The Companies (Strategic Report and Directors' Report) Regulations 2023

KPMG Board Leadership Centre

The draft Companies (Strategic Report and Directors' Report) (Amendment) Regulations were laid in Parliament on 19 July 2023. They are subject to debate and approval by the House of Commons and the House of Lords. If approved, they will come into force from the start of 2025.

The new Regulations will require very large companies (see below) to:

- explain how they are managing significant risks, and building or maintaining resilience
- demonstrate that they have enough realised profits to pay any dividend (or make any other distribution of profit), and explain the company's approach to making dividends and other profit distributions over the short and medium term
- describe the actions taken by the directors to prevent or detect major fraud
- explain how the company assures the quality and reliability of its corporate reporting

Companies in scope

The reporting requirements will apply to UK companies with 750 or more employees and an annual turnover equalling or in excess of £750 million.

In the case of a banking company, 'turnover' will include net income arising from interest, trading, fees and commission. In the case of an insurance company, 'turnover' will include revenue or earned premiums net of reinsurance, depending upon the accounting framework which the company or, in the case of a parent company, the group headed by the company, has used in reporting the income from those activities during the financial year in question.

It should also be noted that the recent proposed changes to the UK Corporate Governance Code effectively extend the requirement to produce a Resilience Statement and Audit and Assurance Policy (AAP) to all companies that adopt the Code irrespective of the size criteria.

So, if an entity adopts the Code (as a premium listed company or on a voluntary basis), then subject to 'comply or explain' they would need to produce a Resilience Statement and an AAP.

Subject to certain conditions, reporting exemptions are available for UK subsidiaries that are consolidated by a UK parent when the parent provides these disclosures for the group which include the UK subsidiaries.

Applicable date

For companies with an equity listing on a UK regulated market (and meeting the above size thresholds), the reporting requirements will be applicable for accounting period beginning on or after 1 January 2025.

For all other companies meeting the size thresholds, the requirements will be applicable for accounting period beginning on or after 1 January 2026.

Resilience Statement

Companies will need to set out how they are managing their principal risks and building or maintaining resilience over the short, medium and longer term.
The Resilience statement, which will form part of the Strategic Report, will require companies to:

- disclose the chosen period for the short term and medium term analysis. The short-term must equal the period covered by the going concern statement; the definition of medium-term must be accompanied by an explanation of how the chosen period aligns with the company's strategy, business planning and investment cycle.

— set out the principal risks that threaten the business in the short and medium term, along with *inter alia* information on risk likelihood, impact, and mitigating actions. In assessing principal risks, companies will need to consider several specified matters including areas of dependency, digital security risks, cyber security and the impact of climate-related and sustainability-related risks

— confirm that at least one reverse stress test has been carried out and disclose a summary of the reverse stress test and mitigating actions unless this information will be seriously prejudicial to the company's interests

— summarise the long-term trends or factors which could significantly threaten the company's business beyond medium term, along with estimated timings and discussions of how these will be managed.

Distributable reserves and distribution policy

The Regulation will require companies to disclose (in the notes to the accounts):

— the amounts of distributable reserves, or a minimum figure, at the beginning and the end of the reporting period

— a summary of changes during the reporting period and

— for public companies, the effect of the net asset restriction.

The distribution policy, which will be part of the Directors' report, will explain the plan for dividends and share repurchases over the short and medium term as defined in the Resilience Statement, including the factors and risks relevant to implementing and sustaining the policy.

The Regulation does not require explicit statements by directors confirming the legality of proposed dividends and any dividends paid in year as was initially set out in the proposed reforms. Instead, the directors will need to explain how they have considered the level of distributable profits when recommending a dividend.

Material Fraud statement

The Regulations require directors to include a material fraud statement in the Directors' report. This must set out:

— the directors' assessment of the risk of material fraud to the company's business operations including how the company's susceptibility to material fraud was assessed and the types of material fraud that were considered

— the main measures in place or any future measures that will be set up to prevent and detect the occurrence of material fraud

Both fraud and 'material' are defined. Fraud is considered material when its nature or magnitude could be expected to influence the decisions which a reasonable shareholder would take in connection with its shareholding in the company.

Audit and Assurance policy

This policy, which will be part of the Directors' report, will set out how the company is currently obtaining assurance and how it plans to obtain assurance over its annual reports and accounts, including voluntary disclosures, over the next three years.

The policy must include a description of the company's operation and governance of internal auditing and assurance, including an explanation of:

— how any management conclusions and judgments, which are disclosed in the annual report and accounts, may be challenged within the company, and

— whether, and if so how, the company is proposing to strengthen its internal audit and assurance capabilities over the next three years

Furthermore, the policy should address:

— what external assurance, if any, the company intends to seek in the next three years beyond the statutory audit

— whether, and if so how, the company intends to seek external assurance over some or all of the company's Resilience statement, and the effectiveness of the company's internal controls over financial reporting

— an explanation of the extent to which shareholder views have been taken into account in the development of the audit and assurance policy, together with an explanation of the extent to which the views of employees and any other stakeholders have been taken into account;

To help understand whether, and how, any external assurance commissioned by a company beyond the statutory audit will be carried out, the Regulations require that the Audit and Assurance Policy sets out whether any external assurance proposed will be 'limited' or 'reasonable' assurance (as defined by the FRC), or whether an alternative form of engagement or review will be undertaken.

The Policy will also be required to state whether any external assurance beyond the statutory audit will be carried out according to a recognised professional standard.

Companies will also need to provide an annual update on how the audit and assurance policy has been implemented and any updates made during the reporting period.

Next steps

The Financial Reporting Council (FRC) plans to consult separately on detailed non-statutory guidance to companies about good practice in complying with the new reporting statements required by the regulations. The FRC is expected to publish draft guidance for consultation on its website by the end of 2023 or early 2024.

The KPMG Board Leadership Centre

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