Financial Reporting Council

June 2014

Feedback Statement

Guidance on the Strategic Report

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Contents

1 Introduction

1.1 The aim of the Financial Reporting Council (FRC) is to promote high quality corporate governance and reporting to foster investment. The FRC believes that encouraging entities to prepare a high quality **strategic report** – which provides shareholders with a holistic and meaningful picture of an entity's **business model**, **strategy**, development, performance, position and future prospects – is a key part of achieving this aim.

Background

1.2 In August 2013, the Government published new Regulations[1] for the strategic report and **directors' report**. The Regulations resulted in an amendment to existing company law requirements and became effective on 1 October 2013. The main change was the introduction of a requirement for certain companies to prepare a strategic report as part of their **annual report**. The requirements apply for periods ending on or after 30 September 2013.

1.3 The Department for Business, Innovation and Skills (BIS) requested that the FRC prepare non-mandatory guidance supporting the new legal requirements for the strategic report. While the changes introduced by the Regulations represent a relatively modest change to the pre-existing legal requirements, the FRC believes that they should act as a catalyst for entities to prepare clear and concise narrative reports that facilitate fair, balanced and understandable reporting. The new guidance is, therefore intended to encourage preparers to consider how the strategic report fits within the annual report as a whole with a view to improving the overall quality of financial reporting.

Objectives of the guidance

1.4 The objectives of the *Guidance on the Strategic Report* (the 'guidance') are to:

- ensure that relevant information that meets the needs of shareholders is presented in the strategic report;
- encourage companies to experiment and be innovative in the drafting of their annual reports, presenting narrative information in a way that enables them to best 'tell their story' while remaining within the regulatory framework; and
- promote greater cohesiveness in the annual report through improved linkage between information within the strategic report and in the rest of the annual report.

This guidance replaces the Accounting Standards Board's *Reporting Statement: Operating and Financial Review*.

1.5 During August 2013, the FRC published an Exposure Draft 'Guidance on the Strategic Report'. The consultation closed on 15 November 2013.

The feedback statement

1.6 The purpose of this feedback statement is to:

- summarise the comments on the Exposure Draft; and
- explain how the comments received have been taken into account in finalising the guidance.

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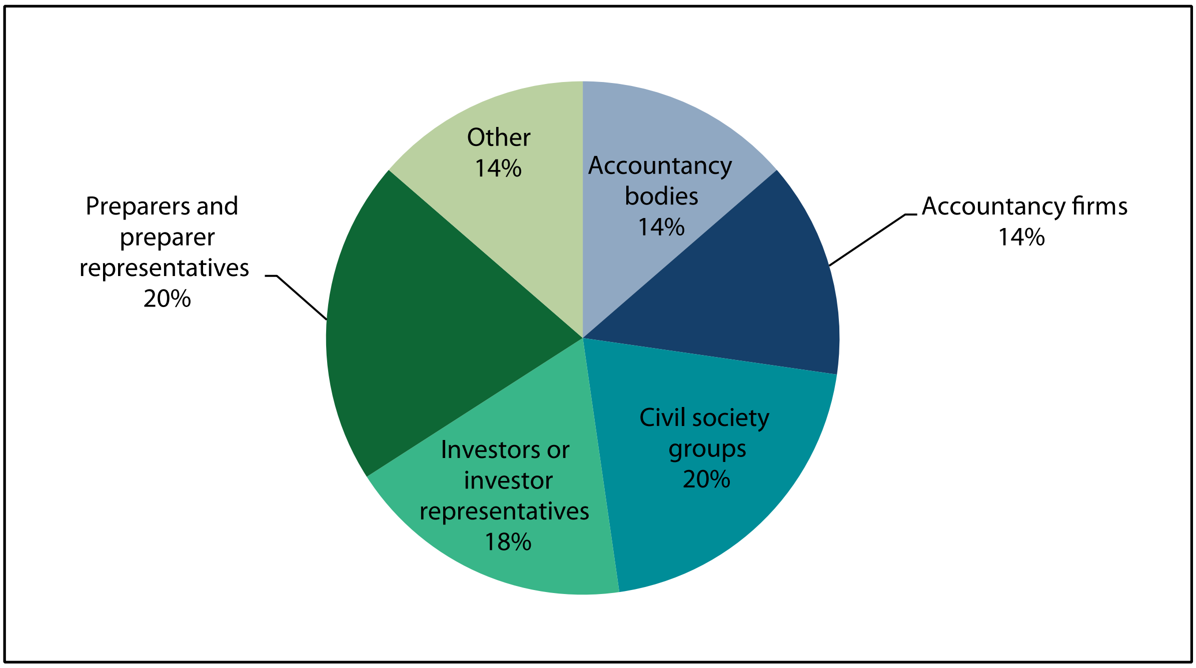
[1] The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the 'Regulations').

1.7 For further detail on the rationale for the decisions made in finalising the guidance refer to the Accounting Council's advice to the FRC, published within the guidance.

Respondents

1.8 A full list of respondents to the consultation is included in Appendix II. The FRC received 44 comment letters from a range of stakeholder groups.



2 Main themes

2.1 On the whole the Exposure Draft has been well received, with the majority of respondents appreciating the clear, accessible, principles-based, light-touch approach that has been taken. The majority of respondents also support our efforts in moving the 'cutting clutter' and 'clear and concise reporting' debates forward.

Scope

2.2 Respondents were generally supportive of the approach of the guidance in terms of setting the **strategic report** in context, with the aim of encouraging more relevant reporting in the **annual report** as a whole. However, one respondent felt that the scope of the guidance should be restricted to the strategic report, rather than extending to other **components** of the annual report.

Strategic report with supplementary material

2.3 Many respondents highlighted the lack of detailed guidance in the Exposure Draft in relation to the option to issue the strategic report with supplementary material under section 426 of **the Act** (replacing the option to send summary financial statements to shareholders instead of the full annual report). A number of respondents requested clarification on how a strategic report could be issued as a standalone document if it included by **cross-reference** information disclosed elsewhere in the annual report.

'Safe harbour' provisions

2.4 A common concern amongst respondents was whether the 'safe harbour' provisions contained in section 463 of the Act would be applicable to information presented elsewhere in the annual report and included only by cross-reference in one of the three specified components[2] covered by the provisions.

Unquoted companies

2.5 Some respondents noted that the guidance was principally aimed at **quoted companies**. They expressed concern that the majority of companies preparing a strategic report will not be quoted companies and, as such, would not be bound by the requirement for the strategic report to be 'understandable' (a requirement of **the Code**), and would only be within the scope of three of the eight content elements (derived from the strategic report disclosure requirements set out in section 414C of the Act).

Dual listing reporting requirements

2.6 Some respondents noted that the Exposure Draft did not provide specific guidance on the issuance of dual purpose annual reports, such as those designed to meet the requirements of the Act and also US listing rules requirements. In particular, respondents noted that a substantial proportion of the detailed 20-F reporting on risks and controls that US listed companies provide would not be expected to be material for the strategic report, which focuses on **principal risks** and uncertainties.

Online reporting

2.7 Respondents suggested that the structuring of annual reports to achieve more effective communication would be assisted by allowing certain sections of the annual report to be published online.

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[2] The strategic report, the directors' remuneration report and the **directors' report**.

Best practice and post-implementation review

2.8 Several respondents stated that the FRC should conduct a post-implementation review of the guidance, and consider publicising examples of strategic reports which demonstrate effective application of the concepts set out in the guidance. Respondents also highlighted the need for continual review of reporting by the Corporate Reporting Review Team (CRRT) to ensure that non-compliance with reporting obligations is addressed; emphasised the urgency of issuing the final guidance; and were keen for the FRC to keep the guidance updated for developments in best practice.

FRC response

Scope

2.9 With the introduction of the strategic report, the FRC believes that there is an opportunity to make the annual report a more cohesive document. We believe that this can only be achieved by setting the strategic report in the context of the annual report as a whole and therefore the scope of the guidance should go beyond the strategic report, emphasising linkages between the strategic report and other components of the annual report.

Legal points

2.10 The FRC has sought clarifications from BIS on the legal queries raised by respondents in relation to issuing the strategic report with supplementary material and the application of 'safe harbour' provisions to cross-referenced information. Clarifications on the legal requirements are provided in a letter from BIS that can be found on the FRC website at https://www.frc.org.uk/Narrative-Reporting.

Unquoted companies

2.11 The guidance is intended to illustrate best practice reporting for all entities preparing a strategic report. In the FRC's view, best practice would not be achieved if an unquoted company prepared a strategic report that was not understandable due to not being within the scope of the Code, from which this term is drawn. Similarly, it would not be best practice for an unquoted company to prepare a strategic report that omitted, for example, information on a material human rights issue, simply because there was no explicit legal or regulatory requirement to disclose it.

Dual listing reporting requirements

2.12 It is the FRC's view that dual listing requirements could be met within an appropriately structured annual report, for example by presenting additional information that is non-mandatory in the UK and not **material** for the purposes of the strategic report through **signposting** to an appendix.

Online reporting

2.13 The publishing requirements for annual reports are defined by legislation, however the Act does permit annual reports to be issued online where allowed by the company's articles and the shareholders have agreed.

Best practice and post-implementation review

2.14 The FRC will consider the need for a post-implementation review and subsequent amendments required to keep the guidance up to date.

3 Detailed analysis of responses to questions

The annual report

Section 3 of the Exposure Draft 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?

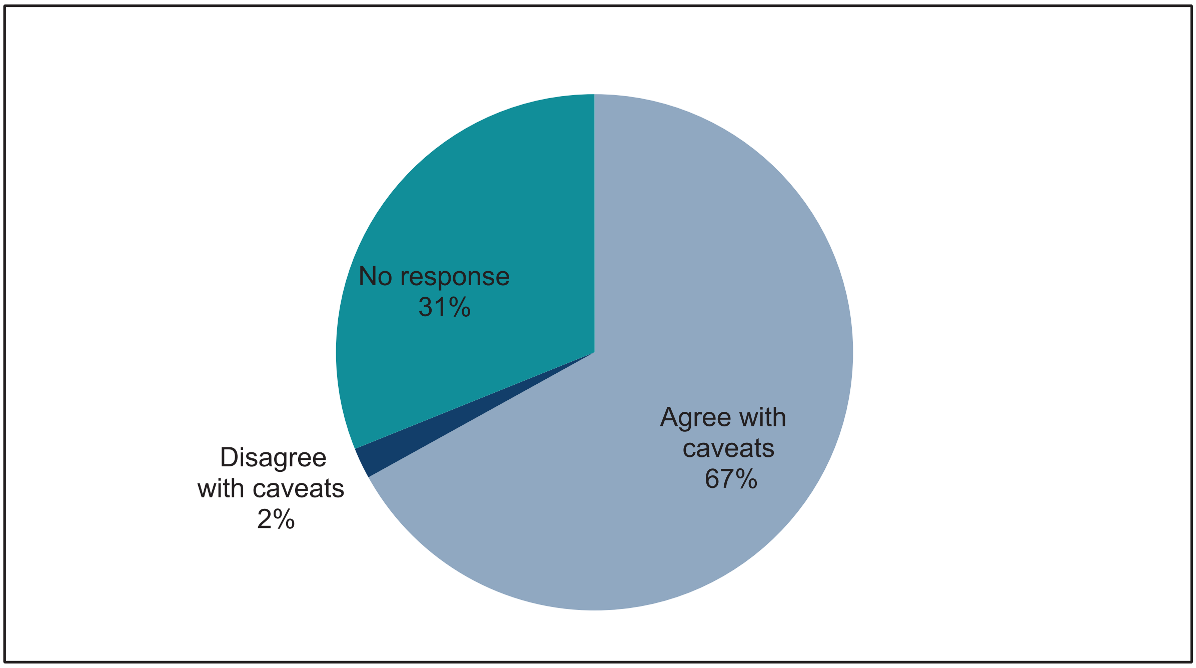
Question 2

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

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?

Respondents' views on Question 1 – *Illustration 1*



The usefulness of *Illustration 1*

3.1 The majority of respondents to *Question 1* believed that *Illustration 1* provided a helpful summary of the regulatory requirements for the preparation of **annual reports**, which would assist preparers in considering how best to structure their annual reports.

3.2 However, several respondents expressed concerns that the illustration might discourage innovation in the structure of annual reports, by imposing a rigid and compliance-based structure.

3.3 Other comments included that:

- companies would benefit from best practice examples of linkage between the various **components** of the annual report;
- the illustration should include other common, non-mandatory sections of annual reports such as an audit committee report, a nominations committee report, a chairman's statement, or a chief financial officer's report; and
- one respondent felt that the notes to the financial statements should also be included in the illustration.

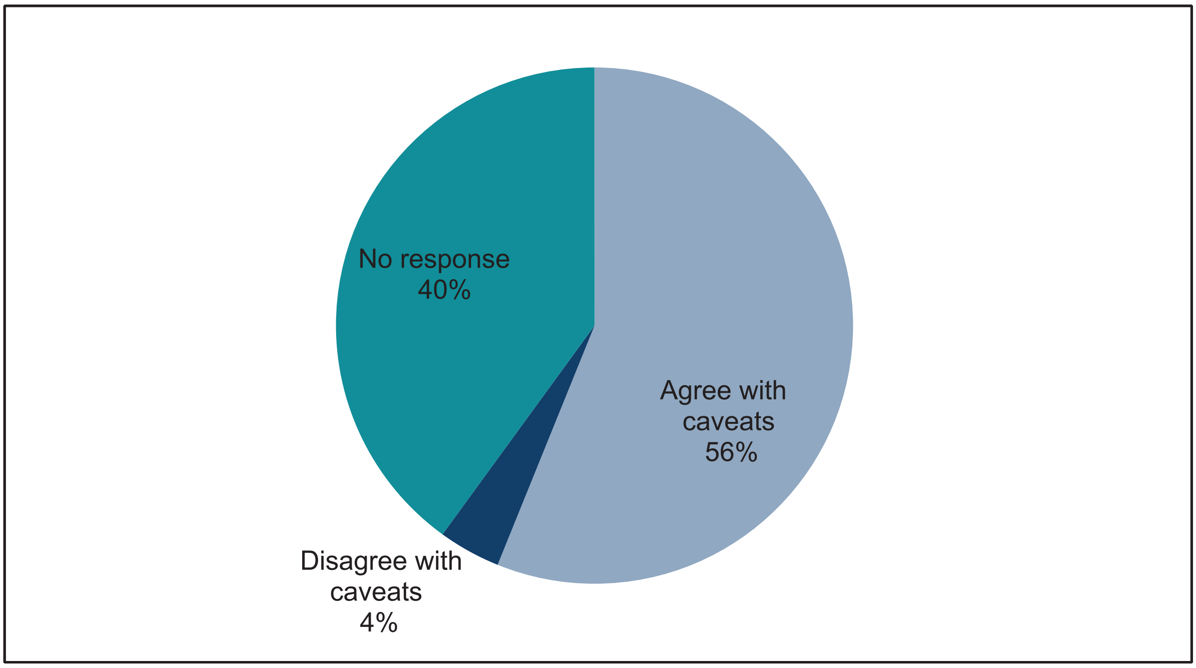
FRC response

3.4 *Illustration 1* (renamed 'Table 1' in the final guidance) is not intended to impose a specific structure or order for the annual report or restrict the directors to including only the components it identifies. It aims to provide a high-level summary of the minimum requirements for annual reports as set out in law and regulation, to enable directors to consider the placement of information to facilitate more relevant communication while also ensuring compliance with legal and regulatory requirements.

3.5 Following review of the comments received, we concluded that the inclusion of non-mandatory sections in the illustration might result in a greater risk that companies would see the guidance as being more structurally prescriptive than intended. However, as noted in section 3.8 of the guidance, other sections that are not required by law or regulation (e.g. a chairman's statement or a chief financial officer's report) may be included in the annual report as a subsection of a mandatory component or in a separate non-mandatory section, if that is considered the best way of ensuring that the document is both relevant and understandable.

3.6 The guidance on the placement, layering and linkage of information has been expanded to assist preparers with considering how to structure annual reports to achieve more effective communication with shareholders.

Respondents' views on Question 2 – *objectives of the annual report*



The audience of the annual report

3.7 The majority of respondents broadly agreed with the objectives of the components of annual reports set out in *Illustration 1*, and particularly welcomed the emphasis on communication of relevant information to shareholders as the primary objective of annual reports. A minority of respondents, from civil society groups, felt that the guidance was too focused on the needs of shareholders and that one of the objectives of the annual report should be to communicate to a wider group of stakeholders. However, most respondents were keen not to move towards such an approach as they were concerned that it would undermine the broader aim of encouraging clear and concise reporting that is relevant for shareholders.

The structure of the illustration

3.8 Some respondents felt that analysing the annual report in terms of the objectives of its individual components might undermine the aim of creating more cohesive reporting. Others felt that the distinction drawn between the higher-level 'component objectives' and the more detailed, lower-level 'section objectives' was confusing.

Consistency with existing legislation and guidance

3.9 A number of comments were received in relation to the interaction between the Exposure Draft and existing legislation and guidance, including:

- the need to align the objectives of the annual report with the objectives of financial reporting set out in the International Accounting Standards Board's (IASB) *Conceptual Framework for Financial Reporting*;[3]
- requests for the differing regulatory requirements for **quoted companies** and unquoted companies to be outlined in the illustration;

[3] IASB's *Conceptual Framework for Financial Reporting*, paragraph OB2.

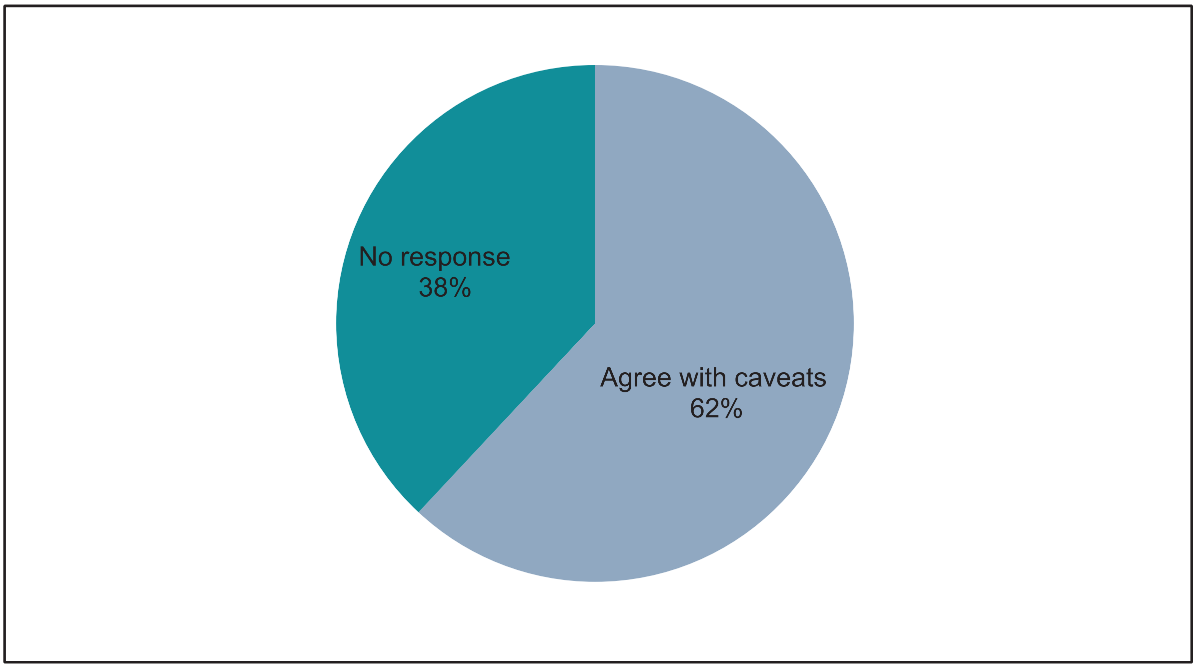
- concerns that the term 'stewardship' could be interpreted as implying a new responsibility for directors in addition to the duties imposed under section 172 of **the Act**;
- an observation that the term 'executive remuneration' might be taken to imply that non-executive directors were outside of the scope of the directors' remuneration report; and
- the suggestion that 'fair, balanced and understandable' should be included as objectives, rather than qualities, of annual reports.

FRC response

3.10 It is the FRC's view that in order to ensure that the annual report is a clear and concise document that facilitates fair, balanced and understandable reporting, it is essential for there to be clarity around its purpose and primary audience. The purpose of the annual report is to provide relevant information to shareholders, as set out in the Act. However, information of interest to other stakeholders may be included in the annual report if it is also **material** to shareholders.

3.11 In response to the comments received we have simplified *Illustration 1*, added separate sections highlighting the requirements relevant to both quoted and unquoted companies, removed the categorisation of objectives into 'higher' and 'lower' levels, and amended other terminology to provide more clarity where appropriate.

Respondents' views on Question 3 – *placement of information*



Section 463 of the Act – 'safe harbour' provisions

3.12 A number of respondents queried whether the protections offered by section 463 the Act – sometimes referred to as the 'safe harbour' provisions – will apply to information included by **cross-reference** in the components to which the provisions apply (the **strategic report**, the directors' remuneration report and the **directors' report**).

Section 426 of the Act – the strategic report with supplementary material[4]

3.13 Respondents were keen for the final guidance to include further details of the requirements and restrictions around the option to issue the strategic report with supplementary material. In particular, several respondents were concerned how the strategic report could be fair, balanced and understandable as a standalone document suitable for issuing to shareholders who do not require a full annual report if the strategic report cross-references information contained elsewhere in the annual report.

Cross-referencing and signposting information

3.14 Several respondents requested clarification on the regulatory limits to the flexibility to relocate mandatory information between the components through cross-referencing, and to the **signposting** of **complementary information** placed outside the annual report (e.g. on the company website). A number of respondents found the 'core' and 'supplementary' approach to assessing the appropriate placement of information confusing and suggested that these terms were amended or defined further.

3.15 Some respondents were also concerned that relocating information within the annual report could make it unclear to shareholders which information had been subject to audit.

[4] Section 426 of the Act replaces the option to issue summary financial statements to shareholders.

3.16 Some respondents pointed out that duplication of information sometimes results in more understandable annual reports and that this should not be discouraged if directors believe it facilitates clear communication.

FRC response

3.17 The FRC sought clarifications from BIS on the scope and limitations of the 'safe harbour' protections offered by section 463 of the Act, and the requirements where a company takes the option to issue the strategic report with supplementary material under section 426 of the Act. Clarifications on these issues are provided in a letter from BIS that can be found on the FRC's website at https://www.frc.org.uk/Narrative-Reporting.

3.18 As noted above, a number of respondents found the distinction between 'core' and 'supplementary' information confusing. This distinction was intended to ensure that the most important information is given prominence over other, more detailed information, in order to promote effective communication with shareholders. The final guidance has been updated with revised terminology in this area to provide more clarity on: the placement of information both within and outside the annual report; the cross-referencing and signposting of information; and the importance of ensuring that the level of assurance provided over the information in the various components of the annual report is clear to shareholders.

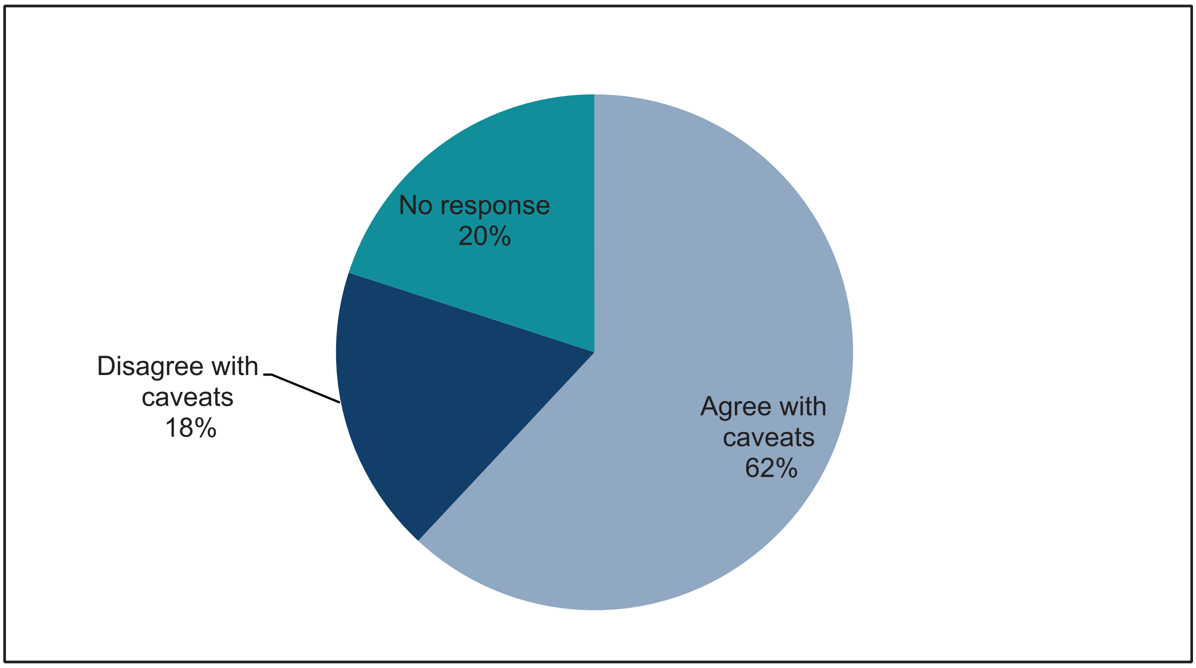
Strategic reports and materiality

Section 5 of the Exposure Draft 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?

Respondents views on Question 4 – *materiality*



Definition of materiality

3.19 The majority of respondents were supportive of the approach taken to the application of materiality to the strategic report. The guidance defines information as being material for the purposes of the strategic report if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole.

3.20 The comments received highlighted various points and suggestions to the FRC for consideration:

- respondents felt that the terminology in the guidance should be as consistent as possible with auditing standards, existing legislation and reporting frameworks and other projects taking place in relation to materiality. Several respondents requested further guidance on applying materiality to the strategic report;
- respondents welcomed the explicit guidance to exclude immaterial items from the strategic report, except where they are required to be included by legislation;
- respondents were generally in favour of a greater emphasis on the qualitative elements of materiality for the purposes of preparing the strategic report;

- civil society groups felt that the definition of materiality in the guidance was narrower than the concept outlined in the Act, which refers to the disclosure of information 'necessary for an understanding of the development, performance or position of a company's business';
- conversely, one respondent felt that the definition in the guidance was too wide, and would result in a requirement for all information that is material for any component of the annual report to also be disclosed in the strategic report;
- other respondents requested clarification on certain terminology used within the Exposure Draft, such as 'important' and 'relevant to shareholders' needs'; and
- two respondents requested further guidance on how materiality should be assessed when there are different types of shareholder with different information needs.

Shareholder focus

3.21 While the majority of respondents were supportive of the approach taken, five respondents from civil society groups questioned the appropriateness of the content of the strategic report being determined according to whether information is material to shareholders, on the grounds that some actions may have a disproportionate impact on non-shareholder stakeholders, particularly in the case of environmental or human rights issues. These respondents suggested that directors should use the strategic report to provide disclosure to other stakeholders on the conduct of their duties under section 172 of the Act.

Section 414C(14) of the Act – disclosure of confidential information

3.22 Three respondents requested clarification on the application of the exemption in section 414C(14) of the Act, which allows directors not to disclose material confidential information that would be 'seriously prejudicial' to the interests of the entity. Such situations are highly entity-specific; however respondents noted that where detailed information is confidential, summarised information that is not seriously prejudicial may meet substantially all shareholder information needs.

Disclosure

3.23 Five respondents, including some investors, suggested that the materiality assessment process and rationale for materiality judgements should be disclosed.

FRC response

3.24 While directors are explicitly required to take the interests and issues set out in section 172 of the Act into account in the conduct of the business, this does not imply any specific duties to non-shareholder stakeholders or impose disclosure requirements above those set out in section 414C of the Act. The FRC believes that, in meeting the disclosure requirements set out in section 414C, the strategic report will fulfil its statutory purpose.

3.25 The guidance emphasises the qualitative nature of determining material information for inclusion in the strategic report. Given that this is inherently more judgemental and issue-specific than determining a primarily quantitative materiality threshold for financial statements, we have not recommended the disclosure of the materiality assessment process applied in preparing the strategic report, as in our view this is likely to provide information that is of limited use.

3.26 Paragraph 5.1 of the final guidance clarifies that materiality for the strategic report is determined within the context of the annual report as a whole. One respondent was concerned that all of the information material for other components of the annual report would also be material for disclosure in the strategic report. However, the strategic report is a forward-looking summary which provides shareholders with a holistic picture of an entity's business model, strategy, development, performance, position and future prospects – and the determination of materiality for the strategic report has a qualitative focus. Therefore, the FRC does not expect all information which is material for other components of the annual report to be material for the strategic report.

3.27 The FRC believes that where the disclosure of detailed information on a material issue would be seriously prejudicial to the interests of an entity, substantially all shareholder information needs may be met through the disclosure of summarised information that is not seriously prejudicial.

3.28 While sympathetic to the call for greater guidance on the application of materiality in the context of the strategic report, we chose to limit the amendments to the guidance on materiality for the strategic report to the clarification of a relatively small number of specific application points raised by respondents. The FRC is mindful of work on the topic of materiality being undertaken by the IASB and does not want to prejudge the conclusions of that project by developing potentially inconsistent guidance.

The strategic report

Section 6 of the Exposure Draft contains detail on the purpose, content and structure of the strategic report.

Question 5

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

Question 6

In this Exposure Draft, 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 draft guidance in paragraphs 6.26 and 6.27 achieves the correct balance?

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?

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?

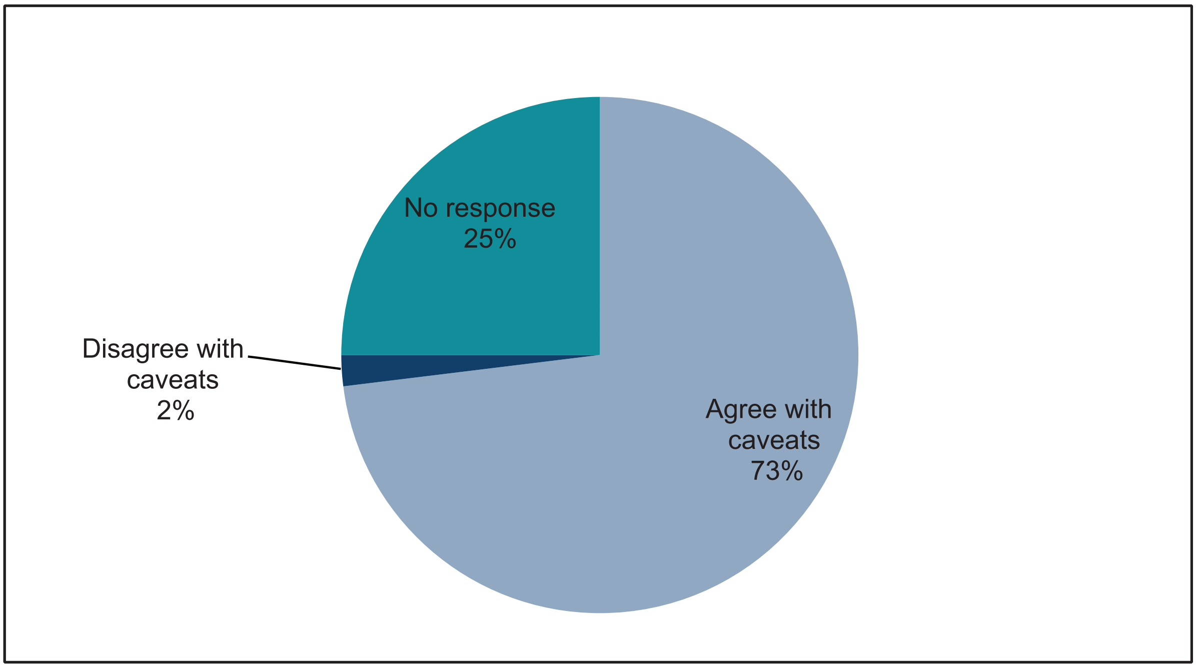
Question 9

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

Question 10

This Exposure Draft 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?

Respondents views on Question 5 – *communication principles*



Overview

3.29 The majority of respondents expressed support for the communication principles set out in the Exposure Draft. There were varying views on whether the level of guidance should be expanded or reduced. Three respondents suggested additional communication principles.

3.30 Respondents suggested that the communication principles could be applied to other areas of the annual report and that the Financial Reporting Lab could undertake a project on communication principles. One respondent was concerned about consistency with other guidance.

3.31 Some respondents noted that the legislation and regulations underpinning some of the communication principles refer to quoted companies, and requested further clarification on the strategic report requirements applicable to unquoted companies.

Fair, balanced and understandable

3.32 Respondents made a number of comments on the 'fair, balanced and understandable' communication principle, including:

- noting that relatively few companies preparing a strategic report would be within the scope of **the Code**, from which the terms 'fair, balanced and understandable' have been drawn;
- some suggested amendments to this terminology, or requested further definition of 'fair, balanced and understandable';
- some were concerned that the word 'neutral' could be misinterpreted as a requirement for inclusion of an equal number of positive and negative comments, regardless of the circumstances or performance of the entity;

- some felt it would be helpful for the guidance to provide examples of disclosures which satisfy this communication principle;
- one expressed the view that producing ‘fair, balanced and understandable’ reporting should be given precedence over considerations of the materiality of information; and
- another suggested that the guidance should emphasise that graphical presentation of information can be misleading.

Concise but comprehensive

3.33 A number of respondents suggested that conciseness and comprehensiveness appear to be mutually exclusive qualities. One respondent was concerned that the conciseness requirement would result in information that is required by law being left out of the strategic report, whereas others felt that the ‘comprehensive’ requirement would result in the inclusion of immaterial information.

Forward-looking orientation

3.34 Respondents agreed that forward-looking disclosure should be encouraged. One respondent suggested that protection from liability for such disclosures should be provided to directors.

3.35 One respondent felt that the guidance should emphasise why forward-looking information is so important to the strategic report. Another respondent requested expanded guidance to outline the level of disclosure required for both past performance and the implications of circumstances for the short-, medium- and long-term future.

Entity-specific information

3.36 Respondents agreed with the entity-specific communication principle. The only suggestions from respondents in relation to this principle were to rearrange the wording of the explanatory paragraph, and to include an example of entity-specific information.

Linkage

3.37 Respondents felt that linkage of information would assist with reducing duplication of information. However, some respondents requested more clarity on where linkage is appropriate and how this would impact the structure of annual reports. Another respondent felt that the guidance should distinguish between linkages within the strategic report and linkages to information in other components of the annual report. One respondent requested for more examples of linkage to be added to the guidance.

Structure

3.38 See the responses to *Question 6* for an analysis of the comments received in relation to the structure of the strategic report.

FRC response

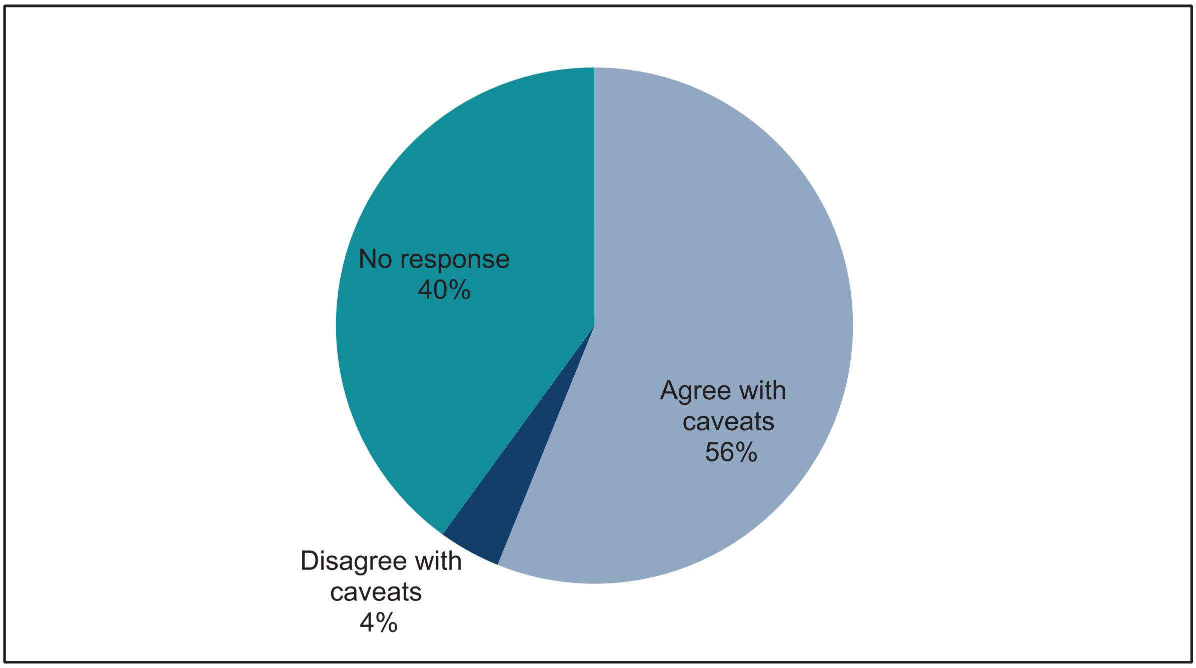
3.39 The guidance is intended to illustrate and promote best practice reporting and that information should be disclosed when it is relevant to shareholders. While the legislation underpinning the communication principles refers to quoted companies, the FRC does not believe that it would be best practice for an unquoted company to prepare a strategic report which omitted, for example, information on a material human rights issue, simply because there is no explicit legal or regulatory requirement to address such matters.

Similarly, we do not believe that best practice would be achieved if an unquoted company prepared a strategic report which was not fair, balanced and understandable.

3.40 Appendix III and IV of the guidance highlight the applicability of the strategic report and directors' report disclosure requirements to different types of entity.

3.41 The reference to 'comprehensive' is included within the communication principles because it is an explicit requirement of section 414C(3) of the Act. Its inclusion does not conflict with the recommendation that the strategic report should also be concise as we have interpreted 'comprehensive', in this respect, to be a function of breadth of information rather than depth of information. The depth of information on any particular subject should be a function of materiality, as detailed in the guidance.

Respondents views on Question 6 – *consistency versus innovation*



Structure

3.42 The majority of respondents welcomed the proposed approach to reviewing the structure of the strategic report on an annual basis.

3.43 Two respondents thought that the guidance should place more emphasis upon consistency of structure and comparability between financial periods, and that significant changes in the structure of the annual report from the previous financial period should be highlighted.

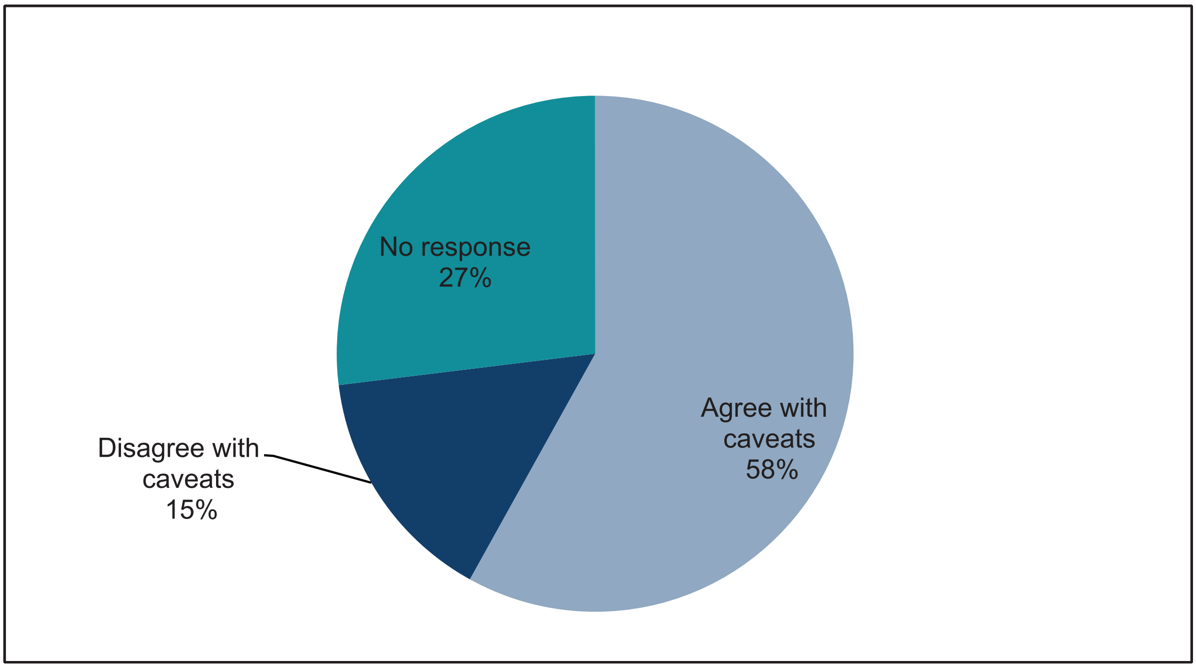
3.44 A minority of respondents requested examples of appropriate changes to structure, or further guidance on what to change and when. One respondent felt that the guidance on reviewing the structure was unnecessary as companies already perform such reviews.

FRC response

3.45 There was general agreement with the guidance on the structure of the strategic report. Although consistency from year to year is a quality investors desire, we believe that an over emphasis on consistency might inhibit the more general improvements in communication that are regarded as a priority.

3.46 The FRC would like to encourage a flexible approach to the placement of information in the annual report and its components. The most appropriate structure for effective communication is a matter of judgement based on the entity's facts and circumstances and the directors' assessment of the information needs of its shareholders.

Respondents views on Question 7 – *content elements*



Overview

3.47 A large number of comments were received from respondents in relation to the draft guidance on the content elements of the strategic report. The majority of the respondents were supportive of the approach taken in the guidance; however several suggestions for improvements were received.

Objectives, strategy and business model

3.48 Some respondents felt that the term '**objectives**' was unhelpful in this context as it was thought to be too wide and might result in onerous disclosure. Other respondents were in favour of more detailed disclosure on business strategy, for example more emphasis on non-financial objectives, and the linkage of environmental, employee, social, community and human rights matters (EESCH) to **key performance indicators (KPIs)**. A number of respondents also wanted the guidance to emphasise that there should be a primarily forward-looking focus to reporting on business strategy.

3.49 For further information on respondents' comments around the disclosure of an entity's business model, see the responses to *Question 8* below.

Business performance

3.50 Respondents were keen for the guidance to emphasise that KPIs must be quantifiable, and for comparatives from the previous financial period to be included to assist shareholder evaluation of performance. Some respondents felt that there was a need for more guidance on non-financial KPIs to improve reporting in this area.

3.51 One respondent observed that the European Securities and Markets Authority (ESMA) is carrying out a project in relation to alternative performance measures and suggested the FRC should review the guidance for consistency with the ESMA conclusions.

Principal risks and uncertainties

3.52 Respondents requested that the FRC consider the consistency of the guidance with existing guidance and frameworks, such as the findings of the Sharman Inquiry. Some respondents wanted a greater emphasis on the importance of non-financial risks, and one respondent felt that positive opportunities should be disclosed alongside risks with a potentially negative impact, to ensure balanced disclosure.

Environmental, employees, social, community and human rights matters

3.53 A number of respondents requested more detailed guidance on the types of disclosures required in respect of EESCH matters, particularly in relation to human rights issues. Two respondents observed that paragraph 6.64 of the Exposure Draft did not explicitly outline the requirement set out in section 414C(7)(b) of the Act – for a company to disclose its EESCH policies, the effectiveness of those policies and to state which information, if any, is not provided. Other respondents suggested that the guidance should refer directly to existing related guidance and frameworks, for example the UN *Guiding Principles on Human Rights*. One respondent suggested greater linkage between EESCH matters and the disclosure of risks.

Other considerations

3.54 Some accountancy bodies and accountancy firms suggested that the FRC consider the consistency of the guidance with the developments in integrated reporting.

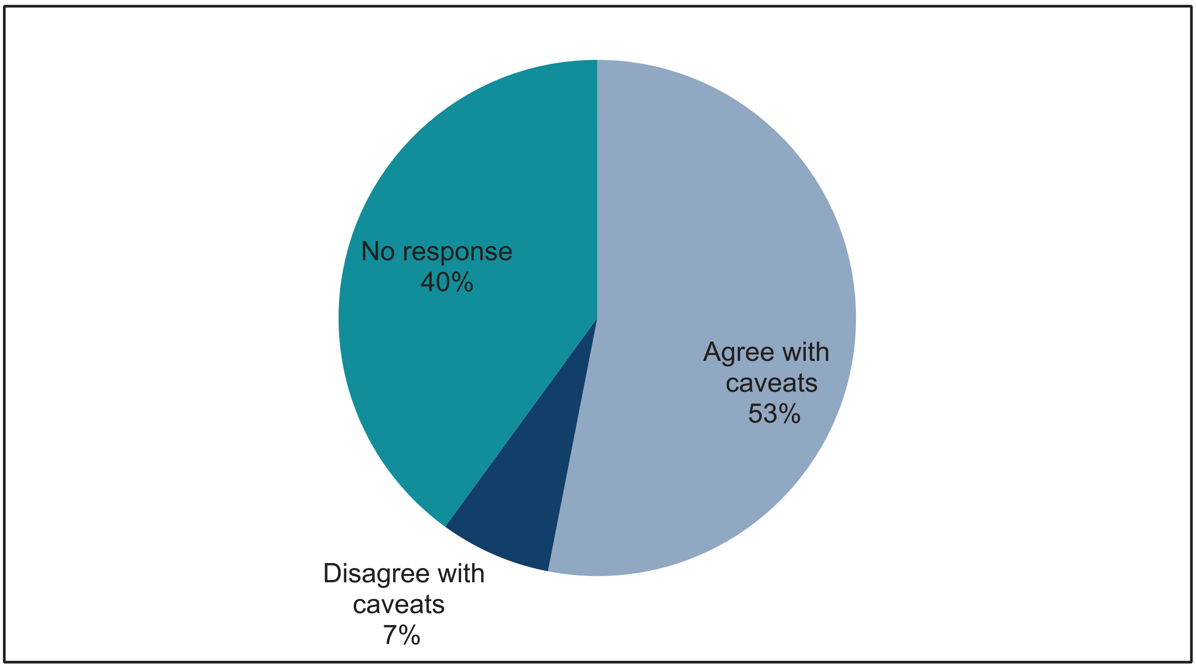
FRC response

3.55 The FRC wishes to provide some guidance on how information might be presented in the strategic report without being seen to be too prescriptive regarding its structure or content. The wording of the content elements (set out in bold in the guidance) is generally consistent with that used in the Act, subject to minor alterations where it was considered necessary to clarify the language used. These bold content elements are supplemented with supporting detail that describes the nature of the information that we believe should be considered for disclosure in respect of each requirement.

3.56 In contrast to an integrated report, the strategic report is required as part of the annual report in the UK, with its purpose and content largely determined by legislation. This fact notwithstanding, the *International Integrated Reporting Framework* and the *Guidance on the Strategic Report* encourage similar qualitative characteristics and content. The *Guidance on the Strategic Report* is also broadly consistent with the guidance in the IASB's IFRS Practice Statement *Management Commentary*.

3.57 The final guidance includes further detail on the disclosure of business models, principal risks and uncertainties, and EESCH matters. Further detail on the rationale in respect of the content elements of the strategic report, considered by the FRC in finalising the guidance, can be located within the Accounting Council's advice to the FRC which is published within the guidance.

Respondents views on Question 8 – *business model definition*



Business model definition

3.58 The majority of respondents supported the definition of a business model provided in the guidance and were in favour of maintaining consistency with the definition set out in the Code. Most respondents felt that the level of guidance provided was appropriate as it avoided being too prescriptive; however several respondents considered that it would be helpful to expand upon it further. Suggestions for improvements included:

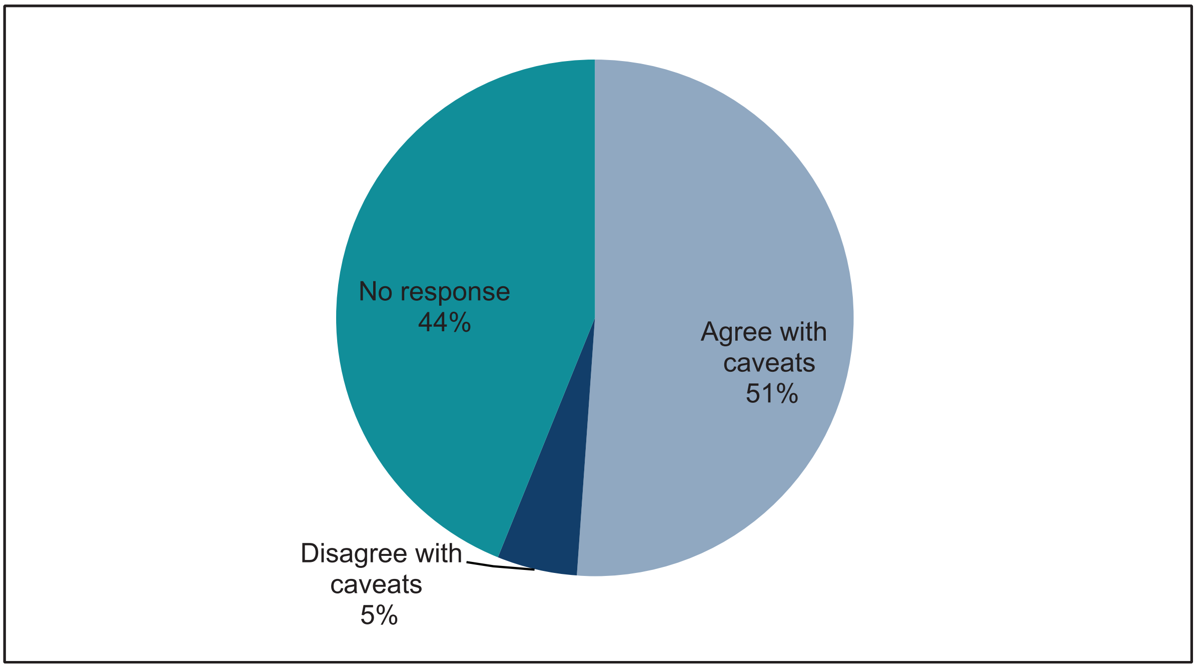
- more emphasis on strategy and how the business model achieves value creation and preservation, reducing the focus on the operational aspects of the model;
- amendments to the diagram in paragraph 6.29 of the Exposure Draft and inclusion of example business model disclosures;
- one respondent also requested that the guidance provide a definition of the term 'value'; and
- that the business model disclosure should explain how the entity differs from its competitors.

FRC response

3.59 The FRC believes it is important for investors to understand how the value generated by business activities is captured and converted into financial benefits. This quality of a business model description has now been included in the content element guidance.

3.60 The diagram in paragraph 6.29 of the Exposure Draft was amended following the comments received and updates made to the explanatory paragraphs where appropriate.

Respondents views on Question 9 – *business model versus strategy*



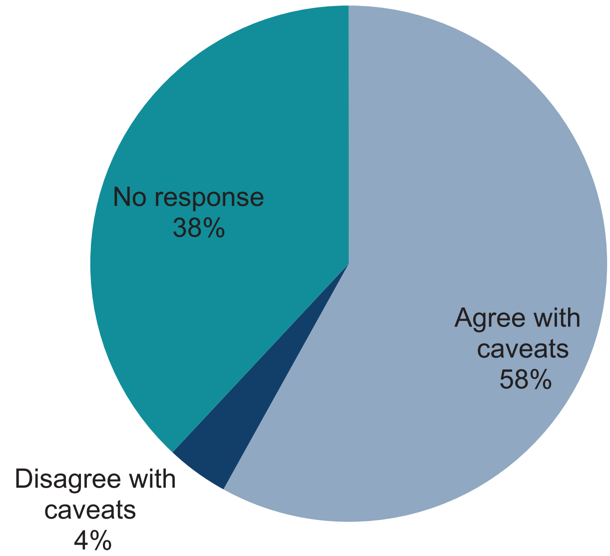
Differentiation between business model, strategy and objectives

3.61 Almost all respondents agreed with the level of differentiation between the business model, strategy and objectives. However, one respondent suggested that the guidance should describe in more detail how the three concepts are interlinked, whereas another respondent felt that these concepts should be differentiated further.

FRC response

3.62 The FRC acknowledges that different businesses use different terms for objectives, strategy and business model. In addition, distinguishing between these concepts is challenging and reaching a consensus on how they should be differentiated is difficult, as they are inextricably linked. Disclosures in this area will be entity specific and the guidance does not intend to imply that other definitions or terminology cannot be used in the strategic report.

Respondents views on Question 10 – *linkage examples*



Linkage examples

3.63 There was broad consensus amongst the respondents that the linkage examples provided were helpful, although some respondents requested more detailed examples or suggested additional examples for inclusion. Some respondents felt that there should be greater linkage between the business model, KPIs and risks. One respondent also wanted more clarity on the distinction between signposting and cross-referencing.

3.64 Two respondents thought that the examples provided would be better presented within an appendix to the guidance. Other minor drafting points were raised, however respondents were broadly supportive of the approach to the linkage of information outlined and no major concerns were noted.

FRC response

3.65 It is the FRC's view that improvements to the linkage of information will encourage more cohesive reporting that is more relevant to shareholders.

3.66 The guidance has been updated to clarify the distinction between signposting and cross-referencing. Additional examples of linkage have been included in the guidance, and the section of the guidance relating to the placement of information in the annual report has been expanded.

Appendix I – Glossary

the Act	The Companies Act 2006.
annual report	The annual accounts and reports that members of the company are entitled to receive under section 423 of **the Act.**
business model	How the entity generates or preserves value over the longer term.[5]
complementary information	Complementary information is information that is relevant to shareholders but is not necessary to effectively communicate the information that is required by law or regulation. Complementary information can be more detailed information or additional voluntary information (e.g. a five-year summary or a glossary).
components	The distinct reports and other sections that are required to be included in the **annual report** by law or regulation (e.g. the **strategic report**, the **directors' report**, the corporate governance report, the directors' remuneration report and the financial statements).
cross-referencing	A means by which an item of information, which has been disclosed in one **component** of an annual report, can be included as an integral part of another component of the annual report. A cross-reference should specifically identify the nature and location of the information to which it relates in order for the disclosure requirements of a component to be met through the relocated information. A component is not complete without the information to which it cross-references. Cross-referenced information must be located within the annual report. Cross-referencing is different to **signposting**.
the Code	The 2012 UK Corporate Governance Code.
directors' report	The report that is required by section 415 of the Act which incorporates the disclosures specified by the Act or its associated regulations.
key performance indicators (KPIs)	Quantitative measures used by directors to assess progress against **objectives** or **strategy**, track **principal risks**, or otherwise monitor the development, performance or position of the business.

[5] **The Code**, Provision C.1.2.

material (in the context of the strategic report)	Information is material if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole. Only information that is material in the context of the strategic report should be included within it. Conversely, the inclusion of immaterial information can obscure key messages and impair understandability of information provided in the strategic report. In such circumstances, the immaterial information should be excluded from the strategic report.
objective	A specific aim that the entity wishes to achieve.
principal risk	A risk or combination of risks that can seriously affect the performance, future prospects or reputation of the entity. These should include those risks that would threaten its business model, future performance, solvency or liquidity.
quoted company	A company whose equity share capital has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000; or is officially listed in an EEA State; or is admitted to dealing on either the New York Stock Exchange or the exchange known as NASDAQ.[6]
signposting	A means by which a shareholder's attention can be drawn to **complementary information** that is related to a matter disclosed in a component of the annual report. A component must meet its legal and regulatory requirements without reference to signposted information. Signposts should make clear that the complementary information does not form part of the component from which it is signposted. Signposted information may be located either within or separately from the annual report. Signposting is different to **cross-referencing**.
strategic report	The report, required by section 414C of the Act, which provides shareholders of the company with the ability to assess how the directors have performed their duty under section 172 (duty to promote the success of the company).
strategy	A plan or approach which is intended to help the entity achieve an objective.

[6] Section 385 of the Act.

Appendix II – List of respondents

	Respondent	Organisation type
1	Association of International Accountants	Accountancy body
2	BP Plc	Preparer
3	Ian Reynolds	Other
4	Legal & General Investment Management Ltd	Investor
5	Association of Investment Companies	Investor representative
6	BDO	Accountancy firm
7	Amnesty International UK	Civil society group
8	ACCA	Accountancy body
9	Institute of Business Ethics	Civil society group
10	PwC	Accountancy firm
11	CIMA	Accountancy body
12	Investor Relations Society	Preparer representative
13	Prism Cosec	Preparer representative
14	CIPFA	Accountancy body
15	Share Action	Civil society group
16	Association of Financial Mutuals	Preparer representative
17	British Private Equity and Venture Capital Association	Investor representative
18	Grant Thornton	Accountancy firm
19	Local Authority Pension Fund Forum	Investor representative
20	ICAS	Accountancy body
21	Black Sun Plc	Other
22	Future Value	Other
23	EY	Accountancy firm
24	CLT Envirolaw	Other
25	Institution of Occupational Safety and Health	Civil society group
26	Association of British Insurers	Investor representative
27	Institute of Chartered Secretaries and Administrators	Preparer representative

28	Merchant Cantos	Other
29	Oxfam	Civil society group
30	The Corporate Responsibility Coalition	Civil society group
31	Shift/John Ruggie	Civil society group
32	Aviva Investors	Investor
33	KPMG	Accountancy firm
34	Glaxo Smith Kline Plc	Preparer
35	BT Plc	Preparer
36	Deloitte	Accountancy firm
37	Climate Disclosure Standards Board	Civil society group
38	TUC	Civil society group
39	30% Club	Other
40	Quoted Company Alliance	Preparer representative
41	GC100	Preparer representative
42	Investment Management Association	Investor representative
43	Hermes Equity Ownership Services	Investor representative
44	ICAEW	Accountancy body

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