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Dear Deepa

Re: Exposure Draft: Guidance on the Strategic Report

Thank you for giving us the opportunity to comment on the FRC's draft guidance.

We support the FRC's objectives to make reporting more relevant and cohesive, and to encourage companies to experiment and be innovative in preparing their annual reports. Indeed, as a creative communications agency with over 25 years' experience in corporate reporting, we have been helping our clients improve the effectiveness of their reporting for many years.

Our response has been based on discussions among our internal team of corporate reporting consultants and sustainability consultants, and with our clients. We also staged a seminar, attended by approximately fifty PLC annual report preparers, to gauge sentiment on some of the key issues.

Section 3 The annual report

Section 3 of this draft guidance includes an illustration (Illustration 1) which is intended to clarify the purpose of each part of the annual report and help those that prepare annual reports to make judgements regarding where information would be best presented.

Question 1

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

We believe that illustration 1 is useful in providing a one page overview of the components of the annual report, and in particular the main sources of disclosure requirements.

We believe the diagram would be more helpful if the following structural changes were considered:

1. Remove Directors' Report from the Narrative Reports column. When the Business Review was part of the Directors' Report there may have been a stronger reason to link the two. Now that the Strategic Report has been separated from the Directors' Report, we see no reason why the two should be paired together. A more logical place for the Directors' Report would be either under the Corporate Governance Statements component, or better still, in a new and final column, perhaps entitled Other Information.
2. Supplementary Information plays an important role in the guidance, and yet it is not shown or referenced in Illustration 1. We believe Supplementary Information should be included. Those companies that choose to present Supplementary Information in their annual reports will make their own decisions regarding its position in the report, possibly after the Strategic Report, or at the end of the annual report as an appendix. We believe that for the purposes of the diagram, Supplementary Information should be shown in an additional final column headed Other Information, alongside the re-positioned Directors' Report.

Question 2

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

We agree with the objectives of all Components and Sections, provided that the Directors' Report is relocated from the Narrative Reports component. If, as suggested above, a final column were introduced to accommodate the Directors' Report and Supplementary Information, we suggest the objective should be as follows: *'To provide other statutory information, and if necessary, more detailed coverage of topics addressed in the Strategic Report and/or Financial Statements.'*

Question 3

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?

We believe that the introduction of the concept of 'core and supplementary' information will make reports more relevant and understandable, particularly if companies do remove immaterial content from the report altogether. We support your guidance suggesting that *'Other detailed information could be presented in appendices to the annual report or, where company law or other regulation allows it, in a separate document or online.'* However we believe companies may be more willing to cut immaterial content from the report if the emphasis in the guidance is switched as follows: *'Other detailed information could be presented in a separate document or online, or, where specific information is required by company law or other regulation, in appendices to the annual report.'*

Section 5 of this draft guidance addresses the application of the concept of materiality to the strategic report, remaining as faithful as possible to the definition of materiality used in International Financial Reporting Standards (IFRSs).

Question 4

Do you agree with this approach? Is the level of guidance provided on the subject of materiality appropriate?

Yes. By defining materiality in the context of shareholder needs, rather than a broader definition such as that used by GRI, preparers can focus on the information of value to the key audience for the annual report.

Question 5

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, we agree with the principles.

Question 6

In this draft guidance, we have aimed to strike a balance between the need to ensure that the structure and presentation of the strategic report is sufficiently tailored to the entity’s current circumstances and the need to facilitate comparison of the strategic report from year to year. Do you think the guidance in paragraphs 6.26 and 6.27 achieves the correct balance?

We believe that continuity of a company’s story is an important factor in reporting from year to year. The story is influenced by the content, rather than the structure and presentation of the strategic report. Consequently we suggest that the guidance is adjusted to read as follows:
6.26 The structure and broad content of the strategic report should be reviewed annually to ensure that it continues to meet its objectives in an up to date, efficient and effective manner.
6.27 When contemplating a change to the structure or broad content of the strategic report, directors should consider whether the change represents an improvement in the quality of information provided.

Question 7

The ‘content elements’ in bold type described in paragraphs 6.28 to 6.73 do not go beyond the requirements set out in the Act, although the precise wording may have been expanded to make them more understandable. Do you think this is appropriate?

If not, what other ‘content elements’ should be included in this draft guidance?

Yes. We agree with the approach to limit guidance to the content elements specified in the regulations. Companies can then make their own decisions of the materiality and relevance of other information topics to ‘tell their story’.

Question 8

Appendix I 'Glossary' uses the same definition of a business model as the Code ('how the entity generates or preserves value'). Is the level of guidance provided on the business model description in paragraphs 6.38 to 6.41 sufficient?

We agree that the definition of the business model should match the definition used in the UK Corporate Governance Code. However, we believe that the guidance extends the definition and also provides too many aspects that should be included in the description of the business model. We would therefore suggest the following adjustments to the guidance. By using wording such as 'may wish to consider' rather than 'should', companies would be allowed more flexibility in how they tell their story.

6.37 The strategic report should include a description of the entity's business model.

6.38 The description of the entity's business model should set out how it generates or preserves value.

6.39 Each entity will want to articulate its business model(s) in its own way. In doing so, an entity may wish to consider the following factors:

- *what the entity does*
- *why it does it (ie what makes it different from, or the basis on which it competes with, its peers),*
- *how it captures value*
- *the parts of the entity's business process that are most important to the generation, preservation or capture of value*
- *how it is structured*
- *the market in which it operates*
- *how the entity engages with that market (eg what part of the value chain it operates in, its main products, services, customers and its distribution methods)*
- *the nature of the relationships, resources and other inputs that are necessary for the successful continuation of the business*
- *risks that could affect any part of the business model.*

6.40 A description of the business model provides context for the annual report as a cohesive document.

Question 9

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 it is helpful to distinguish between Objectives and Strategies. Currently few companies flag meaningful objectives in their annual reports. In fact, what many companies present as strategies could, arguably, be more accurately described as their objectives. Guiding preparers to make this distinction will encourage companies to be more specific about their strategies.

It would be helpful to present examples of a fictitious company's objectives and its strategies to achieve those objectives.

Example

Objective (1 of 3-5 objectives):

Increase the efficiency of our business

Strategies to achieve the above objective:

- *Expand manufacturing operations to be close to customers in new markets*
- *Create centres of excellence for R&D*
- *Invest in staff training and development*
- *Centralise corporate functions*

Each of the strategies would be discussed in detail, perhaps including progress, priorities and performance measures and targets.

Lastly, the diagram presented under 6.29 describes the business model as '*what the business does*'. We feel this should be adjusted to align with the definition used in 6.38: '*how the business generates or preserves value.*'

Question 10

This draft guidance includes illustrative guidance (the 'linkage examples') on how the content elements might be approached in order to highlight relationships and interdependencies in the information presented. Are these linkage examples useful? If not, what alternative examples or approach should be used?

Yes, the linkage examples are helpful.

In summary, we are supportive of the draft guidance. Should you wish to discuss any of the points raised in more detail, we would be very happy to do so.

With kind regards



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