Response from **Professor Carol Adams PhD CA FAICD, Professor of Accounting, Durham University Business School** on the:

UK Financial Reporting Council (FRC) Consultation on Draft Amendments to Guidance on the Strategic Report: Non-Financial Reporting

Thank you for the opportunity to respond to the Draft amendments to the Guidance on the Strategic Report: Non-financial reporting (the **Exposure Draft**) and accompanying draft Guidance on the Strategic Report (the **FRC Staff Draft Guidance**) at https://www.frc.org.uk/consultation-list/2017/consultation-on-guidance-on-the-strategic-report

I have been researching international corporate financial and non-financial reporting for around 25 years and have been involved in the work of the Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), Climate Disclosure Standards Board (CDSB) and in the AA1000 Standard series through their governance structures and/or technical work.

It is pleasing to see the significant increase in attention given to non-financial reporting over this period not least because qualitative accounting research clearly demonstrates that corporate reporting influences (and is influenced by) both organisations and society. The increased attention to non-financial reporting is of paramount importance in an increasingly globalised business world where the relationship between corporate activities and success on the one hand and the external environment (including social and environmental issues) on the other, is significant.

I particularly welcome the aim to enhance the link between section 172 of the UK Companies Act 2006 with respect to Directors' responsibilities to promote the success of a company and the purpose of a strategic report. Research demonstrates that when Boards are involved in the development of corporate reports that take a long-term focus and which recognise that value is more than profit they are cognisant of a wider range of risks and opportunities and set strategy accordingly (see Adams 2017a).

I also applaud the intention that the proposed guidance reflects key developments in corporate reporting and note the synergies of your draft guidance with other Frameworks, particularly the Task Force on Climate related Financial Disclosure (TCFD) and the International <IR> Framework. There are also synergies with the work of the Climate Disclosure Standards Board (CDSB) and the Global Reporting Initiative (GRI) (for example, with respect to the encouraged content of identifying major stakeholders). However, I urge you to either explicitly refer to those developments in standards/guidelines and/or include an appendix which explicitly draws out where use of such globally recognised frameworks will further enhance the strategic report. This would be valuable to report preparers.

Further, I encourage you to note that companies and key global standard setters are providing guidance to companies on responding to the Sustainable Development Goals (SDGs) and make explicit reference to the existence of sustainable development issues in the external environment which pose a risk to a company's ability to create value in the long term (see Adams, 2017b). Proposed para 7.62[1] provides an opportunity to do this as does para 7.27.

[1] Proposed para 7.62: "In considering the external trends, it is important that entities consider both the trends in the market in which the entity operates and the trends and factors relating to society more generally. For instance, an entity should consider the risks and opportunities arising from factors such as climate change and

Please find below my response to your consultation questions.

Question 1 – Do you agree with the approach to updating the Guidance for the changes arising from the implementation of the non-financial reporting Directive?

Yes, but as stated above I would like to see explicit reference to other guidance and standards which can assist companies in developing their approach to the strategic report.

Question 2 – Do you support the enhancements made to Sections 4 and 7 to strengthen this link [with s 172]?

Yes. I particularly welcome the aim to enhance the link between s 172 of the UK Companies Act 2006 with respect to Directors' responsibilities to promote the success of a company and the purpose of a strategic report. Research demonstrates that when Boards are involved in the development of corporate reports that take a long-term focus and which recognise that value is more than profit they are cognisant of a wider range of risk and opportunity and set strategy accordingly (see Adams 2017a).

I like the acknowledgement in the proposed new para 4.2 that creating value for shareholders requires developing relationships with stakeholders, but I note that this emphasis is not consistent with the discussion of stakeholders v shareholders elsewhere.

I suggest deleting the last sentence of para 4.2. Concerning the penultimate sentence of this para I would argue that with respect to some stakeholders it is not so much the relationships themselves that need to be taken into account in board decision making, but rather the information about the external environment that those relationships give the company access to.

The reference to 'impacts' of the entity's activities in para 4.3 requires explanation. Does this equate to outcomes for the capitals in the International <IR> Framework?

In para 4.5 I note that the reference to 'sources of value' and their description equates to the multiple capitals approach of the International <IR> Framework. It would be preferable to stick with 'multiple capitals' to avoid confusion, but at the very least there should be reference to the IIRC's 2013 Framework (see also response to Question 6 below). Reference to the International <IR> Framework might also assist companies in articulating their business model as required in proposed para 7.12.

Question 3 – Do you have any suggestions for further improvements in this area?

See response to question 2 above.

Question 4 – Do you agree with the draft amendments to Section 5?

---

the environment, and where material, discuss the effect of these trends on the entity's future business model and strategy."

No. This statement in para 5.6 is an understatement and the reference to materiality needs more work: "In the context of qualitative information in general and non-financial information in particular, however, a numerical materiality figure is of less importance and a separate assessment may be required." It is hard to see (at least without further explanation) how a numerical materiality figure is ever relevant in the case of qualitative information and a different type of assessment is most definitely required.

Further the definition of materiality in para 5.2 is inconsistent with para 4.2 which appropriately recognises that creating value for shareholders requires developing relationships with stakeholders. Therefore issues which are material for stakeholders can become material for shareholders. The definition of materiality should reflect this and requires greater consideration.

Question 5 – Do you have any suggestions on how the Guidance could encourage better linking of information in practice, or common types of disclosures that would benefit from being linked?

Yes, by making reference to the recommendations of the TCFD and the International <IR> Framework as resources for companies preparing their Strategic Report.

Question 6 – Do you agree with how the sources of value have been articulated in the draft amendments to the section on strategy and business model in Section 7?

No. The terms 'sources of value' and 'multiple capitals' (as in the International <IR> Framework) are both relatively new to corporate reporters. I believe it is better to stick to the existing term 'multiple-capitals' rather than create further confusion with another new one. Research work carried out in preparing the Capitals Background Paper for <IR> (of which I was a co-author) identified that some of the capitals are well understood (even if the terms are not always liked).

Question 7 – Do you consider that disclosures on how value is generated would be helpful?

Yes, if aligned to the requirements of the International <IR> Framework. But not if it conflicts with that guidance and results in increased confusion.

Question 8 – Do you consider that the draft amendments relating to reporting of non-financial information give sufficient yet proportionate prominence to the broader matters that may impact performance over the longer term?

No. Given the tendency for annual reports to ignore climate change (KPMG, 2017), the guidance should place more emphasis on it. Further, it should emphasise the sustainable development issues that gave rise to the SDGs (see Adams, 2017b). These present significant risks (and also opportunities) to business and society.

The GRI Standards could usefully be mentioned as providing additional support for disclosures in proposed para 7.32.

Question 9 – Are there any other specific areas of the Guidance that would be benefit from improvement?

No, but see introduction to this response.

References

Adams, CA, (2017) Conceptualising the contemporary corporate value creation process, *Accounting Auditing and Accountability Journal* 30 (4) 906-931 http://dx.doi.org/10.1108/AAAJ-04-2016-2529 Read here

Adams, C A (2017) *The Sustainable Development Goals, integrated thinking and the integrated report*, IIRC and ICAS. Read here.

KPMG (2017) *Survey of Corporate Responsibility Reporting 2017*. Read here.

regards

Carol Adams, Professor
Durham University Business School, Mill Hill Lane, Durham, DH1 3LB
t: +44 (0)191 3345425 **w:** www.durham.ac.uk/business www.drcaroladams.net

66th in the world in the Financial Times Global MBA Ranking 2016