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Deepa Raval
Financial Reporting Council
Aldwych House
71-91 Aldwych
London
WC2B 4HN

By email to: narrative@frc.org.uk

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Dear Ms Raval

Exposure Draft: Guidance on the Strategic Report

PwC welcomes the opportunity to respond to this consultation. As auditors and business advisors to many of the UK's leading companies we support initiatives to drive improved corporate reporting. And, having invested well over a decade working on the information needs of investors and preparers, we feel well equipped to provide an informed view on their expectations for guidance on the new narrative reporting regulations. Our principal comments are set out below, with responses to the specific consultation questions in the Appendix to this letter.

Guidance and best practice examples to be kept up to date

Along with many of our clients, we have previously found the Accounting Standards Board's Reporting Statement (RS1) to provide helpful, practical insight into good practice narrative reporting, and we are pleased that the draft guidance on the Strategic Report ('the Guidance') has adopted a similar approach. We acknowledge that the Guidance aims to be shorter and more streamlined than RS1 and therefore needs to strike a balance between conciseness and providing users with examples to illustrate key points. However, many of our clients tell us that practical examples are very helpful, so we would encourage the FRC to ensure that users of the Guidance will know where to go for these; there are a number of organisations that publish good practice examples to help companies develop their reporting.

Related to this, it is important that the Guidance is treated as a live document to be updated and revisited as best practice develops, or regulatory requirements change. The finalised International Integrated Reporting Council (IIRC) framework should also be reflected in due course and the FRC's own recent consultation on Guidance on risk management, internal control and the going concern basis of accounting may have implications that should be taken into account.

The strategic report as part of the annual report

The Guidance sets the strategic report in the context of the FRC's disclosure framework for the annual report. An annual report as a whole is of course unlikely to meet the 'fair, balanced and understandable' criteria of the UK Corporate Governance Code without a high quality strategic report. But we question whether it is consistent with the Code provision to require the strategic report itself to be fair, balanced and understandable when it is simply a part of the overall annual report. The FRC should instead indicate that the strategic report contributes to an annual report that is fair, balanced pwc

and understandable taken as a whole and recognise more fully that it is providing guidance that is relevant for the whole annual report. For instance, the communication principles that are identified in the Guidance should be applied to the annual report as a whole, not just the strategic report.

We also believe that the requirement in section 414C (3) to the Companies Act 2006 for the review of the business to be 'balanced and comprehensive' needs to be reconciled to the Guidance on the strategic report. This is addressed in the advice from the Accounting Council to the FRC that accompanies the draft Guidance (paragraph 33) but not in the Guidance itself. In fact we believe it would be helpful to incorporate much of the Accounting Council's commentary into the Guidance.

The strategic report as a standalone document

We strongly believe that the Guidance should address the use of the strategic report as a standalone document. This has been an area of much debate with our clients because, although the narrative reporting regulations allow the summary financial statement (SFS) to be replaced by a strategic report, the two documents differ in their scope and purpose. The SFS was a summary of information derived from the annual report and was not intended to provide sufficient information to allow a full understanding of the business; the strategic report must by definition include all the information that is relevant to shareholders' needs in respect of the areas the report addresses.

The Guidance should reflect these different scopes and purposes. We suggest that companies simply looking to replace the SFS with an equally brief document should be encouraged to issue a summary of the full strategic report and refer shareholders to the full version in the annual report. If companies are not able to take the shorter option we believe there is a risk that a number of those that previously produced SFS will cease to issue to shareholders anything other than the annual report. We have already had discussions with a number of organisations that are now focussed on developing an online 'annual review' that is not part of the statutory reporting suite.

On the other hand, for those companies that see value in issuing a full strategic report on a standalone basis (which are not necessarily those that previously issued a SFS), we believe that a number of items need to be added to the requirements in the narrative reporting regulations. In particular a full standalone strategic report should include at least summary versions of the primary financial statements (including earnings per share), key information on corporate governance arrangements and a short summary of remuneration policy (as well as the single total figure disclosure). All price-sensitive public reports and reports to regulators should be fair, balanced and understandable under the principles of the UK Corporate Governance Code, but for a standalone strategic report this judgement will need to take into account the restricted scope of information provided, even if our suggested additions are made.

Use of cross-referencing

One of the key messages of the draft Guidance is the need to improve linkage throughout the annual report. There is more to linkage than cross-references, but they are an important aspect of it and it is not clear from the narrative reporting regulations whether cross-referencing is a valid approach to constructing a strategic report or whether the relevant disclosures need to be contained within the strategic report itself.

We consider that it would run entirely counter to the principles of the Cutting Clutter initiative to insist on specific placement for content that might also have a role elsewhere, but we recommend that the FRC explicitly confirms this in the final Guidance. An example to illustrate this point would be diversity reporting, where a company may wish to include in the nomination committee report both the disclosures around policy that are required under the UK Corporate Governance Code and the numerical breakdown required by the narrative reporting regulations. We believe that this should be permitted, provided that the strategic report is cross-referred to the nomination committee report.

Users should not, however, have to go outside the document that they are reading to access all the required information so, for example, a cross-reference from the annual report to information in a separate corporate social responsibility report currently would not be appropriate in respect of social, community or human rights issues. Cross-references within the annual report to or from the strategic report will also be problematic if the strategic report is also to be issued on a standalone basis.

If you have any questions or would like to discuss any of the points raised in this letter in more detail, please contact Peter Hogarth (0207 213 1654) or Mark O'Sullivan (020 7804 3459).

Yours faithfully

PricewaterhouseCoopers LLP

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Appendix

Responses to consultation questions

Question one

Do you think that illustration 1 is helpful in achieving this objective?

Yes, we believe that the illustration provides a clear summary of where all the different components sit within the framework although it does run the risk of being seen as a proposed format for setting out an annual report. We feel that more could be done to emphasise that the illustration presents information that should be included and not the format in which it should be presented. For example, the integration of a financial review with financial statements would appear to be at odds with this structure. Similarly. we would encourage something within the illustration that highlights the importance of linkage between elements underlining that key information could be included within the strategic report and then cross referenced. It may also be helpful to acknowledge that the directors' report will be unlikely to contain much 'core' information after the advent of the strategic report – as illustration 1 notes, its contents will be 'other statutory information'.

Illustration 1 also reinforces our view that the Guidance should recognise more explicitly that it addresses the annual report as a whole, as well as the role of the strategic report within the overall framework.

Question two

Do you agree with the objectives of each component and section of the annual report which are included in illustration 1?

Yes, we believe that the objectives will be most useful for new preparers, as the objectives largely reflect current reporting practice.

Question three

Do you think the guidance on the placement of information in the annual report in paragraphs 3.10 to 3.14 will have a positive influence in making the annual report more understandable and relevant to shareholders?

The 'core and supplement' approach reflects what a number of leading reporters already do. Its full value will, however, only be realised when the supplementary information is permitted to be provided separately online, so regulators should come back to this issue as soon as possible. In the meantime for many UK companies the core and supplement approach simply means a re-ordering of existing content.

Question four

Do you agree with this approach (materiality to remain faithful to definition used in IFRS's)? Is the level of guidance on the subject of materiality appropriate?

We agree it is sensible to be consistent with other regulations and we would be reluctant to see the FRC interpreting what 'material' means in isolation. However, we believe that the application of qualitative as against quantitative materiality in the context of narrative reporting is challenging. Other stakeholder groups are consulting on this issue (for instance ICAS in its discussion paper on assuring management commentary) and the Guidance should continue to reflect developments in this area.

Question five

Do you agree with the proposed 'communication principles', set out in paragraphs 6.5 to 6.27 of the draft Guidance, which describe the desired qualitative characteristics of information presented in the strategic report? Do you think that any other principles should be included?

Yes, on the whole we support the proposed communication principles, which are in line with what we believe to be characteristics of good reporting. But see our covering letter for comments on how the fair, balanced and understandable criteria should be incorporated into the Guidance, and how this needs to be reconciled to the requirement in the narrative reporting regulations for the business review to be 'balanced and comprehensive'.

Question six

Do you think the guidance in paragraphs 6.26 and 6.27 achieves the correct balance?

We do not feel that there is any particular value in this part of the Guidance as we would consider this standard practice amongst most UK companies.

Question seven

Do you think this is appropriate (content elements not going beyond requirements set out in Act)? If not, what other 'content elements' should be included in the draft guidance?

We agree that it is appropriate that the Guidance does not go beyond the requirements set out in the Act. However, there is an instance where it does this. The Act states that "...the strategic report must include a description of the company's strategy" [CA06 Sec 414C (8) (a)], however the Guidance at paragraph 6.31 states that "the strategic report should include a description of the entity's principal objectives and its strategies for achieving those objectives". We believe that the Guidance should recognise this difference and explain how the addition of 'objectives' reconciles to the Act.

Question eight

Is the level of guidance provided on the business model description in paragraphs 6.38 to 6.41 sufficient?

Whilst we are very supportive of providing guidance on the business model, we believe that the Guidance proposed could be improved; paragraphs 6.38-40 could be seen as three overlapping business model descriptions rather than different elements of the same one.

Feedback we have received suggests that business model reporting is an area companies have struggled with since its introduction into the UK Corporate Governance Code and there is very limited consistency in what should be included within a good business model description, so that we are now seeing up to four distinct types of business model disclosure emerging. The four types are: 1) a 'business description', focusing on structure and activities; 2) a business model set in a strategic context; 3) an explanation of how the company generates a return; and 4) an explanation of how 'value' is created. Beyond these four, we are also seeing some companies provide more context to their model by setting out the company's position in the wider value chain. In order to make these disclosures more consistent and comparable it would be helpful if the Guidance recognised this state of affairs and provided advice on how the various approaches can be reconciled – it is likely that the best solution will involve elements of each.

We would also encourage the FRC to emphasise in the Guidance the role of linkage around business models. Our annual survey of narrative reporting in the FTSE 100 for 2013 suggests only 11% of companies integrate their business model with other elements of their reporting, such as risks, corporate social responsibility or measures. We believe this shows that companies are simply presenting an overview of their business model rather than making its relevance and importance clear.

It is also important to note that there are other organisations, for example the IIRC, who are currently developing definitions and examples of what good business model reporting should look like. We believe that the FRC should consider updating its guidance to reflect these as they continue to develop and evolve.

Question nine

Do you think that this draft Guidance differentiates sufficiently between the concepts of business model, objectives and strategies? If not, why not and how might the guidance be improved?

We believe that companies are generally comfortable with what is meant by objectives and strategy, so in our view the draft Guidance should focus on explaining how the business model relates to these and how companies can build disclosures that avoid repetition and overlap. We believe that it may be more beneficial for the guidance to avoid defining what a business model should include, but instead focus on what key questions companies should be considering when defining their own business model. The Guidance should also encourage companies to consider how significant changes in the business (such as M&A activity) should be reflected in the business model, strategy or objectives – there may otherwise be a tendency for these disclosures to be rolled forward as some elements will usually not change much in the short to medium term. PwC has considerable experience of advising clients in these matters and would be happy to discuss them with the FRC if that would be helpful.

Question ten

Are the linkage examples useful? If not, what alternative examples or approach should be used?

We believe the linkage examples are useful as a starting point to engender debate, but they are too high level to be of real practical use. The FRC, through its Reporting Lab, could consider highlighting those companies who already show good practice in this area.