficulty in locating material information.***
>
> ***The TAC highlights the benefit of simplifying and streamlining the existing rules in the UK, including in the Companies Act 2006 and FCA Listing Rules, which would greatly assist in the implementation of these standards and would minimise duplication or confusion as to where information should be disclosed."***
>
> *UK Sustainability Disclosure Technical Advisory Committee (2024).*
> *Agenda Paper 2: Technical assessment and endorsement recommendations.*

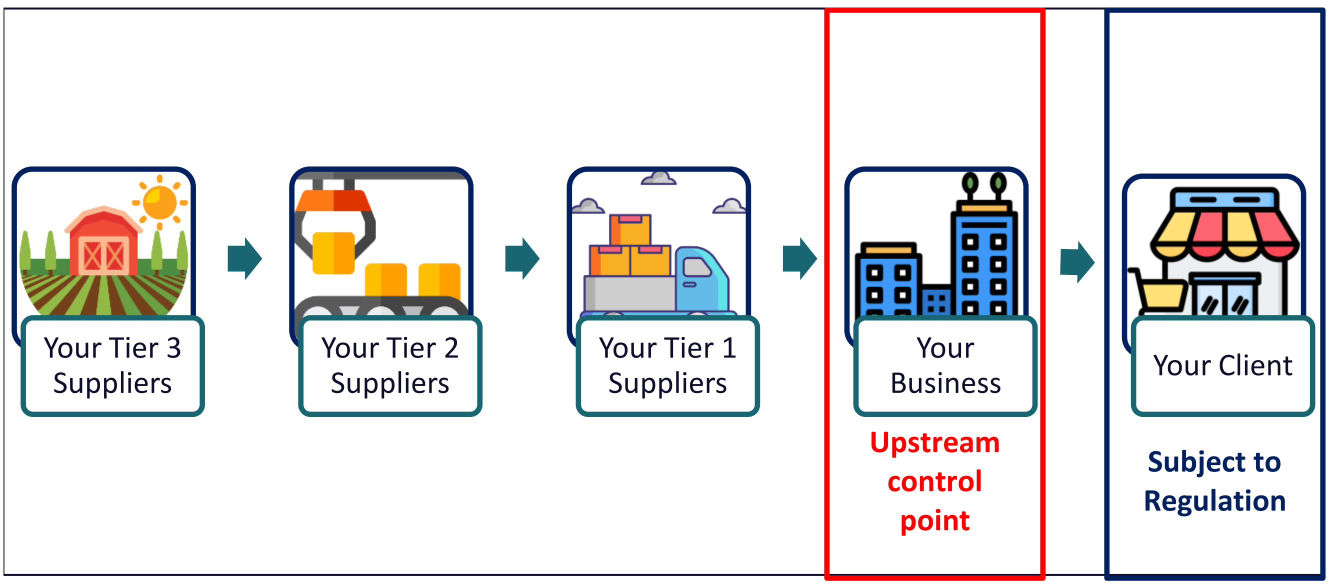
[1] (a) medium-sized and large private companies; and (b) AIM and quoted companies, traded and banking LLPs that are not Public Interest Entities (PIEs) and PIEs that have 500 or fewer employees.

Purpose and contents of strategic report

The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under section 172 of the Companies Act 2006 (duty to promote the success of the company).

Small companies, and those that would be small if they were not part of an ineligible group, are not required to prepare a strategic report. However, they could be ideal "*control points*", and we encourage them to consider this article as it will help them prepare for the sheer amount of information requests they will receive from clients, partners, and other stakeholders.

Figure 1: *Is your business at an upstream or downstream control point?*



> ***"'Control point enterprises' will likely have greater visibility and/or leverage over their own suppliers and business relationships further up the supply chain than enterprises closer towards consumers or end-users. Conducting due diligence on control point enterprises to determine whether they are in turn conducting due diligence … provides some comfort that risks of adverse impact directly linked to suppliers have been identified, prevented and mitigated."***
>
> *OECD (2018), OECD Due Diligence Guidance for Responsible Business Conduct.*

The content elements of the strategic report set out in the Act can be analysed into three broad categories: strategic management, business environment, and business performance and position.

Figure 2: *The content elements of strategic reports*

Strategic management	Business environment	Business performance and position
• Strategy • Business model	• Trends and factors • Principal risks and uncertainties • Environmental, social, community and human rights matters • Climate-related financial disclosures	• Analysis of performance and position • Key Performance Indicators (KPIs) • Employee gender diversity

A good strategic report should describe the environment in which a business exists (*context*), how the business interacts with the environment (*business model and strategy*), and the result of these interactions (*position and performance).* A good strategic report should also show the inter-relationships and inter-dependencies between these three categories.

The Financial Reporting Council (FRC) encourages all companies that are required to produce a strategic report to apply the relevant sections which are only applicable to quoted companies, as best practice. For example, when presenting information on the "*business environment"* category, they are encouraged to include information about

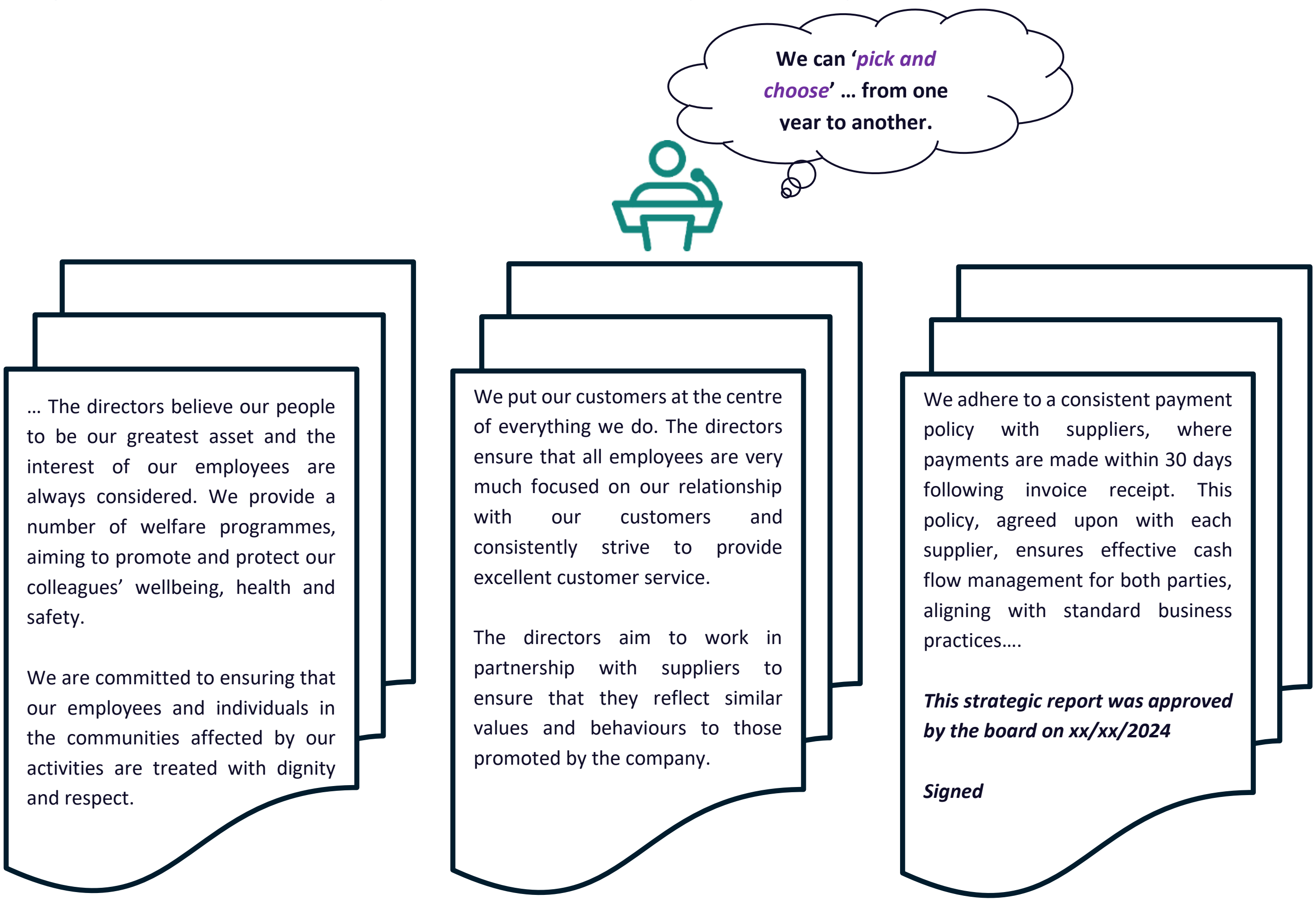
- environmental matters (including the impact of the company's business on the environment),
- the company's employees, and
- social, community and human rights issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies."

To date, many small and medium-sized companies, which fall outside the scope of this specific requirement choose to include this information in their strategic reports to effectively demonstrate best practice reporting. However, if the TAC's recommendation that ***all material information should be included in the strategic report*** is adopted, companies will no longer '*pick and choose*' the specific information they include in strategic reports.

As a result, the TAC highlights the benefit of ***simplifying and streamlining the existing rules in the UK, including in the Companies Act 2006 and FCA Listing Rules*** in order to minimise duplication or confusion as to where information should be disclosed.

The TAC also notes that UK entities which are ***required to comply with both the EU's CSRD and UK requirements*** could be at a competitive disadvantage if the interoperability challenges are not considered.

Figure 3: *Illustration of selected section of a strategic report in 2024**



**See page 11 below for an illustration of what might change in this extract of strategic report from 2025.*

The UK Sustainability Reporting Standards

Background

Early in 2024, the UK government established two committees to assist with the assessment and endorsement of Sustainability Disclosure Standards issued by the International Financial Reporting Council (IFRS), and any implementation of resulting UK Sustainability Reporting Standards (UK SRS). The two committees are

- the Sustainability Disclosure Technical Advisory Committee (TAC), and
- the Policy and Implementation Committee (PIC).

The purpose of the TAC, whose operations are supported by the FRC is to assess IFRS Sustainability Disclosure Standards on a technical basis and provide independent recommendations on endorsement to the UK Business and Trade Secretary.

In May 2024 the TAC initiated its technical assessment of the two inaugural IFRS Sustainability Disclosure Standards issued by the International Sustainability Standards Board (ISSB), namely IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and IFRS S2 Climate-related Disclosures (IFRS S2).

The government aims to make endorsement decisions on the first two standards (IFRS S1 and IFRS S2) by the first quarter of 2025 and these standards will form part of a UK-wide Sustainability Disclosure Reporting framework.

The following section outline the endorsement recommendations of the TAC in relation to IFRS Sustainability Disclosure Standards, focusing on recommendations which may have an impact on the preparation of strategic reports. We also provide our analysis of the benefits, challenges and implications of these recommendations.

Summary of endorsement recommendations and criteria

"Overall, the TAC's technical assessment concludes that the endorsement of both IFRS S1 and IFRS S2 for the creation of UK Sustainability Reporting Standards meet the endorsement criteria*. The TAC is of the opinion that:

- ***the endorsement of IFRS S1, including the proposed amendments, would be conducive to the long-term public good in the UK; and***
- ***the endorsement of IFRS S2, including the proposed amendments, would be conducive to the long-term public good in the UK."***

****Endorsement criteria***

"The TAC's ToR state that the TAC's analysis of an IFRS Sustainability Disclosure Standard should be used to provide recommendations to the Secretary of State on whether:

- *use of the IFRS Sustainability Disclosure Standard is likely to result in an improvement in the international comparability of sustainability-related reporting in the UK;*
- *use of the IFRS Sustainability Disclosure Standard is likely to support companies in making disclosures that are understandable, relevant, reliable and comparable;*
- *use of the IFRS Sustainability Disclosure Standard is likely to improve the quality of corporate reporting within the UK in the long-term; and*
- *companies are likely to be able to provide the disclosures required by the IFRS Sustainability Disclosure Standard within the timeframes that a company normally reports without undue cost or effort.*

The TAC may also provide recommendations on whether:

- *the use of the IFRS Sustainability Disclosure Standard is likely to be conducive to the UK's economic growth and international competitiveness, taking into account the costs and benefits of compliance; and*
- *the IFRS Sustainability Disclosure Standard is likely to be coherent with, and suitable for inclusion in, UK domestic legislation and regulation."*

UK Sustainability Disclosure Technical Advisory Committee (2024).
Agenda Paper 2: Technical assessment and endorsement recommendations.

Endorsement recommendations and links with the Companies Act 2006 and strategic reports

Identifying sustainability-related risks and opportunities	
Endorsement recommendations	***Links with the Companies Act 2006 and strategic reports***
The TAC recommends that the requirements in IFRS S1 and IFRS S2 relating to identifying sustainability-related risks and opportunities are maintained without amendment.	Questions remain on how IFRS S1 will be applied in conjunction with the sustainability-related information entities are required to disclose in line with the current UK legal framework. There might be a challenge to align reporting under IFRS S1 with reporting under existing UK reporting requirements, especially in relation to section 172 of the Companies Act 2006.

Materiality of sustainability-related financial information	
Endorsement recommendations	***Links with the Companies Act 2006 and strategic reports***
The TAC recommends that the requirements in IFRS S1 relating to materiality are maintained without amendment.	In preparing a section 172 statement about environmental matters, the company's employees, community and human rights issues, a company will now be required to report on material topics, using a prescribed standard and include specific metrics. In conducting a materiality assessment in compliance with IFRS S1, companies trading with other companies in the EU may find it beneficial to conduct a double-materiality assessment. This will ensure that they meet both IFRS and CSRD's requirements.

<table>
<tr><th colspan="2">Sources of guidance</th></tr>
<tr><th>Endorsement recommendations</th><th>Links with the Companies Act 2006 and strategic reports</th></tr>
<tr><td>The TAC recommends that the requirements in IFRS S1 and IFRS S2 relating to sources of guidance are maintained without amendment.</td><td>IFRS S1 requires that in the absence of an IFRS Sustainability Disclosure Standard (SDS) that specifically applies to a sustainability related risk or opportunity, an entity shall apply judgement.

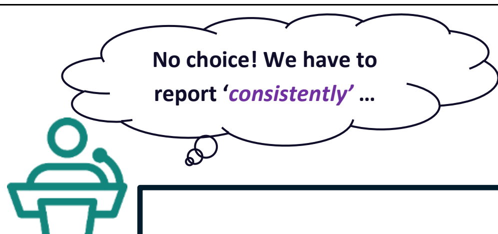
In making that judgement, an entity may refer to the following, to the extent that these sources assist in meeting the objective of, and do not conflict with IFRS SDS

• the Global Reporting Initiative (GRI) Standards; and
• the European Sustainability Reporting Standards (ESRS).

The TAC stakeholders’ consultation led to the recommendations that the references to these sources of guidance should be maintained as they could support interoperability and international comparability.

UK companies trading with other companies in the EU may find it beneficial to consider the European Sustainability Reporting Standards (ESRS) where relevant. This will ensure that they are adequately prepared to respond to information requests from their EU partners.</td></tr>
</table>

Location of sustainability-related disclosures	
Endorsement recommendations	***Links with the Companies Act 2006 and strategic reports***
The TAC recommends that the requirements in IFRS S1 for the location of sustainability-related financial disclosures are maintained without amendment.	The recommendation is to simplify and streamline the existing rules in the UK relating to the location of sustainability-related disclosures. The EU's CSRD requires companies to disclose this information in the management report. The TAC believes that all material information should be included in the strategic report. It also highlights the benefit of simplifying and streamlining the existing rules in the UK, which would minimise duplication or confusion as to where information should be disclosed.



… The directors believe our people to be our greatest asset and the interest of our employees are always considered. We provide a number of welfare programmes, aiming to promote and protect our colleagues' wellbeing, health and safety. We are committed to ensuring that our employees and individuals in the communities affected by our activities are treated with dignity and respect…

Example additional information from 2025: (1) Voluntary and (2) involuntary turnover rate for lodging facility employees (**SV-HL-310a.1**)

We put our customers at the centre of everything we do. The directors ensure that all employees are very much focused on our relationship with our customers and consistently strive to provide excellent customer service…

Example additional information from 2025: 1) Number of customer complaints filed, (2) percentage with monetary or non-monetary relief (**FN-CF-270a.4**)

The directors aim to work in partnership with suppliers to ensure that they reflect similar values and behaviours to those promoted by the company…

Example additional information from 2025: Discussion of strategy to manage environmental and social risks within the supply chain, including animal welfare (**FB-FR-430a.3**)

This strategic report was approved by the board on xx/xx/2025

Signed

For further information about any of the contents of this article, please visit our website or contact us at info@esgriskviewer.com

www.esgriskviewer.com