



August 2017

Draft amendments to Guidance on the Strategic Report Non-financial reporting

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Introduction

- (i) In June 2014, the Financial Reporting Council (FRC) published its *Guidance on the Strategic Report*. Since that time, there has been an increasing focus on the need for businesses to consider their impact on society and report on the broader matters that may impact the sustainability of the business over the longer term.
- (ii) In December 2016, the Government published Regulations¹ to implement the EU Directive on disclosure of non-financial and diversity information ('non-financial reporting Directive'). The new Regulations amend the strategic report requirements as set out in the Companies Act 2006 ('the Act') and are effective for financial years beginning on or after 1 January 2017.
- (iii) Whilst the new Regulations only apply to certain large entities with more than 500 employees, much of the content is similar to the pre-existing disclosure requirements in the strategic report. This reflects one of the aims of the EU Directive, to harmonise reporting of non-financial information across Member States.
- (iv) In the UK, there have been complementary developments arising from the Government's agenda for corporate governance reform which places emphasis on the conduct of business. In particular, there have been calls, including from the FRC, for a greater focus on the director's duty under section 172 'Duty to promote the success of the company' and in so doing to 'have regard to' the broader matters under section 172 of the Act. This duty is referred to in the purpose of the strategic report set out in the Act and some of the matters referred to in section 172 are similar to those in the non-financial reporting requirements within the strategic report.

172 Duty to promote the success of the company

- (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:
 - (a) the likely consequences of any decision in the long term;
 - (b) the interests of the company's employees;
 - (c) the need to foster the company's business relationships with suppliers, customers and others;
 - (d) the impact of the company's operations on the community and the environment;
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
 - (f) the need to act fairly as between members of the company'.

- (v) In light of recent developments, the FRC is updating its *Guidance on the Strategic Report* to:
 - reflect changes arising from the UK implementation of the non-financial reporting Directive;
 - enhance the linkage between section 172 and the purpose of the strategic report; and
 - make targeted improvements to certain areas of the guidance to reflect key developments in corporate reporting.

¹ The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (the 'Regulations')

- (vi) Broadly, the feedback on the *Guidance on the Strategic Report* to date has been that it is a helpful document, therefore this update is not intended to be a fundamental review.
- (vii) Given that the non-financial reporting Regulations are now effective, we believe that it is necessary to consult on amendments to the guidance at this stage in order to ensure that companies have direction on the application of the Regulations for financial years beginning on or after 1 January 2017. However, we continue to monitor developments following the publication of the Government's *Corporate Governance Reform Green Paper*. A government response to the consultation on the Green Paper is expected shortly. One of the specific issues on which the Government sought views was the option of introducing clearer requirements for companies to report on how they are giving consideration to the different stakeholder interests specified in section 172 of the Companies Act 2006. If this option is taken forward, or if there are any other legislative changes that affect the strategic report requirements, we will update the *Guidance on the Strategic Report* to reflect changes to UK law.

Approach to update

- (viii) The Regulations that implement the non-financial reporting Directive have created some complexity in the reporting framework. In drafting these amendments, the FRC has, following a careful consideration of the legislative framework, taken a pragmatic approach to assist entities with implementation of the new Regulations in the simplest manner. The aim is to ensure that the strategic report and annual report as a whole remain cohesive, incorporating financial and non-financial information.
- (ix) The draft amendments enhance the pre-existing strategic report requirements, integrating additional content from the new Regulations rather than duplicating. The guidance remains non-mandatory with a view to encouraging best practice.
- (x) The FRC has applied the following principles for the application of the new Regulations:
 - The amendments arising from the new Regulations should be interpreted within the context of the pre-existing strategic report requirements.
 - The new requirements form part of the strategic report and therefore should be viewed as integral to the overriding requirement for the strategic report to include a fair, balanced and comprehensive review of the development, performance and position of the company; and describe the principal risks and uncertainties facing the company.
 - Whilst the Regulations use the term 'non-financial information statement', the information necessary to meet the requirements in the new Regulations does not need to be presented as a separate statement.
 - For entities within the scope of the new Regulations, the information should be provided to the extent necessary for an understanding of the company's development, performance and position, and impact of its activity. The primary focus is on what information is necessary for a user to have a reasonable understanding of the subject-matter rather than individual stakeholders. However, in rare circumstances if a particular perspective is needed, then it is that of the members.
- (xi) One of the overarching aims of this update is to encourage entities to consider the broader matters that may impact the business over the longer term. With that in mind, we are proposing encouraged content elements that go beyond the specific legal requirements in the Act but are areas where disclosure, based on discussions with stakeholders, would be informative.

Invitation to comment

1. The FRC is requesting comments by 24 October 2017. The FRC is committed to developing guidance and standards based on evidence from consultation with users, preparers and others. Comments are invited on all aspects of the proposals. In particular, comments are sought on the questions below.
2. Comments are most helpful if they indicate the specific paragraph or groups of paragraphs to which they relate, contain a clear rationale and, where applicable, suggest an alternative approach or text.

Approach to update

3. The Regulations to implement the non-financial reporting Directive directly reflect the requirements of that Directive. The new disclosure requirements, set out in section 414CB of the Act, share many similarities with the content in the pre-existing strategic report requirements, but differ in certain respects and in scope.
4. The Act requires the new disclosure requirements to be included within the strategic report. The purpose of the strategic report as set out in the Act is to inform members of the company and to help them to assess how the directors have performed their duty under section 172. The draft amendments have been incorporated into the guidance such that the strategic report remains a single cohesive document. This has been achieved by enhancing the guidance with the additional requirements and recommending that these are best practice for all entities.

Question 1

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

The purpose of the strategic report and section 172

5. The purpose of the strategic report is to inform members of the company and help them assess how directors have performed their duty under section 172 (duty to promote the success of the company).
6. The draft amendments aim to strengthen the link between the purpose of the strategic report and the matters directors should have regard to under section 172 of the Act.
7. Where appropriate, we have also included encouraged content elements that go beyond the specific legal requirements but can assist when considering how the strategic report meets its overall purpose.

Question 2

Do you support the enhancements that have been made to Sections 4 and 7 of the Guidance to strengthen this link?

Question 3

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

Materiality

8. The draft amendments to Section 5 *Materiality* enhance the focus on non-financial information and long term value.

Question 4

Do you agree with the draft amendments to Section 5?

Linkage

9. The Guidance encourages linking of related information in the annual report through the narrative. The communication principle relating to linkage in Section 6 *The strategic report: communication principles* has been enhanced to encourage entities to better integrate related information in their reports.

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?

Content elements

10. The draft amendments to Section 7 *The strategic report: content elements* have been revised to:
- encourage companies to consider the broader matters that may impact the value of the company over the longer term, particularly in relation to the guidance relating to strategy and business model; and
 - strengthen the guidance relating to non-financial reporting to reflect changes arising from the non-financial reporting Directive.
11. In addition, the proposals place greater emphasis on the notion of value generation. With that in mind, the FRC, through the draft amendments, is encouraging entities to consider how value is generated through the use of qualitative and quantitative disclosures. The FRC's aim is to encourage companies to be innovative in this space and develop an approach that is appropriate for their business. Therefore, we have avoided providing prescriptive guidance to enable practice to develop.

Question 6

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

Question 7

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

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?

Other

12. In addition to updating the Guidance to reflect changes arising from the UK implementation of the non-financial reporting Directive and to strengthen the link between the purpose of the strategic report and section 172, we have made targeted improvements in certain areas to reflect recent developments in corporate reporting such as the ESMA *Guidelines on Alternative Performance Measures*.

Question 9

Are there any other specific areas of the Guidance that would benefit from improvement?

[Draft] Amendments to Summary

1. The following paragraphs set out the [draft] amendments to the Summary (deleted text is struck through, inserted text is underlined).

Background

2. Paragraph (ii) and (iii) are amended as follows:
 - (ii) In August 2013, the Government published new Regulations 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 entities to prepare a strategic report as part of their annual report. ~~The requirements apply for periods ending on or after 30 September 2013.~~
 - (iii) 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 the strategic report should be that they should act as a catalyst for entities to prepare clear and concise narrative reports that facilitate and result in 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 corporate financial reporting.
3. A new paragraph (iv) and associated footnote are inserted above the sub-heading 'Aims of the guidance'. Paragraph (v) is deleted and paragraph (iv) is renumbered to (v). Subsequent footnotes are renumbered sequentially:
 - (iv) In December 2016, the Government published non-financial reporting Regulations^[*footnote]. For certain entities, the Regulations introduce additional non-financial reporting requirements for the strategic report. The requirements apply for financial years beginning on or after 1 January 2017.
[*footnote] The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016.
4. Paragraphs (viii) to (xii) and (xiv) are amended as follows:
 - (viii) The guidance encourages that the companies to provide information ~~provided~~ in annual reports ~~should be more~~ that is relevant to shareholders. With that in mind, the guidance is framed in the context of the annual report as a whole. In practice, an annual report comprises a number of components. The information contained in each of these components has different objectives that should guide preparers to where disclosures could be located. The aim is to promote cohesiveness and enable related information to be linked together.
 - (ix) Placement is a key theme in the guidance with a view to providing entities with the building blocks to be innovative in the location of information while working within the regulatory framework. The aims are to ensure that important information ~~that is important to shareholders~~ is prominent and improve the accessibility of information. The guidance recommends that information that is provided to meet the needs of individual stakeholders not relevant for shareholders should be provided outside the annual report where this is permitted by law or regulation.
 - (x) The ~~overriding~~ primary objective of the strategic report is to provide information for shareholders ~~that will enable and help~~ them to assess how the directors have performed their duty, under section 172 of the Act, to promote the success of the company⁴ while having regard to the matters set out in that section. It should reflect

the ~~directors'~~ board's view of the company and provide context for the related financial statements.

~~(xi) Stakeholders as a whole will have an interest in the long-term success of an entity and in meeting the needs of shareholders, the information in the annual report may~~ will also be of interest useful to other stakeholders. The annual report should not, however, be seen as a replacement for other forms of reporting addressed to other stakeholders.

~~(xi) The guidance includes sections on the application of materiality to the strategic report, communication principles and content elements.~~

(xii) The guidance recommends that ~~only~~ information that is material to shareholders should be included in the strategic report. Immaterial information should be excluded as it can obscure the key messages and impair understandability. In meeting the information needs of shareholders, the strategic report will also provide information which is useful to an entity's other stakeholders taken as a whole and will meet many of their information needs.

(xiv) The content elements for the strategic report set out in the guidance are derived from the Companies Act 2006, and include a description of the entity's strategy, ~~objectives~~ and business model. In addition, the strategic report should include an explanation of the main trends and factors affecting the entity; a description of its principal risks and uncertainties; and an analysis of the development and performance of the business; ~~and an analysis using~~ including key performance indicators. Disclosures ~~Entities should disclose information~~ about the environment, employees, social, community, and human rights, anti-corruption and anti-bribery matters ~~issues considering the impact of its activity are required when material~~. There is also a requirement to include disclosures on gender diversity.

5. In paragraph (xiii), reference to the company's directors has been replaced with the board. The same change has also been made to paragraph 3.6, 3.8, 5.11 and the example, 5.12, 6.3, 6.6 and the example under paragraph 6.21.

6. A new paragraph (xv) is inserted as follows:

(xv) On 5th July 2017, the European Commission published 'Guidelines on non-financial reporting'. The Commission Guidelines are non-binding and state that companies may use other reporting frameworks, including this guidance, in preparing non-financial information.

[Draft] Amendments to Section 1 Objectives and how to use this guidance

1. The following paragraph sets out the [draft] amendments to Section 1 *Objectives and how to use this guidance* (inserted text is underlined).
2. Additional text is inserted at the end of paragraph 1.3 after the box entitled 'Linkage example', as follows:

Encouraged content element

The encouraged content elements identify areas where there are no explicit disclosure requirements in the Act. However, entities could include additional content to ensure that the strategic report meets its overall purpose – to inform members of the company and help them assess how directors have performed their duty under section 172 (to promote the success of the company).

[Draft] Amendments to Section 2 Scope

1. The following paragraphs set out the [draft] amendments to Section 2 *Scope* (deleted text is struck through, inserted text is underlined).
2. The *Summary of legal requirements* in paragraph 2.1 and footnote 5 are amended as follows:

Summary of legal requirements

The Act sets out different levels of reporting depending on the type of company.

Section 414A of the Act requires all companies that are not small⁵ to prepare a strategic report.

For a financial year in which the company is a parent company, and the directors of the company prepare group accounts, the strategic report must be a group strategic report relating to the entities included in the consolidation.⁶

Where a company has more than 500 employees and is a **traded company, a banking or an insurance company**, section 414CA requires the strategic report to include additional non-financial information.

A detailed analysis of the Act's requirements in respect of the strategic report, including information on the application of the statutory requirements to different types of entity, is set out in Appendix III and Appendix IV.

Section 415 of the Act also requires all companies to prepare a **directors' report** which contains other information specified by the Act and its associated regulations. The extent of disclosure in a directors' report also varies depending on the type of company. An analysis of the requirements of the Act and its associated regulations in respect of the directors' report is set out in Appendix IV.

Section 4(1)(a) of the Partnerships (Accounts) Regulations 2008 requires qualifying partnerships to prepare a strategic report.

Both the strategic report and the directors' report are integral parts of the **annual report**.

[footnote 5] Section 414B of the Act. A company or qualifying partnership is entitled to the small companies exemption in relation to the strategic report for a financial year if – (a) it is entitled to prepare accounts for the year in accordance with the small companies regime (s382), or (b) it would be so entitled but for being or having been a member of an ineligible group. The small companies regime does not apply to a company that is, or was at any time within the financial year to which the accounts relate – a public company; a company that is an authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company, or; carries on insurance market activity (s384(1)).

3. Paragraph 2.2 is amended as follows:
 - 2.2 As noted in the 'summary of legal requirements' above, the extent of disclosure that is required for a company will vary according to the type of company. However, this guidance does not differentiate on this basis. **Material** It is best practice to disclose information that is necessary for an understanding of the development, performance, position or future prospects of the entity⁹ or the impact of its activity ~~should be disclosed~~ in the strategic report, irrespective of the existence or otherwise of an explicit statutory disclosure requirement.

4. Paragraph 2.3 is deleted.

~~2.3 This guidance is written with the requirements for **quoted companies** in mind (and particularly those listed companies that apply **the Code**), the narrative reporting requirements for which are more extensive than those in the law for unquoted companies. However, this guidance still represents best practice for all companies required to prepare a strategic report.~~

[Draft] Amendments to Section 3 The annual report

1. The following paragraphs set out the [draft] amendments to Section 3 *The annual report* (deleted text is struck through, inserted text is underlined).
2. Paragraph 3.5 is renumbered to 3.6 and amended as follows, and a new paragraph 3.5 is inserted. Subsequent paragraphs and footnotes are renumbered sequentially.

3.5 The annual report cannot provide all of the information that shareholders and other stakeholders may find useful and is only one of the reports that entities might produce. Other forms of corporate reporting, delivered through alternative channels, may also provide a source of information.

3.56 **The annual report as a whole should be fair, balanced and understandable and should provide the information necessary for shareholders to assess the entity's position and performance, business model and strategy.⁹**

[Footnote 9] The **Code**, Provision C1.1.

3. A new paragraph 3.7 is inserted with the associated sub-heading and footnote as follows:

Auditor's responsibilities

3.7 The auditor's report is required to state^[*footnote] whether, based on the work undertaken in the course of the audit, the information in the strategic report, directors' report and corporate governance statement:

- is consistent with the financial statements;
- has been prepared in accordance with applicable legal requirements; and
- contains any material misstatements.

[*footnote] ISA (UK) 720 – Revised June 2016, paragraph 22D.

4. The following text is inserted in Table 1 (under the respective row headings) in respect of the strategic report:

Component objectives

To provide information for members and help them assess how directors have performed their duty under section 172 (duty to promote the success of the company).

Main sources of annual report disclosure requirements for a UK company with a premium listing on the London Stock Exchange

The Act s414CA

The Act s414CB

5. Paragraph 3.11 (now renumbered to 3.13) is amended as follows:

3.143 The annual report is a medium of communication between the ~~company's directors board and its~~ shareholders. Its structure should facilitate that communication while also complying with ~~company law~~ **the Act** and other regulatory requirements. In general, information should ~~only~~ be placed in the annual report when it is ~~relevant material~~ to shareholders. Information that is ~~primarily~~ provided to meet the needs of individual stakeholders ~~other users~~ should be placed elsewhere (e.g. online or in another report), where law or regulation permits.

6. Paragraph 3.12 is deleted.
~~3.12 Each component of the annual report should focus on the communication of the information relevant to meeting the objectives of that component.~~
7. Paragraph 3.13 (now renumbered to 3.14) is amended as follows:
~~3.13~~⁴ The Act envisages each component of the annual report to be a separately identifiable part of the annual report. Therefore, the strategic report, corporate governance report, directors' remuneration report, financial statements and directors' report should generally include only the content that is necessary to effectively communicate the information required by law or regulation meet the objectives of those components.
8. The cross-reference in paragraph 3.14 (now renumbered to 3.15) is amended to read as "paragraph 3.14".
9. Paragraph 3.18 (now renumbered to 3.19) is amended as follows:
~~3.18~~⁹ **Complementary information** that is not required to be included in the annual report (i.e. it is voluntary and not necessary help to meet the objectives of that component), but which the directors wish to place in the public domain, should generally be published separately (e.g. on the company website). The directors may, however, sometimes consider it appropriate to include some of this complementary information in the annual report. In such cases, that information could be included either in a separate, non-statutory section of the annual report or in the directors' report.
10. The cross-references in paragraph 3.21 (now renumbered to 3.22) are amended to read as "paragraphs 3.14 and 3.15".

[Draft] Amendments to Section 4

The strategic report: purpose

1. The following paragraphs set out the [draft] amendments to Section 4 *The strategic report: purpose* (deleted text is struck through, inserted text is underlined).
2. Paragraph 4.1 is amended as follows:
 - 4.1 The **strategic report** should provide shareholders of the company with information that will enable them to assess how the directors have performed their duty to promote the success of the company for the benefit of members as a whole, while having regard to the matters set out in section 172.²⁰
3. Paragraph 4.2 is renumbered and moved to paragraph 4.8 and amended, paragraphs 4.3 and 4.4 are deleted and new paragraphs 4.2, 4.3 and 4.4 are inserted as follows:
 - 4.2 The success of a company is dependent on its ability to generate and preserve value. Companies do not exist in isolation; they need to build and maintain relationships with a range of stakeholders in order to generate and preserve value. The strategic report should provide information about the relationships that are most important to the entity's ability to do so and should also explain how those relationships are taken into account in the boards' decision making. This information will provide an insight into the purpose of the entity and its culture.
 - 4.3 The strategic report should provide shareholders with information to allow them to understand the **strategy**, development, performance, position and impact of the entity's activity, including potential long term outcomes.
 - 4.4 In considering impact, the board should consider the impact of the entity's activities on stakeholders as a whole, including the impact on society more widely. These are matters which may affect an entity's success in the long term.
 - ~~4.3 Information in the strategic report should complement the financial statements. In doing so, it should enable the annual report to be a more cohesive document.~~
 - ~~4.4 In complementing the financial statements, the strategic report should provide information about the business and its development, performance or position that is not reported in the financial statements but which might be relevant to the shareholders' evaluation of past results and assessment of future prospects.~~
 - 4.28 The strategic report should reflect the collective view of the company's directors board.
4. Paragraph 4.5 is amended as follows:
 - 4.5 The strategic report should provide additional explanations of amounts recognised in the financial statements and explain the conditions and events that shaped the information contained in the financial statements. The strategic report should also include information relating to sources of value that have not been recognised in the financial statements and how those sources of value are managed, sustained and developed, for example a highly trained workforce, intellectual property or internally generated intangible assets, as these are relevant to an understanding of the entity's development, performance, position or impact of its activity.
5. Paragraph 4.6 is deleted as follows:
 - ~~4.6 The strategic report has three main content related objectives:
 - (a) to provide insight into the entity's business model and its main strategy and objectives;~~

~~(b) to describe the principal risks the entity faces and how they might affect its future prospects; and~~

~~(c) to provide an analysis of the entity's past performance.~~

6. A new paragraph 4.6 is inserted as follows:

4.6 There should be consistency between the strategic report and the information presented in the financial statements.

7. A new paragraph 4.7 is inserted as follows. Subsequent paragraphs are renumbered sequentially.

4.7 The strategic report should contain sufficient information to help members of the company to assess how the directors have performed their duty under section 172 and had regard to the matters listed therein. This may require the inclusion of information additional to that prescribed in the Act. However, the matters listed should not be applied as a checklist.

[Draft] Amendments to Section 5 The strategic report: materiality

1. The following paragraphs set out the amendments to Section 5 *The strategic report: materiality* (deleted text is struck through, inserted text is underlined).

2. A new paragraph 5.1 is inserted. Subsequent paragraphs are renumbered sequentially.

5.1 The strategic report requirements use terms such as 'principal' (e.g. as used in the term '**principal risks** and uncertainties') 'key' (e.g. as used in the term '**key performance indicators**' (KPIs)) and 'necessary for an understanding of'. These terms serve as a filter to ensure that neither too little nor too much information is included and serve as a guide to the level of detail that should be provided. As materiality is a commonly understood term in financial statements; this guidance uses the term material in conjunction with principal, key or necessary for an understanding of, to help guide entities in making the judgement of what level of disclosure is necessary.

3. Paragraph 5.1 (now renumbered 5.2) is amended as follows:

5.42 **Information is material if its omission or misrepresentation could reasonably be expected to 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 the understandability of information provided in the strategic report. Immaterial information should be excluded from the strategic report.

4. Paragraph 5.2 (now renumbered 5.3) is amended as follows:

5.23 The **strategic report** and the **annual report** more broadly should ~~only~~ contain information that is **material** to shareholders. A company's shareholder base may comprise groups with different needs and interests and the needs of all significant shareholder groups, including those who take a long-term view on investment, should be considered when determining whether a matter is material.

5. A new paragraph 5.4 is inserted as follows. Subsequent paragraphs are renumbered sequentially unless otherwise indicated.

5.4 Stakeholders as a whole will have an interest in the long-term success of an entity. Providing information that is material for shareholders will also thereby provide information that is useful to all stakeholders taken as a whole. When determining whether information is material, an entity should consider whether the fact or circumstance would affect the ability of the entity to generate or preserve value in the long term.

6. Paragraph 5.3 (now renumbered to 5.5) is amended as follows:

5.35 Materiality is ~~an entity-specific aspect of relevance~~ based on the nature or magnitude (or both) of the actual or potential effect of the matter to which the information relates ~~in the context of an entity's annual report~~. It requires directors to apply judgement based on their assessment of the relative importance of the matter to the entity's development, performance, position or future prospects and the impact of its activity.

7. A new paragraph 5.6 is inserted as follows:

5.6 The disclosure of the auditing materiality figure in the audit report may focus attention on materiality as a number. 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.

8. Paragraph 5.4 (now renumbered to 5.7) is amended as follows:

5.47 Materiality in the context of the strategic report will depend on the nature of the matter and magnitude of its effect, judged in the particular circumstances of the case. However, due to the nature of the information contained in the strategic report, and the purpose it serves:

- (a) qualitative factors ~~will~~ may often have a greater influence on the determination of materiality in the context of the strategic report, particularly in relation to non-financial information ~~than might be the case when making materiality judgements in respect of items in the financial statements. Both financial and non-financial information could be material;~~ and
- (b) the materiality of an item in the financial statements ~~will often~~ may be based on its magnitude relative to other items included in the financial statements in the year under review but may also be based on the potential effect over the longer term. The potential magnitude of future effects of a matter on the entity's development, performance, position of future prospects should also be considered when determining the materiality of a matter in the context of the strategic report.

9. Paragraph 5.6 is deleted and the heading above that paragraph amended to 'The Companies Act':

5.68 ~~Although the Act does not use the term 'material' the concept is implicit in many of its requirements. For example, the disclosure of trends and factors (described in paragraph 7.17) is only required to be included in the strategic report '...to the extent necessary for an understanding of the development, performance or position of the company's business'. Where information is required 'to the extent necessary for an understanding it should be included in the strategic report when it is material to shareholders.~~

10. Paragraph 5.7 is renumbered and moved to 5.10 and amended as follows:

5.710 The terms 'key' (e.g. as used in the term '**key performance indicators (KPIs)**') and 'principal' (e.g. as used in the term '**principal risks and uncertainties**') refer to facts or circumstances that are (or should be) considered material to an shareholder's understanding of the development, performance, position or future prospects or impact of the business. These will generally ~~For example, these could be the~~ performance measures and risks considered by the board.

11. Paragraph 5.8 (now renumbered to 5.11) is amended as follows:

5.811 The number of items disclosed as a result of the requirements to disclose principal risks or KPIs will generally be relatively small; they should not, for example, result in a comprehensive list of all performance measures used within the business or of all risks and uncertainties that may affect the entity. They should be consistent with how the board manages the entity.

12. Paragraph 5.9 is not renumbered and is amended as follows:
- 5.9 The strategic report should focus on those matters that are material to an understanding of the development, performance, position, or future prospects, and, for non-financial information, the impact of the entity's activity when taken as a whole. In the annual report of a parent company, for example, the strategic report should be a consolidated report and should include only those matters that are material in the context of the consolidated group.
13. Paragraph 5.12 (now renumbered 5.14) is amended as follows. The summary of legal requirements below 5.12 remains unchanged.
- 5.14~~14~~ There may be occasions when the board ~~directors~~ considers that the disclosure of detailed information about impending developments or matters in the course of negotiation would be seriously prejudicial to the interests of the company. ~~In such cases, summarised information that is not seriously prejudicial may meet substantially all shareholder information needs.~~ Where entities rely on this derogation to omit information, directors should still consider whether there is summarised information that is not seriously prejudicial which should be disclosed.
14. Paragraph 5.13 and the heading is deleted as follows:

~~Addressing the needs of different shareholder groups~~

- ~~5.13 As noted in paragraph 5.2, the strategic report should contain only the information that is material to shareholders. Sometimes, a company's shareholder base will comprise groups with different needs and interests (e.g. retail investors vs. institutional investors); the needs of all significant shareholder groups should be considered when determining if a matter is material.~~
15. A new paragraph 5.15 is inserted as follows:
- 5.15 The derogation from the general requirement to disclose material information is limited to those situations where disclosure would negatively impact impending developments or ongoing negotiations which are not in the public domain, for instance where the entity is in talks to acquire another entity. It is not a general derogation applying to all commercially sensitive information.

[Draft] Amendments to Section 6

The strategic report: communication principles

1. The following paragraphs set out the [draft] amendments to Section 6 *The strategic report: communication principles* (deleted text is struck through, inserted text is underlined).

2. Paragraph 6.1 is amended as follows:

6.1 The ~~communication~~ following principles provide guidance on how the ~~qualitative characteristics of the disclosures included in the~~ **strategic report** should be prepared. They are also relevant in the ~~drafting~~ preparation of the **annual report** as a whole.

3. New paragraph 6.2 is inserted as follows. Subsequent paragraphs are renumbered sequentially unless otherwise indicated.

6.2 Entities should consider the most effective methods of communicating material information, as well as its placement within the annual report.

4. Paragraph 6.4 (now renumbered to 6.5) is amended as follows:

6.45 The strategic report should be written in plain language. The excessive use of jargon should be avoided ~~where possible~~. Where the use of industry-specific terms is necessary for clear communication, they should be clearly defined and used consistently.

5. Paragraph 6.7 (now renumbered to 6.8) is amended as follows:

6.78 The strategic report should be clear and concise yet comprehensive²⁶ ~~but concise~~.

6. A new paragraph 6.14 is inserted as follows. Subsequent paragraphs are renumbered sequentially unless otherwise indicated.

6.14 Entities should communicate relevant information that enables shareholders to assess the factors that may have an impact on the long-term success of the business. This may involve looking beyond the strategic planning horizon of an entity.

7. The Linkage example below paragraph 6.17 (now renumbered to 6.19) is amended as follows:

Linkage example

~~Separate sections detailing trends in the entity's business environment and the entity's strategy setting out the principal risks and uncertainties and key performance indicators may be individually informative. However, highlighting and explaining linkages between these two elements of the strategic report might provide a deeper insight into the reasons for the entity's strategic choices~~ how the risks might impact on the KPIs in future.

8. The Linkage example below in paragraph 6.18 (now renumbered to 6.20) is amended as follows:

Linkage example

Providing ~~independent~~ information on an entity's ~~business strategy~~ key performance indicators in the strategic report and the drivers of directors' remuneration arrangements in ~~the strategic report and in the directors' remuneration report~~ will be informative. However, highlighting and explaining linkages or differences between these two components of the annual report ~~might~~ will provide a deeper insight into the entity's executive incentivisation policies.

9. Paragraph 6.21 (now renumbered to 6.23) is amended as follows:

6.24~~3~~ The duplication of information should generally be avoided as it usually leads to unnecessary volumes of disclosure detracting from the understandability and usefulness of the annual report as a whole. This can be achieved by using signposting or cross-referencing. In some cases, it may be necessary to repeat certain pieces of information, however this should be limited to circumstances when this would tell the company's story more effectively. ~~This may also be achieved by using signposting or cross-referencing.~~

10. Paragraph 6.23 (now renumbered to 6.25) is amended as follows:

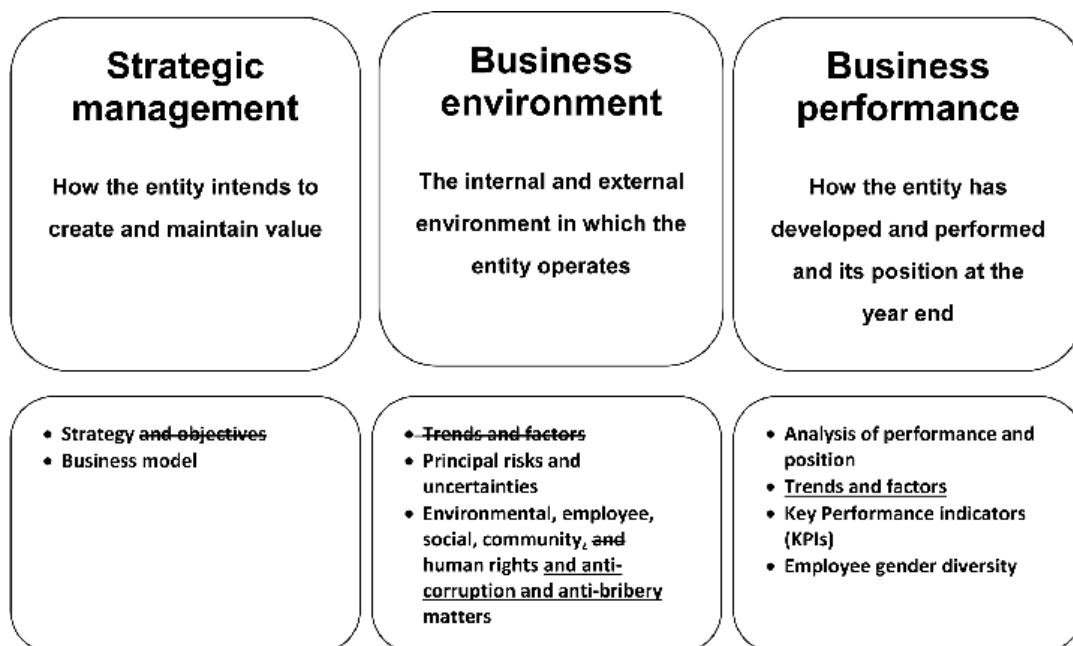
6.23~~5~~ The structure, and presentation and content of the strategic report should be reviewed annually to ensure that it continues to meet its objectives purpose in an efficient and effective manner and contains information that is relevant.

11. Paragraph 6.25 is deleted as follows:

6.25 ~~The content of the strategic report should be reviewed annually to ensure that it continues to be relevant in the current period.~~

[Draft] amendments to Section 7 Content elements

1. The following paragraphs set out the [draft] amendments to Section 7 *The strategic report: content elements* (deleted text is struck through, inserted text is underlined).
2. Paragraph 7.1 is amended as follows:
 - 7.1 The content elements of the **strategic report** set out in **the Act** can be analysed into three broad categories – strategic management, business environment and business performance:



3. Paragraph 7.2 is renumbered to 7.3 and amended, footnote 25 is amended and moved to a new paragraph 7.2 which is inserted as follows. Subsequent paragraphs and footnotes are renumbered sequentially unless otherwise indicated.

7.2 In addition to the specific disclosure requirements set out in the Act^[footnote 25], entities should ensure that the strategic report meets its overall purpose; to provide information to shareholders and help them assess how the directors have performed their duty under section 172. This guidance provides examples in the form of encouraged content elements which, whilst not required by law, may provide information to ensure that the strategic report achieves its overall purpose.

[Footnote 25] As noted in paragraph 2.1, this is best practice guidance. Certain content elements described in this section of the guidance are not mandatory for companies with more than 500 employees that do not meet the definition of a **quoted company, traded company, banking or insurance company** with more than 500 employees. Appendix III sets out which strategic report requirements apply to ~~companies that are not quoted~~ different types of companies.

7.23 ~~Paragraph 7.1 notwithstanding,~~ The various content elements required²⁶ to be included in the **strategic report** should not be addressed in isolation; there are numerous relationships and interdependencies between elements and other disclosures in the **annual report** which, as noted in paragraph 6.17, should be highlighted and explained in the strategic report. In particular, relevant non-financial information should be considered as integral to the strategic report and should be linked, where appropriate, to other content elements. The relevance and

strength of the relationships and interdependencies between the content elements will vary according to the facts and circumstances of the entity.

4. Paragraph 7.4 (now renumbered to 7.5) is amended as follows:

7.45 ~~An entity's purpose, its strategy, and its business model are inter-related concepts. Different businesses may use different terms for these concepts and/or may approach them in a different order. This guidance is not designed to impose a specific order or approach on an entity. Irrespective of the order or approach taken, the disclosure of an entity's objectives, purpose, strategy and business model should together explain what an entity does and how and why it does it.~~

5. Paragraph 7.5 is renumbered and moved to 7.8 and amended, and footnotes 26 and 27 are combined and amended as follows:

7.58 The strategic report should include a description of the entity's strategy and its business model²⁶ ~~the objectives it is intended to achieve.~~

Footnote is amended as follows:

²⁶ Section 414C(8)(a) of **the Act** and **the Code**, Provision C.1.2 for strategy and section 414C(8)(b) of the Act and **the Code**, Provision C.1.2 for business model insofar as quoted companies and s414CB(2)(a) for business model insofar as traded, banking or insurance companies with more than 500 employees.

6. Paragraph 7.6 is renumbered and moved to 7.7 and amended, and a new paragraph 7.6 is inserted as follows. Subsequent paragraphs and footnotes are renumbered sequentially unless otherwise indicated.

7.6 ~~An entity's purpose is why it exists. The entity's strategy describes the intended means of fulfilling its purpose. Together they provide an overview of why and how the entity aims to generate and preserve value.~~

7.67 ~~The purpose of A an entity will usually have be supported by a number of formal objectives that it intends to achieve in pursuit of its ultimate aim or mission that purpose. Objectives can be financial or non-financial in nature and may be expressed in quantitative or qualitative terms. The entity will also have developed a strategy that describes the means by which it intends to achieve these objectives.~~

7. A new sub-heading 'Strategy' is inserted above paragraph 7.7 (now renumbered to 7.9). The linkage example in paragraph 7.7 is moved to the new paragraph 7.11 and amended as follows:

Linkage example

Relating the development and performance of the entity during the year to the strategy that was in place at the time will allow shareholders to assess the directors' actions in pursuit of the entity's objectives, how directors have discharged their duty under section 172, and may be relevant in an assessment of the entity's future prospects.

8. Paragraphs 7.8, 7.9, 7.10 and 7.11 are deleted as follows:

~~7.8 The description of the entity's strategy and objectives should concentrate on the high level priorities related to its development, performance, position and future prospects.~~

~~7.9 Objectives can be financial or non-financial in nature and may be expressed in quantitative or qualitative terms.~~

~~7.10 Where relevant, linkage to and discussion of key performance indicators (KPIs) should be included in any descriptions given in order to allow an assessment of the entity's progress against its strategy and objectives. Similarly, emphasising the relationship between an entity's principal risks and its ability to meet its objectives may provide relevant information.~~

~~7.11 **The strategic report should include a description of the entity's business model.**²⁷~~

9. A new paragraph 7.10, a new encouraged content element and example are inserted as follows:

7.10 The entity's strategy should also explain the values, behaviours and culture that the entity seeks to uphold. The strategy should explain how the financial and non-financial objectives of the entity are drivers for those stated values, behaviours and culture.

Encouraged content element

An entity could set out who it considers its major stakeholders to be, how an entity engages with those stakeholders and how the interests of major stakeholder groups and the matters set out in section 172 were taken into account when making significant strategic decisions in the period.

Example

An entity may have a strategy of moving production overseas. In deciding how to disclose such a strategy, an entity should consider its rationale, the impact on existing employees and how regard was given to their interests, and the impact of the decision in the long term.

10. A new paragraph 7.11 is inserted as follows, followed by the Linkage example moved from paragraph 7.7:

7.11 The entity's purpose and strategy should be reflected in its objectives and key performance indicators (KPIs). The discussion of KPIs should allow an assessment of the entity's progress against its strategy and objectives. Similarly, emphasising the relationship between an entity's principal risks and its ability to meet its objectives may provide relevant information, particularly in relation to an entity's risk appetite. The relationship between the KPIs disclosed in the strategic report and the measures of performance in the directors' remuneration policy may also provide relevant information.

11. A new sub-heading is inserted above paragraph 7.12 and paragraph 7.12 is amended as follows.

Business model

7.12 The description of the entity's business model should provide more detail on set out how it generates or preserves value over the longer term, and how it captures that value. It should describe what the entity does and why it does it. It should also make clear what makes it different from, and/or the basis on which it competes with, its peers. There should be alignment between company purpose, values, strategy and business model.

12. Paragraph 7.13 is amended as follows:

7.13 The description of the business model should also ~~provide shareholders with~~ include a high-level understanding of how the entity is structured, the markets in which it operates, and how the entity engages with those markets (e.g. what part of the value chain it operates in, its main products, services, customers and its distribution methods). It should also provide a broad understanding of the nature of the relationships, resources and other dependencies that are sources of value and are necessary for the success of the business.

13. A new paragraph 7.14 and linkage example is inserted as follows:

7.14 The description of the entity's major products, services and markets and its competitive position within those markets should reflect the way that the business is managed, as should the segment analysis presented in the financial statements. While the level of aggregation and detail may vary, there should be overall consistency between these two information sets.

Linkage example

The value chain that the entity operates within, its suppliers and customers, exposes the entity to operational and reputational risks. The entity's strategy should explain how the values, behaviours and culture that it seeks to uphold are supported by its position in its value chain and the policies and due diligence that it undertakes in pursuit of that strategy.

14. Paragraph 7.14 (now renumbered to 7.15) and example are amended as follows:

7.14~~5~~ An entity will often ~~create~~ generate value through its activities at several different parts of its business process. The description of the business model should focus on the parts of the business processes that are most important to the generation, and preservation ~~or capture~~ of value. The impact of an entity's activity, however, may be greatest in other parts of the business process and these areas should also be considered.

Example

An entity operating in the pharmaceuticals sector might have a ready market for an innovative drug; the key to the value ~~generation-creation~~ process is in the development and approval of that drug. In this case, the business model description should give due emphasis to the critical drug development and approval processes.

15. Paragraph 7.15 is deleted as follows:

~~7.15 The description of the business model should provide shareholders with a broad understanding of the nature of the relationships, resources and other inputs that are necessary for the success of the business.~~

16. Paragraph 7.17 and associated footnote are moved to paragraph 7.58, and a new sub-heading 'Trends and factors' is inserted above as follows:

Trends and factors

7.4758 To the extent necessary for an understanding of the development, performance or position of the entity's business, the strategic report should include the main trends and factors likely to affect the future development, performance or position of the business²⁸

17. Paragraphs 7.18 and 7.19 are moved to 7.62 and 7.63 and are amended as follows:

~~7.4862~~ Trends and factors affecting the business may also arise ~~either~~ as a result of the external environment in which the entity operates ~~or from internal sources~~. They may have affected the development, performance or position of the entity in the year under review or may give rise to opportunities or risks that may affect the entity's future prospects. 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 the environment, and where material, discuss the effect of these trends on the entity's future business model and strategy.

~~7.4963~~ The strategic report should include ~~a description of the entity's major markets and its competitive position within those markets~~. It should also cover other significant features of its external environment (e.g. the legal, regulatory, macro-economic and social environment) and how those influence the business. The strategic report should set out the directors' analysis of the potential effect of the trends or factors identified on the development, performance, position or future prospects of the entity.

18. Paragraphs 7.20 is moved to paragraph 7.64.

19. Paragraph 7.21 is moved to paragraph 7.65 and the example is amended as follows:

Example

An entity may wish to state in its strategic report that the market in which it operates has grown substantially in the past five years. In this case, the strategic report should, where practicable, indicate by how much the market has grown and ~~provide a link to the research or report from which~~ reference the source of the statistics used ~~has been taken~~.

20. Paragraph 7.22 is moved to paragraph 7.66.

21. A new sub-heading and paragraphs 7.17 to 7.21 are inserted as follows:

Sources of value

7.17 As noted in paragraph 7.13, a critical part of understanding an entity's business model is understanding its sources of value, being the key resources and relationships that support the generation and preservation of value. In identifying its key sources of value, an entity should consider both its tangible and intangible assets and consider those resources and relationships that have not been reflected in the financial statements because they do not meet the accounting definitions of assets or the criteria for recognition as assets. This information may provide insight into how the board manages, sustains and develops these unrecognised assets.

Example

An entity may generate a significant portion of its value from its corporate reputation and brand strength. The strategic report should explain an entity's key sources of value and the actions that it takes in order to manage, sustain and develop these sources of value. Other sources of value may include: customer base; natural resources; employees; research and development; intellectual capital; licences, patents, copyrights and trade marks; and market position.

7.18 For many entities, a key source of value that helps ensure that an entity's success is sustainable over the longer term is the existence of mutually beneficial relationships with key stakeholders. These relationships are often built over many years and are based on trust, integrity and transparency. Information on an entity's approach to building and maintaining successful relationships with its key stakeholders, and the impact of its activities on them, helps shareholders' assessment of the entity's future prospects.

Encouraged content element

An entity could describe how it develops and maintains its relationships with its key stakeholders. This could include the regular interactions it has with them, how it communicates with them and how regard is had to their interests in key decisions. For instance, there may be a non-executive director who has specific responsibility for considering the interests of employees and other stakeholders.

7.19 All sources of value may require expenditure by the entity to manage, sustain and develop. The board will use resources to, for instance, invest in research and development, make capital investments, provide returns to shareholders, contribute to pension funds, provide training, pay and benefits to employees, make the entity's operations more sustainable and pay taxes. Some of these items of expenditure will result in assets recognised on the balance sheet, some will result in resources that are not recognised. Providing information on this expenditure may provide insight into how an entity views its sources of value.

7.20 Whilst the costs associated with these decisions may be relatively easy to quantify, measuring the benefits, which could provide greater insights, may be more difficult.

7.21 Some entities are innovating in the provision of such insights by providing analyses of, for example, the economic contribution to different stakeholders, the distribution, retention and re-investment of "added value" (which can be based on sales less the cost of externally purchased goods and services) and the allocation of "free-cash" flows.

Encouraged content element

An entity could describe how its allocation of resources will support the achievement of its strategy, generate and preserve value and will impact on its stakeholders where material to an understanding of the entity's future prospects. This could include a quantitative and qualitative analysis of allocation decisions made (such as investments) and their impact during the year.

22. Footnote 30 (now renumbered 33) in paragraph 7.23 (now renumbered to 7.22) is amended as follows:

³⁰³ It is considered best practice to explain how principal risks are managed or mitigated. The FRC's consultation 'Proposed Revisions to the UK Corporate Governance Code' Provision C.2.1 reflects this.

23. Paragraph 7.24 (now renumbered to 7.23) is amended as follows:

7.24³ The risks and uncertainties included in the strategic report should be limited to those considered by the entity's management to be material to the development, performance, position or future prospects of the entity or the impact of the entity's activity. They will generally be matters that the directors regularly monitor and discuss because of their likelihood, the magnitude of their potential effect on the entity, or a combination of the two. They can arise from both matters facing the entity and from the impact that the entity has on external parties.

24. A new paragraph 7.24 and linkage example is inserted as follows:

7.24 Principal risks should include, but are not necessarily limited to, those risks that could result in events or circumstances that might threaten the entity's business model, future performance, solvency or liquidity. In determining which risks are the principal risks, entities should consider the potential impact and probability of the related events or circumstances arising and the timescale over which they may occur.

Linkage example

Principal risks may result in threats to solvency and liquidity. An entity should consider the period over which principal risks may crystallise and how these have been taken into account when, where relevant, making the viability statement.^[*footnote] Where a viability statement uses a timeframe shorter than that over which risks may crystallise, the entity should explain the potential impact of these long-term risks on the entity's viability.

^[*footnote] A viability statement is only required for these companies who are subject to the Code.

25. Paragraph 7.25 is amended and split into two paragraphs, part retained in paragraph 7.25 and part moved to paragraph 7.27. The linkage example in paragraph 7.25 is also amended. A new paragraph 7.26 is inserted as follows:

7.25 The board Directors should consider the full range of business risks, including both those that are financial in nature and those that are non-financial. Where the entity is facing long-term systemic risks which may have a material effect on the entity's ability to generate and preserve value in the long term, for instance risks arising from climate change or risks arising from changing technology, the strategic report should explain how the directors expect the entity's strategy and business model to change in response to those risks.

Linkage example

~~Principal risks may result from matters described in paragraph 7.29. In such cases, information on the policies adopted by the entity on those matters and effectiveness of those policies (as set out in paragraph 7.45) will be important to the assessment of how the entity manages or mitigates these risks~~

Climate change may require an entity to make changes to its business model, adapt its products and production processes or alter the markets in which it is engaged. In these situations, the entity's strategy and business model should explain how climate change might influence the entity's business in the future and the potential effects of climate change on the development, performance, position or future prospects of the entity.

7.26 Where relevant and proportionate, the entity should describe its business relationships, products and services which are likely to cause adverse impacts in relation to non-financial reporting risks^[*footnote].

[*footnote] S414CB(2)(d) insofar as traded, banking or insurance companies with more than 500 employees.

7.27 The entity should look beyond its own operations and consider risks arising from business relationships, products and services, including the other parts of the supply chain in which it sits. Principal risks should be disclosed and described irrespective of how they are classified or whether they result from strategic decisions, operations, organisation or behaviour, or from external factors over which the board may have little or no direct control. ~~The assessment should include consideration of threats to solvency and liquidity.~~

26. The example which was previously under paragraph 7.31 is moved to under paragraph 7.27 and amended as follows:

Example

An entity that sources its products from overseas could face risks (e.g. reputation risks) relating to customer concerns over labour practices. In this situation, the entity might have put in place a system to validate and monitor adherence to stated labour practice policies across its supply chain. The entity's policy should be described, including whether UK standards are permeated throughout its supply chain or whether different standards are applied in different parts of the world. The due diligence processes adopted to mitigate this risk, including whether external bodies have been engaged to assess practices, should be ~~Where the nature or magnitude of the potential effect of the risk on the business is such that it would be material to shareholders, it should be described and discussed in the strategic report.~~

27. The linkage example in paragraph 7.26 (now renumbered to 7.28) is deleted, and paragraph 7.26 is amended as follows:

~~7.26~~ **7.26** ~~The descriptions of the principal risks and uncertainties facing the entity should be specific so that a shareholder can understand why they are material to the entity. This might include a description of the likelihood of the risk, an indication of the circumstances under which the risk might be most relevant to the entity and its possible effects. An explanation of how the principal risks and uncertainties are managed or mitigated should also be included to enable shareholders to assess the impact on the future prospects of the entity.~~

Linkage example

~~The disclosure of risk management or mitigation might be enhanced with the discussion of the reporting and monitoring process, for example, through disclosures that explain the entity's appetite for risk, how often the risk is reviewed, and by whom. Risk management and mitigation could also be linked to an entity's overall approach to risk management and internal control which is often included in the corporate governance report.~~

28. The example in paragraph 7.27 (now renumbered to 7.29) is amended as follows:

Example

It could be useful to explain the change in risk profile since the previous year and how the entity has responded to the change in terms of its risk mitigation. Where the risk profile of an entity has changed, many entities explain whether the individual risks identified have increased, decreased or remained the same severity. The risk mitigation could also show how the entity has responded to the change.

For instance, in recent years, the cyber risk faced by many entities has significantly increased, The risk disclosures should explain the ways in which cyber risk could affect the business, for instance, a cyber attack, loss of sensitive data leading to a lack of customer confidence, a failure of IT systems leading to a failure to operate certain elements of the business etc. The risk mitigation should explain the processes that the entity has put in place to mitigate the increased risk profile faced.

29. Paragraph 7.28 is deleted.

~~7.28— A risk or uncertainty may be unique to the entity, a matter that is relevant to the market in which it operates, or something that applies to the business environment more generally. Where the risk or uncertainty is more generic, the description should make clear how it might affect the entity specifically.~~

30. Paragraph 7.29 is renumbered and moved to paragraph 7.32, and amended as follows:

7.2932

To the extent necessary for an understanding^[*footnote] of the development, performance or position and the impact of its activity of the entity's business, the strategic report should include information relating to, as a minimum about:

- (a) environmental matters (including the impact of the entity's business of the entity on the environment)^[*footnote]**
- (b) the entity's employees^[*footnote]; and**
- (c) social, and community matters^[*footnote];**
- (d) respect for and human rights^[*footnote]; and issues.**
- (e) anti-corruption and anti-bribery matters^[*footnote].**

^[*footnote] Section 414C(7) insofar as quoted companies that are not traded, banking or insurance companies with more than 500 employees, section 414CB(1) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414C(7)(b)(i) insofar as quoted companies that are not traded, banking or insurance companies with more than 500 employees, section 414CB(1)(a) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414C(7)(b)(ii) insofar as quoted companies that are not traded, banking or insurance companies with more than 500 employees, section 414CB(1)(b) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414C(7)(b)(iii) insofar as quoted companies that are not traded, banking or insurance companies with more than 500 employees, section 414CB(1)(c) and (d) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414C(7)(b)(iii) insofar as quoted companies that are not traded, banking or insurance companies with more than 500 employees, section 414CB(1)(d) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414CB(1)(e) insofar as traded, banking or insurance companies with more than 500 employees.

31. Paragraph 7.30 is deleted and replaced as follows:

~~7.30 There can be a strong relationship between the development, performance, position or future prospects of an entity and some or all of the matters described in paragraph 7.29, particularly over the longer term. This may be because a particular matter gives rise to a principal risk or uncertainty or because the entity has gained a competitive advantage from its policies and response to such matters. The relative importance of the matters will depend on the sector in which the entity operates and its strategy and business model.~~

Non-financial reporting

7.30	Non-financial information should be integrated throughout the strategic report.
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32. New paragraph 7.31 is inserted as follows:

7.31 Although the Act sets specific requirements for the non-financial information listed below, to the extent necessary for an understanding of the development, performance and position and the impact of its activity, these matters should not be considered in isolation, but should be considered when determining the entity's strategy and business model, principal risks and uncertainties and KPIs. They are also relevant to an understanding of the way in which directors have performed their duty under section 172.

33. Paragraphs 7.32 to 7.34 are deleted as follows:

~~7.32 The information should make clear how any matters identified under paragraph 7.29 might affect the development, performance, position or future prospects of the entity's business.~~

~~7.33 The influence, or potential influence, of the matters described in paragraph 7.29 on the development, performance, position or future prospects of the entity's business may sometimes be better described through the integration of the relevant information with other content elements, rather than through the use of a separate 'corporate social responsibility' section of the strategic report but, in any case, clear linkage should be provided.~~

Linkage example

The way an entity conducts its business in relation to the issues in paragraph 7.29 may affect its licence to operate/trade in a particular location or market, or may potentially result in a major event that will directly or indirectly affect the entity (e.g. a material litigation, loss of revenue or reparation cost). The risk of such an event may constitute a principal risk or uncertainty to the entity and/or the actions taken in response to these matters may constitute a strategy that warrants disclosure. In such circumstances, the information about the issue might be most appropriately disclosed alongside a description of the related risk or strategy rather than in a separate part of the strategic report.

~~7.34~~ Where information on a specific matter described in paragraph 7.29 is considered necessary for an understanding of the development, performance, position or future prospects of the entity's business, a description of some or all of the following items could be included in the strategic report when they are considered relevant:

- ~~(a)~~ the entity's policy in respect of the matter, together with a description of any measures taken to embed the commitment within the organisation;
- ~~(b)~~ any process of due diligence through which the entity:
 - ~~(i)~~ assesses the actual or potential impacts arising from its own activities and through its business relationships;
 - ~~(ii)~~ integrates the findings from these assessments and takes action to prevent or mitigate adverse impacts;
 - ~~(iii)~~ tracks the effectiveness of its efforts; and
 - ~~(iv)~~ communicates its efforts externally, in particular to affected stakeholders.
- ~~(c)~~ the entity's participation in any processes intended to remediate any adverse effects that it has caused or to which it has contributed.

34. New paragraph 7.33 and 7.34 are inserted as follows:

7.33 The board should consider the impact of an entity's activity and disclose information that is material to its long-term success.

7.34 These matters may pose threats to and provide opportunities for the success of an entity's business. The adverse (or positive) impact of an entity's activity in relation to the matters may inhibit (or further) the success of the entity's business, now or in the future. An entity should consider the impact of its activities on the stated matters and then report on those aspects which could materially affect the future performance or development of the entity.

35. Paragraph 7.31 (now renumbered to 7.35) is amended as follows. The example that follows paragraph 7.31 is moved to paragraph 7.27.

7.34~~5~~ The strategic report should include information on a matter described in paragraph 7.32 when the influence, or potential influence, on the development, performance, position, or future prospects impact of the entity's business is material to shareholders. Information on these matters will also be useful to stakeholders as a whole, and providing transparent information may help to build and maintain successful relationships with stakeholder groups. The strategic report should also provide signposting to where other, more detailed, information may be found which satisfies the information needs of individual stakeholder groups.

36. Paragraph 7.36 is deleted as follows.

~~7.36~~ Directors may refer to a source of guidance (e.g the UN Guiding Principles on Human Rights) or a voluntary framework that provides advice on how the entity should conduct its business, suggests ways of monitoring or tracking performance, or provides examples of disclosures that might be helpful in communicating information to the entity's stakeholders. In preparing the strategic report the directors may choose to comply fully or partially with that guidance or voluntary framework, or take a more general regard of its content. Where such an approach is taken, directors should nevertheless ensure that only information that is necessary for an understanding of the development, performance, position or future prospects of the entity's business, or that is otherwise required by law, is included in the strategic report.

37. New paragraphs 7.36 to 7.38 are inserted as follows moving some of the text of paragraph 7.29:

7.36 **The information should include a description of any relevant the policies^[*footnote] pursued by the company in respect of relation to non-financial these matters and any due diligence processes^[*footnote] implemented by the company in pursuance of those policies. It should also include a description of the outcome^[*footnote] and the effectiveness of those policies.**
If the company does not pursue policies in relation to one or more of these matters, the strategic report must contain a clear and reasoned explanation for the company not doing so^[*footnote].

^[*footnote] Section 414C(7)(b) insofar as quoted companies that are not traded, banking or insurance companies with more than 500 employees, section 414CB(2)(b) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414CB(2)(b) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414C(7)(b) insofar as quoted companies that are not traded, banking or insurance companies, section 414CB(2)(c) insofar as traded, banking or insurance companies with more than 500 employees.

^[*footnote] Section 414CB(4) insofar as traded, banking or insurance companies with more than 500 employees.

7.37 When disclosure of non-financial information is necessary for an understanding of the entity's development, performance and position and the impact of its activity, the strategic report should include a description of the policies that the entity has in place in relation to the matters described. Where an entity does not have a policy in place in relation to one of the matters, it should state that fact and explain why it is not considered necessary to have a policy.

Example

Many entities have a stated aim of being fully compliant with the UN Guiding Principles on Business and Human Rights by a stated date. Where material, entities could report on the progress achieved to date in meeting this aim, whether it remains achievable and the major hurdles still to overcome.

7.38 The strategic report should include a description of any due diligence processes that an entity has in place to ensure that its policies relating to non-financial matters are adhered to throughout the group, and, where appropriate, through its supply chain. The strategic report should also include a description of the outcome of that due diligence work in relation to the disclosed policies and the outcome of the policies. Where the outcome of policies is measured by reference to a survey or other external evidence, the strategic report could signpost where this complementary information can be found.

Example

The approach to combating bribery and corruption in an entity may vary according to the jurisdictions where it operates. The due diligence which may be necessary to ensure anti-bribery and anti-corruption policies are adhered to in an emerging economy may differ from those necessary to ensure the same policies are adhered to in the UK. Where this is relevant, the information disclosed should be sufficiently specific to enable investors to understand the different risks posed by different parts of the entity's operations.

Linkage example

The way an entity conducts its business in relation to its tax affairs may have an impact on community and social matters in the countries in which it operates. An entity may adopt a strategy of having a transparent tax structure paying a fair rate of tax in each of its major areas of operation which in turn supports those local communities in which it operates.

The execution of this strategy can be seen through the presentation of the tax rates paid in each of its major areas of operation in the period under review.

38. Paragraph 7.40 and associated footnote are inserted as follows:

7.40 **Where information on any of the matters described above is not included in the strategic report because it is not considered necessary for an understanding of the development, performance or position of the company's business, the matters that are not covered in the strategic report should be stated.**^[*footnote]

[*Footnote] Section 414C(7) of the Act.

39. Paragraph 7.37 is split into two paragraphs and renumbered to 7.41 and 7.42 and amended as follows:

7.3741 ~~Information on any of the matters described in paragraph 7.29~~ Where information on any of the matters described in paragraph 7.32 ~~that~~ is not considered necessary for an understanding of the development, performance, position or impact of its activity, ~~that information future prospects of the entity's business~~ should not be included in the strategic report. However, certain entities are required to disclose when no disclosure has been provided on the basis of materiality.

7.42 Where the directors wish to put this information in the public domain, it should be located outside of the strategic report, for example in a separate sustainability or corporate social responsibility report which could be located online. Directors may, however, wish to provide a reference to where this complementary information is available.

40. A new paragraph 7.43 is inserted as follows:

7.43 The board may refer to a source of guidance or a voluntary framework that provides advice on how the entity should conduct its business, suggests ways of monitoring or tracking performance, or provides examples of disclosures that might be helpful in communicating information to the entity's stakeholders.

41. A new sub-heading is inserted above paragraph 7.38 (now renumbered to 7.44) and is amended as follows:

Business performance

Analysis of performance and position

7.3844 The strategic report should provide an **fair, balanced and comprehensive analysis of the development and performance of the business in the financial year and of its position at the end of that year.**³²

42. Paragraph 7.45 is inserted as follows:

7.45 The strategic report should include a narrative of the development, performance and position of the business in the financial year which is consistent with the information contained in the financial statements.

43. The example following paragraph 7.39 (now renumbered to 7.46) is amended as follows:

Example

The strategic report might, where relevant, include comments on:

- the existence and timing of commitments for capital expenditure;
- changes in the effective tax rate and the reasons for that change;
- material prior year items;
- changes in revenue from year to year that result from organic growth, acquisitions, foreign exchange etc (a 'revenue bridge'); or
- financing arrangements (e.g changes in net debt or approach to financing of long term liabilities).

44. Paragraph 7.42 is deleted as follows:

~~7.42~~ The strategic report should include information on the entity's key strengths and tangible and intangible resources. This should include those items that are not reflected in the financial statements. Depending on the nature of the business, these may include: corporate reputation and brand strength; customer base; natural resources; employees; research and development; intellectual capital; licences; patents; copyrights and trademarks; and market position.

45. The example under paragraph 7.49 (now renumbered to 7.55) is amended as follows:

Example

Where an entity uses earnings before interest, tax, depreciation, amortisation (EBITDA) and certain restructuring costs to analyse business performance as a KPI, the measure could be referred to as 'EBITDA before restructuring costs' or similar. A reconciliation to an appropriate financial statement line item and explanation of the adjustment should be provided.

46. A new heading is inserted above paragraph 7.43 (now renumbered to 7.49) as follows:

Key performance indicators

7.439 **The analysis in the strategic report should include financial and non-financial key performance indicators (KPIs).**³⁴

47. Paragraph 7.44 (now renumbered to 7.50) is amended as follows:

7.4450 The KPIs used in the analysis should be those that the directors judge to be most effective in assessing progress against objectives or strategy, monitoring principal risks, or are otherwise utilised to measure the development, performance or position of the entity or the impact of the entity's activity.

48. Paragraph 7.45 (now renumbered to 7.51) is amended as follows:

5.451 Non-financial KPIs ~~can be indicators of~~ provide insight into future financial prospects and progress in managing risks and opportunities. They may include, for example, measures related to product quality, customer complaints, or the matters identified in paragraph 7.32.

49. Paragraph 7.46 (now renumbered to 7.52) is amended as follows:

7.4652 ~~Where possible,~~ KPIs should reflect the way that the board manages the entity's business. They may be generally accepted measures that are widely used, either within the entity's industry sector or more broadly. However, the comparability of the KPIs between industry peers should not override the effectiveness of the KPIs for assessing the performance or position of the entity's own business.

50. A new paragraph is inserted at 7.57 as follows:

7.57 Alternative Performance Measures (APMs) can be a KPI. The European Securities and Markets Authority's (ESMA) Guidelines on Alternative Performance Measures defines APMs as a measure of historical or future performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework. ESMA's Guidelines include the following disclosure principles for presenting APMs.

- (a) APMs should be defined and the basis of calculation explained.
- (b) APMs should be given meaningful labels reflecting their content and basis of calculation.
- (c) A reconciliation of the APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period should be disclosed and the APM should not be given more prominence than the statutory figures.
- (d) APMs should be accompanied by comparatives for the corresponding previous periods.
- (e) The definition and calculation of the APM should be consistent over time.

The principles in the ESMA Guidelines are similar to those set out in paragraph 7.54 above.

51. New paragraphs 7.59 to 7.61 are inserted as follows:

7.59 The strategic report should explain the entity's performance during the year in the context of both how it has performed relative to prior periods, relative to stated targets and relative to the external environment in which it is operating, in order that shareholders can make an assessment of the future development, performance or position of the business.

7.60 If a trend in a part of the business has a material impact on business performance, that should be disclosed. Shareholders should be able to distinguish between movements in performance which have resulted from one-off events and trends which are expected to continue. It is also important to identify the impact of acquisitions and disposals on performance in order for shareholders to be able to understand how the existing business has performed and the likely future impact of the acquisition or disposal.

7.61 Where the structure of a group has changed significantly in the period, for instance as a result of a major acquisition or disposal, an entity might choose to use pro-forma figures to explain trends in addition to the statutory figures. Where pro-forma figures are presented, explanations of how those figures have been calculated and their relationship to amounts extracted from the audited statements should also be presented.

52. A new linkage example is inserted below paragraph 7.66 as follows.

Linkage example

Increasing interest from investors in sustainable investment may require an entity to make changes to its business model such as to adapt its investment strategy. Information on these trends should be linked to the entity's strategy and business model explaining the potential effects on the development, performance, position or future prospects of the entity.

53. Paragraph 7.51 is renumbered to 7.67 and all subsequent paragraphs are sequentially renumbered with cross-references amended accordingly.

Appendix I: Glossary

The glossary is amended as follows (deleted text is struck through, inserted text is underlined). New terms are inserted in alphabetical order.

<u>banking company</u>	<u>Broadly an entity that has permission under Part 4A of the Financial Services and Markets Act 2000 (c8) to accept deposits. See sections 1164(2) and 1164(3) of the Act for full definition.</u>
the Code	The 2012 <u>2016</u> UK Corporate Governance Code.
DTR	The <u>Financial Conduct Authority's</u> Disclosure and Transparency Rules.
insurance company	<p>This guidance uses the term 'insurance company' to refer to:</p> <p><u>An authorised insurance company - an entity who has permission under Part 4A of the Financial Services and Markets Act 2000 (c8) to effect or carry out contracts of insurance (section 1165(2)).</u></p> <p><u>A company carrying on insurance market activity as defined in section 316(3) of the Financial Services and Markets Act 2000 (section 1165(7)).</u></p>
LR	The UK Listing Authority (UKLA) <u>Financial Conduct Authority's</u> Listing Rules.
material (in the context of the strategic report)	<p>Information is material if its omission or misrepresentation could <u>reasonably be expected to</u> 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.</p> <p>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.</p>
<u>purpose</u>	<u>Why an entity exists.</u>
<u>traded company</u>	<u>A company with transferable securities admitted to trading on a regulated market.</u>

Appendix II: The Corporate Reporting Council's advice to the FRC to issue Draft amendments to *Guidance on the Strategic Report*

Introduction

1. This report provides an overview of the main issues that have been considered by the Corporate Reporting Council in advising the FRC during the development of the Draft amendments to *Guidance on the Strategic Report*.
2. The FRC is committed to improving the quality of corporate reporting and remains of the view that the annual report should primarily provide information that is relevant for shareholders. Nevertheless, the FRC recognises that the information in the annual report provides information about the long-term success of the company; an interest shared by both shareholders and stakeholders. The FRC believes that in meeting the information needs of shareholders, the information will also be useful to stakeholders as a whole.
3. The FRC recognises that individual stakeholder groups may need information that goes beyond that provided for shareholders, but considers it appropriate for that information to be communicated outside the annual report using alternative reporting channels. The FRC continues to encourage clear and concise reporting, ensuring that the strategic report focuses on those matters that are of strategic importance.

Advice

4. The Corporate Reporting Council is advising the FRC to issue Draft amendments to *Guidance on the Strategic Report*.

Background

5. The FRC is updating its guidance as a result of the new requirements introduced into the Act by the Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (the 'NFR Regulations').
6. With the introduction of the NFR Regulations, the FRC believes that there is an opportunity to update the guidance not only to reflect these new legislative requirements but also to strengthen the link between the purpose of the strategic report and the director's duty under section 172 (to promote the success of the company), and to reflect developments in reporting which have occurred since the guidance was published in 2014.
7. The FRC has received positive feedback from stakeholders that the *Guidance on the Strategic Report* is a helpful document, therefore the Corporate Reporting Council does not believe that a fundamental review of the guidance is necessary. In developing the amendments to the guidance, the Corporate Reporting Council has also obtained input from stakeholder round tables.

Objectives

8. The objective of this update is to amend the guidance to reflect three aims:
 - To incorporate the new requirements introduced by the NFR Regulations;
 - To strengthen the link between section 172 and the strategic report; and
 - To reflect changes in practice and other developments which have occurred since the guidance was published.

Approach to update

9. The approach to drafting the NFR Regulations has resulted in two sets of similar requirements, with some key differences, and different scoping requirements. This has created additional complexity in the reporting framework and, as a result, confusion about how the new requirements will both apply in practice and interact with the existing strategic report requirements.
10. The proposed amendments to the guidance relating to the NFR Regulations have been drafted within the existing legislative framework for the strategic report. In developing these amendments, the FRC has carefully considered the interpretation of the EU and UK legislative provisions and applied the following principles:
 - The purpose of the annual report and accounts, under the Act, is to report to members of the company. The purpose of the strategic report, as set out in section 414C(1) of the Act, is to inform members of the company and help them assess how the directors have performed their duty under section 172 of the Act. Therefore, the information in the strategic report is primarily for shareholders. However, in meeting the needs of shareholders, the information is also likely to be useful to other stakeholders.
 - Non-financial information should only be disclosed when it is necessary for an understanding of the company's development, performance and position and the impact of its activity.
 - The non-financial information statement should form part of the strategic report and the new requirements should be read within that broader context.
 - It follows therefore, for example, that the assessment of principal risks relating to non-financial matters should form part of the overall review of principal risks to the business as whole.
11. We are aware of an alternative interpretation of the law held by a minority that the non-financial information statement required by the NFR Regulations is a discrete element of the strategic report, with a different audience, materiality and risk assessment to the pre-existing strategic report requirements. In our view, this approach is likely to be difficult to apply in practice, not required by the regulations and will detract from the principle of integration of non-financial matters within the strategic report.

Scope

12. The Corporate Reporting Council believes that the guidance should remain as best practice for all entities. The Corporate Reporting Council notes that the NFR Regulations introduce a new scoping threshold for entities. In light of this complexity and given the similarities between the content of the pre-existing strategic report requirements, the Council considers that aligning the guidance on non-financial reporting for all entities will be the simplest method for applying the new requirements. That said, the Council is mindful of the need to strike an appropriate balance between encouraging best practice and consideration of the reporting burden for entities. Therefore, the guidance should provide clarity on the scope of application of the new disclosures, so that different types of entity can understand which legislative provisions apply to them.
13. The *Guidance on the Strategic Report*, however, is intended to illustrate and promote best practice reporting and the Corporate Reporting Council believes that entities should be encouraged to take account of the principles set out therein, rather than follow a checklist-style approach to strict legal compliance. In particular, where the matters referred to in the NFR Regulations are of strategic importance to that entity, the Corporate Reporting Council supports the inclusion of relevant information on non-financial matters in the strategic report for all entities.

14. The table in Appendix III reflects the existing requirements of s414C. A new table, at Appendix IV, shows the additional requirements for those companies which are subject to the NFR Regulations and where complying with the NFR Regulations provides exemptions from the requirements of s414C.

The annual report

15. The Corporate Reporting Council remains of the view that clarity of purpose and audience of the annual report is essential to ensure that the annual report remains a relevant, concise and understandable document. The Corporate Reporting Council has reconfirmed its view that the annual report should be a document primarily for shareholders, but recognises that information relevant for shareholders will also be useful for stakeholders as a whole.

The strategic report: purpose

16. The purpose of the strategic report, as set out in section 414C of the Act, is to inform members of the company and to help them assess how the directors have performed their duty under section 172. The Corporate Reporting Council believes that whilst entities need to comply with the specified disclosure requirements set out in the Act, more emphasis should be given to ensuring that an entity's strategic report meets this purpose. Section 4 *The strategic report: purpose* has been amended to refer to section 172 and to recognise that disclosure of information additional to that prescribed by the Act may be necessary to ensure that the strategic report meets its overall purpose.
17. In recent years there has been growing concern that companies are focused too much on short-term profits, to the potential detriment of long-term success. The Corporate Reporting Council has proposed amendments to the purpose section of the guidance to encourage entities to focus on and disclose the factors which are important to long-term value generation, and to recognise the importance of maintaining relationships with key stakeholders as part of this.
18. The Corporate Reporting Council recognises the growing divergence between drivers of value in an entity and the assets which are recognised on an entity's balance sheet. The strategic report should provide a narrative of how an entity generates value, with particular focus, where necessary, on those value drivers which are not recognised assets in the balance sheet.

The strategic report: materiality

19. When considering the success of a company over the longer term and in the context of non-financial reporting, the Corporate Reporting Council believes that it will be necessary for boards to consider broader matters. Whilst materiality in the context of the annual report is assessed with reference to shareholders, we believe that the resulting disclosures will be consistent with those made if materiality were assessed by reference to stakeholders as a whole.
20. Since the guidance was published in 2014, audit reports have changed to include the disclosure of an auditing materiality figure. Given this development, and the increase in non-financial information which will be included in the strategic report as a result of the NFR Regulations, the Corporate Reporting Council felt that it was important to emphasise the importance of qualitative as well as quantitative factors in assessing materiality for the purpose of including information in the strategic report.
21. The FRC has noted that in some instances companies have attempted to use the derogation set out in s414C(14) as a general derogation from disclosing information which may be seriously prejudicial. The Corporate Reporting Council supports the amendments

to the guidance to make clear that this derogation only applies in situations where disclosure would negatively impact impending developments on ongoing negotiations which are not in the public domain and is not applicable to commercially sensitive information more generally.

The strategic report: communication principles

22. The Corporate Reporting Council believes that the communication principles set out in the guidance remain appropriate, but has recommended minor amendments to reflect the increased focus on the long term success of the entity and to strengthen the linkage between KPIs and risk and uncertainty disclosures to promote coherence of the strategic report as a whole.

The strategic report: content elements

23. The content elements section of the guidance has been amended to reflect the three aims of this update:
 - To incorporate the new requirements introduced by the NFR Regulations;
 - To strengthen the link between section 172 and the strategic report; and
 - To reflect changes in practice and other developments which have occurred since the guidance was published.

The NFR Regulations

24. The NFR Regulations require the disclosure of information, to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity about environmental matters, the company's employees, social matters, respect for human rights, and anti-corruption and anti-bribery matters.
25. One of the main changes arising from the new Regulations is the requirement for entities to consider the impact of its activity. The Corporate Reporting Council has considered how an entity should approach reporting on the impact of its activity. It believes that entities should consider the impact of its activity on stakeholders and society in general.
26. The Corporate Reporting Council is minded that those matters which have a significant impact on stakeholders and society are likely to impact the long-term success of the business.
27. The Corporate Reporting Council believes that where non-financial matters are of strategic importance to an entity, consideration of those matters should be linked to the entity's strategy, its business model, its KPIs and principal risks and uncertainties and should not be disclosed in isolation.

Section 172

28. The Corporate Governance reform agenda, while still ongoing, has focused attention on the importance of section 172 and its effective application. The Act does not impose explicit requirements on companies to report on how directors have fulfilled their duty under section 172. The Corporate Reporting Council believes, however, that the link between the purpose of the strategic report and section 172 could be strengthened in order to encourage companies to ensure that the strategic report contains sufficient information to help shareholders assess how directors have performed their duty under section 172.
29. The FRC has considered ways to encourage entities to provide information in their strategic report which enables the strategic report to meet its purpose. To this aim, the

FRC has introduced encouraged content elements into the guidance. These identify disclosures for which there are no explicit disclosure requirements in the Act, but which could be helpful to explain to members how the directors have performed their duty under section 172 within the context of disclosing strategy, business model, principal risks and uncertainties etc.

30. The Corporate Reporting Council discussed the importance of understanding the sources of value in an entity's business; those key resources that support the generation and preservation of value in the long term. The Corporate Reporting Council believes that it is important for an entity to identify its key sources of value and the actions that it takes to protect and develop those sources. The Corporate Reporting Council identified that the existence of mutually beneficial relationships with key stakeholders is often a critical source of value and believes that entities should be encouraged to provide information about how those relationships are built and maintained.
31. During the development of this update, the Corporate Reporting Council explored the concepts of a resource allocation statement. We are aware that a small minority of entities already include similar reporting elements within their strategic report, but that there is currently diversity in practice in this reporting and diversity in thought as to what such reporting is intended to achieve. Further work may be required in this area before a consistent reporting format emerges.
32. There are clear areas of overlap between the matters that a director is required to have regard to under section 172 and those matters that an entity is required to report on under the NFR Regulations. The Corporate Reporting Council believes that entities should consider both of these areas together, particularly where the matters are of strategic importance to the entity.

Changes in practice and other developments

33. Since the publication of the guidance in 2014 there have been a number of developments which the Corporate Reporting Council believes should be incorporated into the updated guidance.
34. The publication of the FRC's *Corporate Culture and the Role of Boards* ('the Culture Report') in 2016 highlighted the importance not only of the culture of an entity, but also its purpose. The Corporate Reporting Council believes that communication of an entity's purpose is important to help shareholders to understand how that entity aims to generate value for shareholders, benefit other stakeholders and contribute to the long term success of the entity. The Corporate Reporting Council believes that the references to the purpose of the entity will encourage boards to consider the relationships between its purpose, strategy, business model, KPIs and the culture it is aiming to achieve.
35. The Corporate Reporting Council has considered the application of ESMA's guidance on Alternative Performance Measures to the strategic report. Within the context of the strategic report the Corporate Reporting Council believes that KPIs are often APMs, as defined by ESMA. Accordingly, the Corporate Reporting Council advises that amendments are made to ensure that the guidance is consistent with ESMA's guidance.
36. In considering the proposed changes to the guidance, the Corporate Reporting Council has also had regard to the European Commission's guidance on the non-financial reporting Directive, the Financial Reporting Lab's work on business models, the introduction of viability reporting in the Corporate Governance Code, the Financial Stability Board's Task Force on Climate-related Financial Disclosures, and the way in which entities have reported on trends and factors in the period since section 414C was introduced.

Appendix III The Companies Act 2006 strategic report disclosure requirements

Appendix III is amended as follows (deleted text is struck through, inserted text is underlined):

The following table summarises the disclosure requirements of **the Act** in respect of the strategic report for companies and qualifying partnerships that do **not** fall within the scope of the Non-Financial Reporting Regulations. Those that do should refer to Appendix IV.

S414B A company or qualifying partnership is entitled to the small companies exemption in relation to the strategic report for a financial year if –

(a) it is entitled to prepare accounts for the year in accordance with the small companies regime (s382), or

(b) it would be so entitled but for being or having been a member of an ineligible group.

The small companies regime does not apply to a company that: is, or was at any time within the financial year to which the accounts relate, a public company, is a company that is an authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company; or carries on insurance market activity (s384(1)).

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(1)	The purpose of the strategic report is to inform members of the company and help them to assess how the directors have performed their duty under s172 (duty to promote the success of the company).	✓	✓	✓ (Except these that would not be small if not an ineligible group—s414B)	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(2)(a)	The strategic report must contain a fair review of the company's business.	✓	✓	✓	x
s414C(2)(b)	The strategic report must contain a description of the principal risks and uncertainties facing the company.	✓	✓	✓	x
s414C(3)	The review required is a balanced and comprehensive analysis of the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business.	✓	✓	✓	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(4)(a)	The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include: (i) analysis using financial key performance indicators; and	✓	✓	✓ (Except those that would not be small if not in an ineligible group – s414B)	x
s414C(4)(b)	(ii) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.	✓	✓	✓ (Large companies only – s414C(6))	x
s414C(7)(a)	The strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include the main trends and factors likely to affect future development, performance and position.	✓	x	x	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(7)(b)	<p>The strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about:</p> <ul style="list-style-type: none"> (i) environmental matters (including the impact of the company's business on the environment); (ii) the company's employees; and (iii) social, community and human rights issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies. <p>If the report does not contain information of each kind mentioned in s414C(7)(b)(i), (ii) or (iii), it must state which of those kinds of information it does not contain.</p>	✓	x	x	x
s414C(8)(a)	The strategic report must include a description of the company's strategy.	✓	x	x	x
s414C(8)(b)	The strategic report must include a description of the company's business model.	✓	x	x	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(8)(c), (9) & (10)	<p>The strategic report must include a breakdown showing at the end of the financial year:</p> <ul style="list-style-type: none"> (i) the number of persons of each sex who were directors of the [parent]² company; (ii) the number of persons of each sex who were senior managers of the company (other than persons falling within sub-paragraph (i)) [or who were directors of undertakings included in the consolidation];³ and (iii) the number of persons of each sex who were employees of the company. <p>A senior manager is an employee of the company who has responsibility for planning, directing or controlling the activities of the company, or a strategically significant part of the company.</p>	✓	x	x	x

² In the case of group accounts, this category comprises directors of the parent company only (s414C(10)(a)).

³ In the case of group accounts, this category includes directors of subsidiary undertakings who otherwise would not meet the definition of a senior manager (s414C(10)(b)).

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(11)	The strategic report may also contain such matters otherwise required by regulations made under s416(4) to be disclosed in the directors' report that the directors consider are of strategic importance to the company.	✓	✓	✓ (Except those that would not be small if not in an ineligible group—s414B)	x
s414C(12)	The report must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.	✓	✓		x
s414A(4) & s414C(13)	A group strategic report may, where appropriate, give greater emphasis to the matters that are significant to the undertakings included in the consolidation, when taken as a whole. With the exception of the disclosures required by s414C(8), in relation to a group strategic report s414C has effect as if the references to the company were references to the undertakings included in the consolidation.	✓	✓	✓	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(14)	Nothing in s414C requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.	✓	✓	✓ (Except those that would be small if not in an ineligible group—s414B)	x
s414D(1)	The strategic report must be approved by the board and signed on behalf of the board by a director or the secretary of the company.	✓	✓		x

Appendix IV The Companies Act 2006 strategic report non-financial reporting disclosure requirements

Appendix IV is renumbered to Appendix V, and a new Appendix IV is inserted as follows:

The following requirements apply to companies and qualifying partnerships that fall within the scope of the non-financial reporting requirements, being those with more than 500 employees that are:

- Traded companies
- Banking companies
- Authorised insurance companies
- Companies carrying on insurance market activity

A company that is a quoted company with more than 500 employees may already have met some of the requirements below before the implementation of the non-financial reporting Regulations.

Reference	Requirement
s414CB(1)	The strategic report must contain information, to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity, relating to, as a minimum: <ul style="list-style-type: none"> (a) environmental matters (including the impact of the company's business on the environment); (b) the company's employees; (c) social matters; (d) respect for human rights; and (e) anti-corruption and anti-bribery matters.
s414CB(2)(a)	The strategic report must include a brief description of the company's business model.
s414CB(2)(b)	The strategic report must include a description of the policies pursued by the company in relation to the matters mentioned in s414CB(1) and any due diligence processes implemented by the company in pursuance of those policies.
s414CB(2)(c)	The strategic report must include a description of the outcome of those policies.

Reference	Requirement
s414CB(2)(d)	<p>The strategic report must include a description of the principal risks relating to the matters mentioned in s414CB(1) arising in connection with the company's operations and, where relevant and proportionate:</p> <ul style="list-style-type: none"> (i) a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk, and (ii) a description of how it manages the principal risks.
s414CB(2)(e)	<p>The strategic report must include a description of the non-financial key performance indicators relevant to the company's business.</p>
s414CB(4)	<p>If the company does not pursue policies in relation to one or more of the matters mentioned in s414CB(1), the strategic report must include a clear and reasoned explanation for not doing so.</p>
s414CB(5)	<p>The strategic report must, where appropriate, include references to, and additional explanations of, amounts in the company's annual accounts.</p>

Other requirements of the Strategic Report that also apply to companies within the scope of the non-financial reporting Regulations

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(1)	The purpose of the strategic report is to inform members of the company and help them to assess how the directors have performed their duty under s172 (duty to promote the success of the company).	✓	✓	✓	x
s414C(2)(a)	The strategic report must contain a fair review of the company's business.	✓	✓		x
s414C(2)(b)	The strategic report must contain a description of the principal risks and uncertainties facing the company.	✓	✓		x
s414C(3)	The review required is a balanced and comprehensive analysis of the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business.	✓	✓		x
s414C(4)	The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:				

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(4)(a)	analysis using financial key performance indicators; and	✓	✓	✓	x
s414C(7)(a)	The strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include the main trends and factors likely to affect future development, performance and position.	✓	x	x	x
s414C(7)(b)(iii)	The strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about community issues.	✓	x	x	x
s414C(8)(a)	The strategic report must include a description of the company's strategy.	✓	x	x	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(8)(c), (9) & (10)	<p>The strategic report must include a breakdown showing at the end of the financial year:</p> <ul style="list-style-type: none"> (i) the number of persons of each sex who were directors of the [parent]⁴ company; (ii) the number of persons of each sex who were senior managers of the company (other than persons falling within sub-paragraph (i)) [or who were directors of undertakings included in the consolidation];⁵ and (iii) the number of persons of each sex who were employees of the company. <p>A senior manager is an employee of the company who has responsibility for planning, directing or controlling the activities of the company, or a strategically significant part of the company.</p>	✓	x	x	x

⁴ In the case of group accounts, this category comprises directors of the parent company only (s414C(10)(a)).

⁵ In the case of group accounts, this category includes directors of subsidiary undertakings who otherwise would not meet the definition of a senior manager (s414C(10)(b)).

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414C(11)	The strategic report may also contain such matters otherwise required by regulations made under s416(4) to be disclosed in the directors' report that the directors consider are of strategic importance to the company.	✓	✓	✓	x
s414C(12)	The report must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.	✓	✓	✓	x
s414A(4) & s414C(13)	A group strategic report may, where appropriate, give greater emphasis to the matters that are significant to the undertakings included in the consolidation, when taken as a whole. With the exception of the disclosures required by s414C(8), in relation to a group strategic report s414C has effect as if the references to the company were references to the undertakings included in the consolidation.	✓	✓	✓	x
s414C(14)	Nothing in s414C requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.	✓	✓	✓	x

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company and qualifying partnership	Small private company and qualifying partnership (Except those companies where the small companies regime does not apply)
s414D(1)	The strategic report must be approved by the board and signed on behalf of the board by a director or the secretary of the company.	✓	✓	✓	x

This draft is issued by the Financial Reporting Council for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

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Comments may also be sent in hard copy to:

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Comments should be despatched so as to be received no later than 24 October 2017.

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