Financial Reporting Council

July 2018

Feedback Statement

Amendments to Guidance on the Strategic Report

Non-financial reporting

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368. Registered Office:
8th Floor, 125 London Wall, London EC2Y 5AS

Contents

Overview

(i) In August 2017, the Financial Reporting Council (FRC) published an Exposure Draft, proposing amendments to the 2014 Guidance on the Strategic Report. The objectives of the amendments are to:

- reflect changes arising from the UK implementation of the EU Directive on disclosure of non-financial and diversity information ('non-financial reporting Directive');
- strengthen the linkage between the director's duty under section 172 'Duty to promote the success of the company' and the purpose of the strategic report; and
- make targeted improvements to certain areas of the guidance to reflect key developments in corporate reporting.

Key messages

(ii) Respondents were broadly supportive of the direction of travel but encouraged the FRC to review its approach in certain areas.

(iii) There was support for the FRC encouraging companies to consider broader non-financial matters that may impact company performance over the longer term. Respondents also considered that relevant non-financial information should be integrated with financial information in the strategic report.

(iv) Respondents noted that the new non-financial reporting regulations only apply to a sub-set of entities that are required to prepare a strategic report. Some felt that the extent of the changes proposed was not proportionate and greater clarity on the scope of entities affected was needed.

(v) There was support for the FRC strengthening the link between the purpose of the strategic report and section 172. However, there was caution against the FRC finalising the amendments ahead of the government's planned legislative changes to introduce a specific strategic report requirement on how, in performing their section 172 duty, directors have had regard to the matters set out in section 172.

(vi) A number of respondents noted that the references to 'stakeholders' in the draft amendments was confusing the audience of the strategic report, moving away from a report for shareholders, as set out in legislation, to a multi-stakeholder report.

Summary of FRC response

(vii) In response to feedback, the FRC has amended the Guidance to encourage best practice reporting of non-financial information and encourage boards to give due consideration to their section 172 duty and report on relevant matters relating to that duty.

(viii) In the amendments to the Guidance, the FRC has clarified that the primary audience of the strategic report as set out in legislation remains the shareholders but encourages directors to consider how they have had regard to the interests of wider stakeholders as part of their section 172 duty.

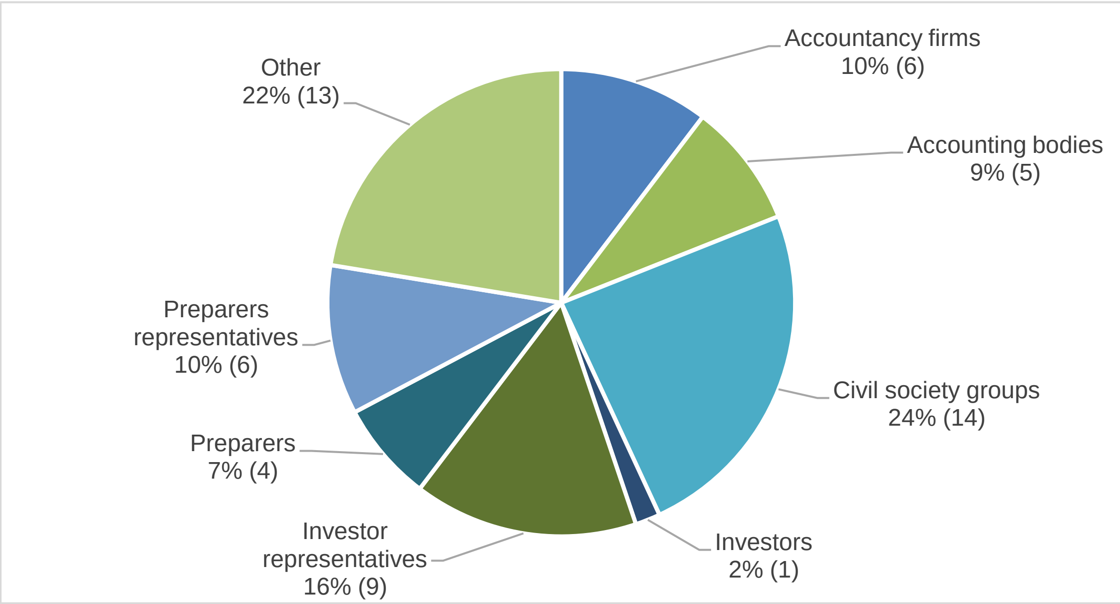
(ix) The FRC delayed publication of the Guidance until July 2018 so that the new legislative reporting requirement in the strategic report relating to reporting on section 172 matters could be incorporated into the Guidance.

Feedback Statement

1 The purpose of this Feedback Statement is to summarise the comments received on the Exposure Draft *Draft amendments to Guidance on the Strategic Report – Non-financial reporting*. The Exposure Draft was issued in August 2017 and the comment period closed on 24 October 2017.

Respondent by category

2 The FRC received 58 responses from a range of stakeholders. One response was marked as confidential and therefore has not been published on the FRC website. A full list of respondents is included at Appendix I to this Feedback Statement.



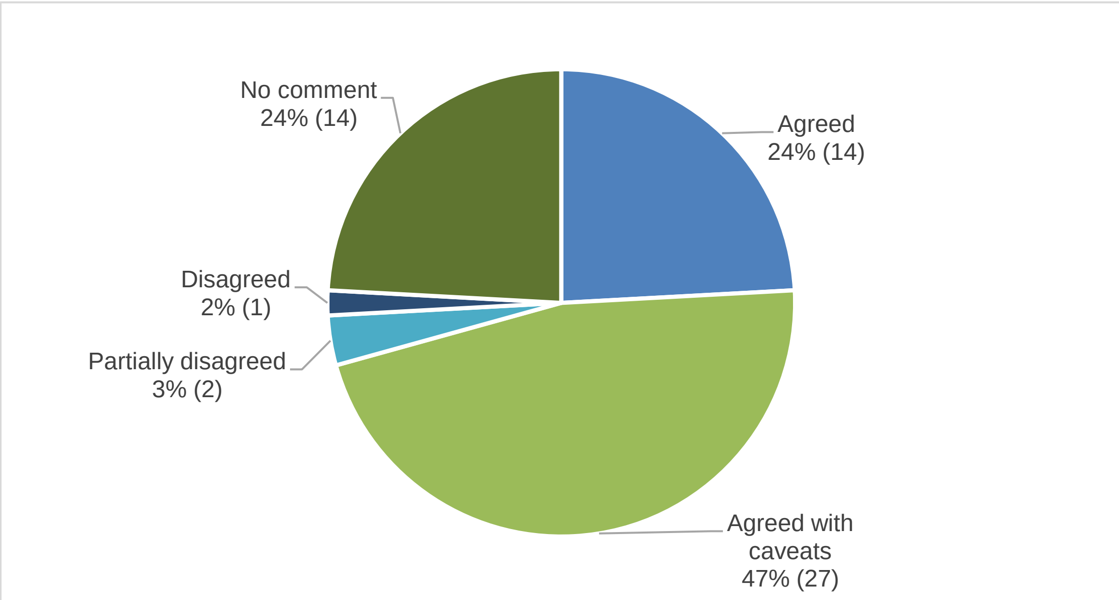
3 The Exposure Draft posed nine questions, the feedback and FRC response is summarised below.

Question 1: Approach to update

4 The Exposure Draft proposed that the draft amendments be incorporated into the Guidance such that the strategic report remains a single cohesive document. The Guidance was enhanced with additional requirements and continued to recommend that these are best practice for all entities.

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

Respondents' views on Question 1



5 44 out of 58 respondents commented on this question.

6 93% of those who responded agreed with our approach to updating the Guidance, indicating support for integrating non-financial information into the strategic report to ensure that it remains a cohesive document. In general, respondents supported the principle of all companies providing non-financial information in their strategic reports. There was also support for the focus on long-term value creation and considering the interests of wider stakeholders.

7 However, many respondents recommended that the FRC should not finalise guidance on the matters related to section 172 (director's duty to promote the success of the company) of the Companies Act until the government issues new legislative requirements which are expected in 2018.

8 A number of respondents expressed concern that, as currently drafted, the Guidance could be seen to be changing the audience of the annual report and the current shareholder primacy model. They highlighted that the current section 172 duty is to the 'members as whole' and that the audience of the strategic report, as set out in legislation is to 'inform members of the company'.

9 A number of respondents commented on the complexity of the legislative requirements and the additional complexity that has been created by the implementation of the non-financial reporting Directive. Some respondents noted that not all companies are subject to the same legislative requirements and called for clearer identification throughout the Guidance on the requirements for different types of entities. In particular, some felt

companies that are not within the scope of the new non-financial reporting requirements should not be burdened with the cost of preparing this information.

10 Whilst some respondents agreed that the Guidance should continue to promote best practice and encourage companies to go beyond the minimum legislative requirements, there should be clearer differentiation between legal requirements and recommended best practice. Providing guidance for all companies on the new non-financial reporting requirements which only apply to a narrow scope may deter some preparers from using the Guidance.

11 Those respondents that expressed some level of disagreement with the approach did so for different reasons; one felt it would be better for the FRC to await the outcome of the government's planned legislation on section 172, another requested clearer differentiation between required and best practice content and one felt that a fundamental review of the Guidance was needed.

FRC response

12 The FRC continues to encourage the broad principle that the strategic report should be a cohesive document containing relevant financial and non-financial information.

13 The FRC has amended the drafting throughout the Guidance so that it is clear that the primary audience of the strategic report, in line with legislation, remains the shareholders. However, it continues to encourage companies to consider the interests of wider stakeholders when running the business and notes that in meeting the needs of shareholders, information in the annual report may also be of interest to other stakeholders.

14 The FRC has amended the scope and content elements sections of the Guidance so that it is clear that the Regulations that implement the non-financial reporting Directive only apply to Public Interest Entities with more than 500 employees ('PIEs'). Quoted companies that are not PIEs will continue to apply the pre-existing non-financial reporting requirements in the strategic report.

15 As part of the 2018 amendments to the Guidance, the FRC has spit the content elements into four sections:

- Section 7 provides an overview of the application of the content elements to different types of entity;
- Section 7A includes the content elements for companies that are not PIEs and therefore not subject to the NFR Regulations. The content elements are substantially unchanged from those in the 2014 Guidance;
- Section 7B has been added which includes content elements for companies that are PIEs and therefore within the scope of the NFR Regulations. There is some overlap of the content of those regulations with the pre-existing strategic report requirements for quoted companies so many companies will already be providing the required disclosures. The guidance in respect of the overlapping requirements mirrors that in Section 7A which covers companies that are not large PIEs. The NFR Regulations provide exemptions for those companies within scope from the overlapping requirements in section 414C so companies using this section do not also need to refer to section 7A.
- Section 8 sets out the content elements relating to the section 172 statement which apply to large companies.

16 Presentation of disclosures required by the non-financial information statement – the Regulations that implement the non-financial reporting Directive use the term 'non-financial information statement'. The FRC encourages integration of non-financial matters within the strategic report. However, the legislation requires the disclosures required by the non-financial reporting Regulations to be included in a separately identifiable statement. We have, therefore, revised our Guidance to ensure that companies include the information in such a statement within their strategic report, noting the information can be included in the statement by cross-referencing to other parts of the strategic report.

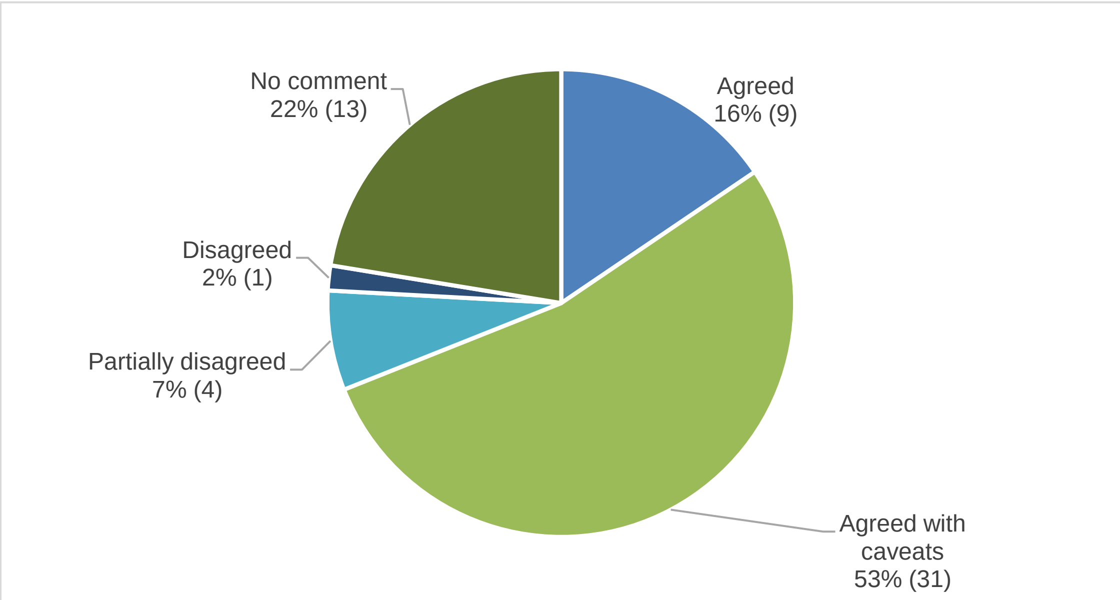
17 In light of the comments received, the FRC delayed finalising the Guidance until the Government published its legislation to introduce a new reporting requirement on section 172. The new guidance on section 172 reporting covers the new requirement for directors to explain how they have had regard to the matters set out in section 172. It also incorporates the encouraged content elements from the Exposure Draft which were supported by respondents.

Questions 2 and 3: The purpose of the strategic report and section 172

18 The Exposure Draft proposed amendments aimed to strengthen the link between the purpose of the strategic report and the matters directors should have regard to under section 172 (duty to promote the success of the company) of the Companies Act 2006. It also proposed encouraged content elements that go beyond the specific legal requirements but could 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?

Respondents' views on Question 2



19 45 out of 58 respondents commented on this question.

20 89% of those that commented, supported the proposed amendments to strengthen the link between the purpose of the strategic report and section 172. However, the main comments were that the FRC should await the outcome of the government's legislation on section 172 before finalising its guidance. A number of respondents made suggestions on elements of a useful disclosure in this area. It was also suggested that any changes should be consistent with the amendments to the Corporate Governance Code.

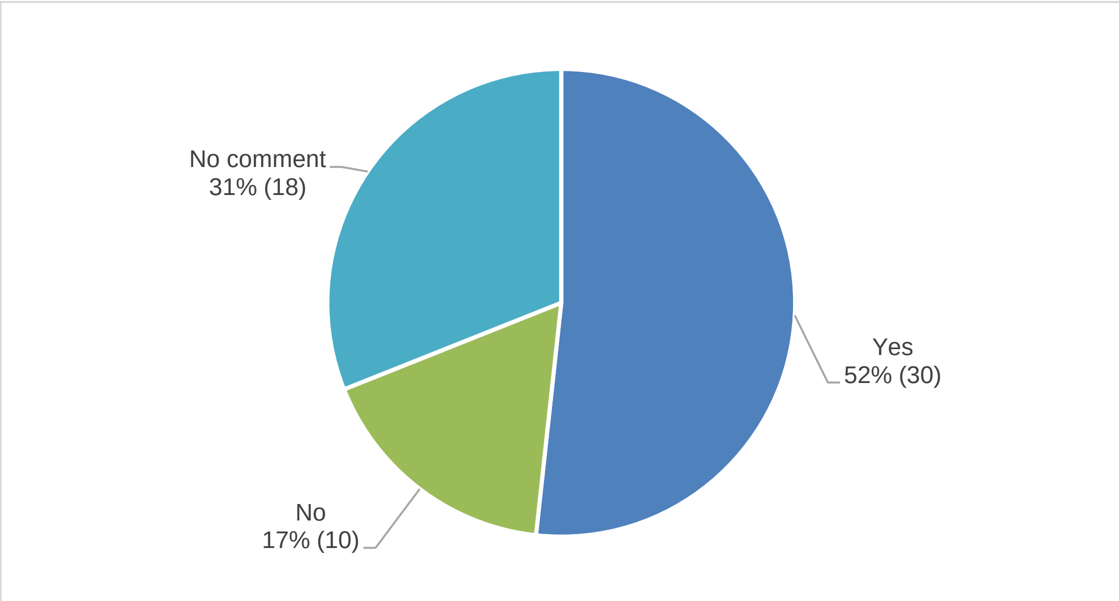
21 There was strong support for the concept of long-term value and considering the interests of broader stakeholders in achieving this aim.

22 Some respondents noted that in developing the final guidance, the FRC should not lose sight of other key elements of the strategic report requirements such as reporting on strategy and ensure that the Guidance does not drive the strategic report towards becoming an ESG report or a report for other stakeholders. Some commented that the FRC should keep the principles of clear and concise reporting in mind, ensuring that the

strategic report only contains relevant information and care should be taken in drafting new areas of the Guidance so that it does not drive boilerplate disclosures.

23 Those that expressed some level of disagreement with the enhancements did so for different reasons. A couple of respondents felt that there was a need for more emphasis on specific matters such as the role of employees in value creation, human rights. Another felt that the draft changes introduce complexity into the Guidance. Some expressed concerns about the approach to section 172, noting that we were encouraging a move away from an enlightened shareholder value model; a personal statement by the chairman may be more effective as our proposals could lead to boilerplate. One suggested that there could be more emphasis on the role of technology to facilitate communication.

Respondents' views on Question 3



24 40 out of 58 respondents commented on this question.

25 75% of those who responded, made suggestions for further improvements to strengthen the link between the purpose of the strategic report and section 172.

26 The key points raised were as follows:

- The need for clearer use of terms ‘shareholder’ and ‘member’.
- There were mixed views on whether it is appropriate for companies to report on company culture as part of the corporate governance statement or the strategic report.
- The need for the Guidance to encourage companies to focus on reporting relating to the ‘most important’ stakeholders to avoid reports with long lists of all stakeholders.
- An explanation is needed on what is meant by ‘impact’.
- There were calls for more guidance on specific issues e.g. human capital, productivity.
- There was support for having examples but requests for these to be more practical and show what a disclosure may look like.

- There was some concern that amendments to purpose section dilutes the emphasis on business model and strategy disclosures
- Some respondents recommended that the FRC should refer to other frameworks within the Guidance. These were mainly calls to refer to frameworks on specific issues such as the TCFD recommendations on climate related risk.
- A number of respondents suggested drafting improvements to specific areas of section 4 and section 7.

FRC response

27 As noted, above, the FRC delayed finalising the Guidance until the Government published its legislation on section 172 reporting.

28 The FRC has made a number of changes to the drafting of sections 4 and section 7 to reflect the comments above.

29 Section 4 *The strategic report: purpose* has been updated so that there is adequate emphasis on other disclosures in the strategic report that are not related to environmental, employee, social, community, human rights, anti-corruption or anti-bribery matters. It has also been amended to highlight that companies should consider materiality when considering their stakeholders.

30 The non-financial reporting Directive introduced the term ‘impact of the entity’s activities’. The FRC has removed references to this term except where used in the context of the new non-financial reporting Regulations. Section 7B contains some additional guidance on the term impact when applied to the new Regulations.

31 The FRC discussed the calls to refer to specific voluntary frameworks in the Guidance but decided that entities should have flexibility in determining which frameworks they use as additional guidance.

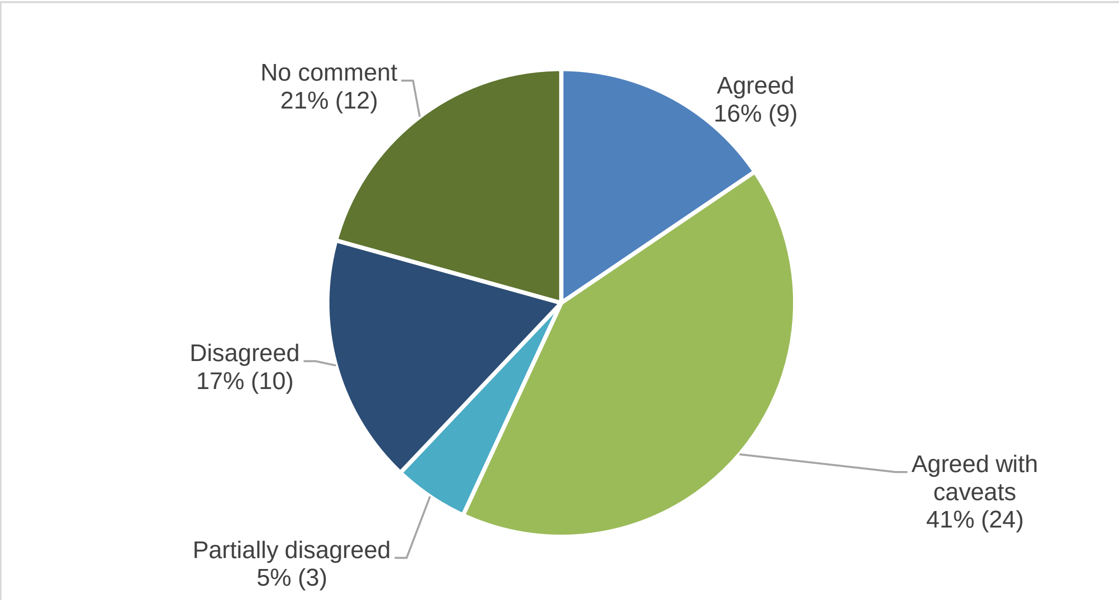
32 Nevertheless, the FRC believes that ensuring that a business is sustainable over the longer term is important and through the Guidance encourages companies to consider matters such as climate risk and report when material. The strategic report provides an overarching framework within which non-financial matters can be considered.

Question 4: Materiality

33 The Exposure Draft proposed amendments to Section 5 *Materiality* that enhanced the focus on non-financial information and long-term value.

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

Respondents' views on Question 4



34 46 out of 58 respondents commented on this question.

35 72% of respondents that commented, broadly agreed with the draft amendments to section 5 on materiality. Many respondents commented that the wording in the materiality section should be made clearer so that information is disclosed in the strategic report when it is material to shareholders.

36 Some respondents noted that it may be helpful to provide some guidance on the process that companies should apply when making materiality judgements in the context of non-financial information.

37 There were differing views on the application of materiality to non-financial information. Some respondents expressed concern about the new paragraph on audit materiality and the Guidance calling for a separate assessment for qualitative information when the accounting and auditing definition of materiality covers both quantitative and qualitative factors.

38 There was some disagreement with the amendments. Two respondents felt that the word ‘economic’ should be removed from the definition of material. Some respondents held the view that reference to ‘impact of activity’ in the context of materiality was confusing. One respondent held the view that a different basic definition of materiality was needed. A number of respondents felt that it was important that the Guidance was clear that materiality should be assessed with reference to the needs of shareholders. One respondent expressed concern about the addition to the provision relating to

disclosure of confidential information. They expressed concern that this paragraph was interpreting law more narrowly than applied in practice.

FRC response

39 The FRC has amended the materiality section considering the comments from respondents. The FRC believes that the basic definition of materiality remains appropriate as it is generally well understood but some additional guidance has been provided on its application in the context of the strategic report. The paragraph relating to audit materiality has been removed as this was confusing.

40 The terms used in the Companies Act that provide a filter to the level of information that should be disclosed have also been clarified.

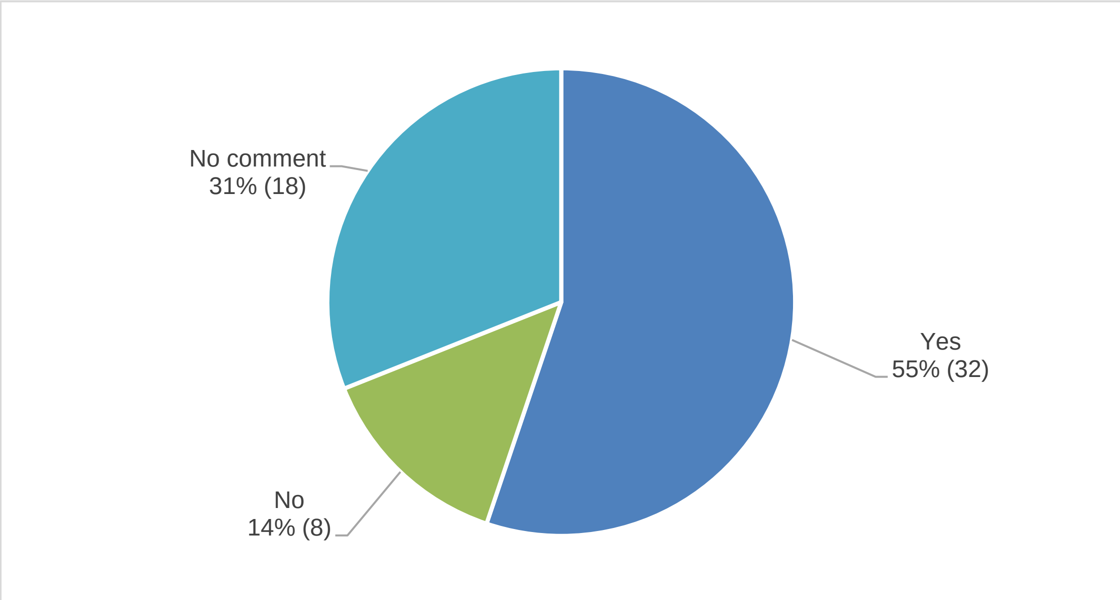
41 The FRC considered whether disclosure of the materiality process would be helpful. Given that this is likely to be different for each company and could lead to boilerplate, therefore on balance the FRC considers that guidance on this may be unhelpful.

Question 5: Linkage

42 The Exposure Draft proposed that the Guidance encourages linking of related information in the annual report through the narrative. It was proposed that the communication principle relating to linkage in Section 6 *The strategic report: communication principles* is 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?

Respondents' views on Question 5



43 40 out of 58 respondents commented on this question.

44 80% of those that commented, made suggestions on the types of disclosures that could be linked. Some respondents noted that we should place greater emphasis on the notion of linkages to information in other documents outside the annual report.

45 Respondents supported the concept of the annual report being a cohesive document that tells the story between different parts of the annual report. However, some respondents noted that it will not be possible for the FRC to illustrate all different types of disclosures that could be linked. This could be achieved through alternative mechanisms such as publicising examples of best practice on the FRC website perhaps through the Financial Reporting Lab or CRR.

FRC response

46 The FRC has used linkage examples throughout the guidance to identify common areas of linkage. Section 3 *The annual report* discusses the placement of information and encourages signposting of information outside of the annual report.

Questions 6, 7 and 8: Content elements

47 The Exposure Draft proposed amendments to Section 7 *The strategic report: content elements* 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.

48 The proposals placed greater emphasis on the notion of value generation. With that in mind, the FRC would be 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, prescriptive guidance has been avoided 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?

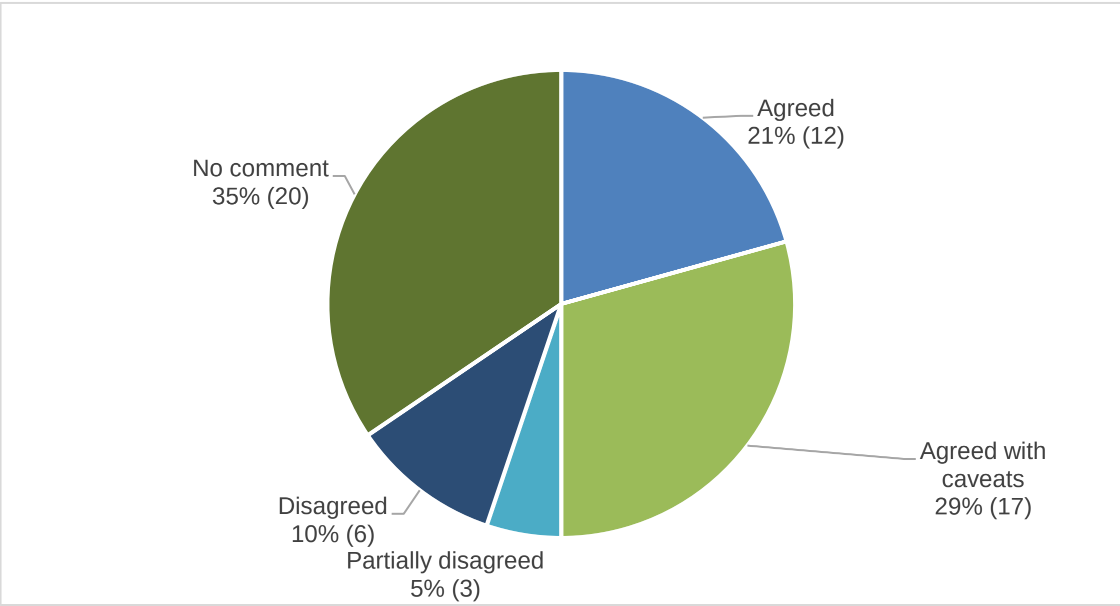
Question 7

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?

Respondents' views on Question 6



49 38 out of 58 respondents commented on this question.

50 76% of those that commented, agreed with the articulation of sources of value. Many respondents commented that it is important for companies to provide information on broader drivers of value, including intangibles. A number of respondents felt that there was scope for the drafting in this area to be more clear and concise and recommended

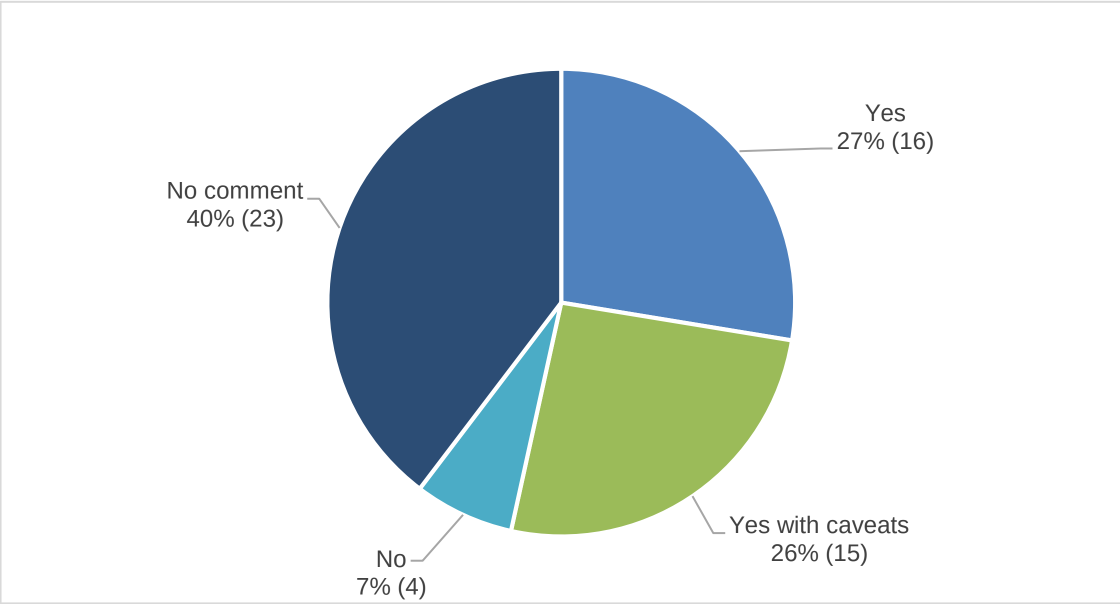
the use terminology that was widely understood such as ‘value creation’. They also considered that some of the concepts could be more clearly explained e.g. culture.

51 Some respondents noted specific aspects of value creation that could feature e.g. human capital.

52 Some respondents expressed concerns about the ‘encouraged content elements’ in section 7, noting that these did not have a statutory underpinning and could lead to ‘box ticking’.

53 Those respondents that disagreed with the articulation of sources of value felt that the guidance in this area could be clearer and better linked to other areas such as company purpose, values, business model. A few respondents felt that the new content did not flow well in the current structure of the document.

Respondents' views on Question 7



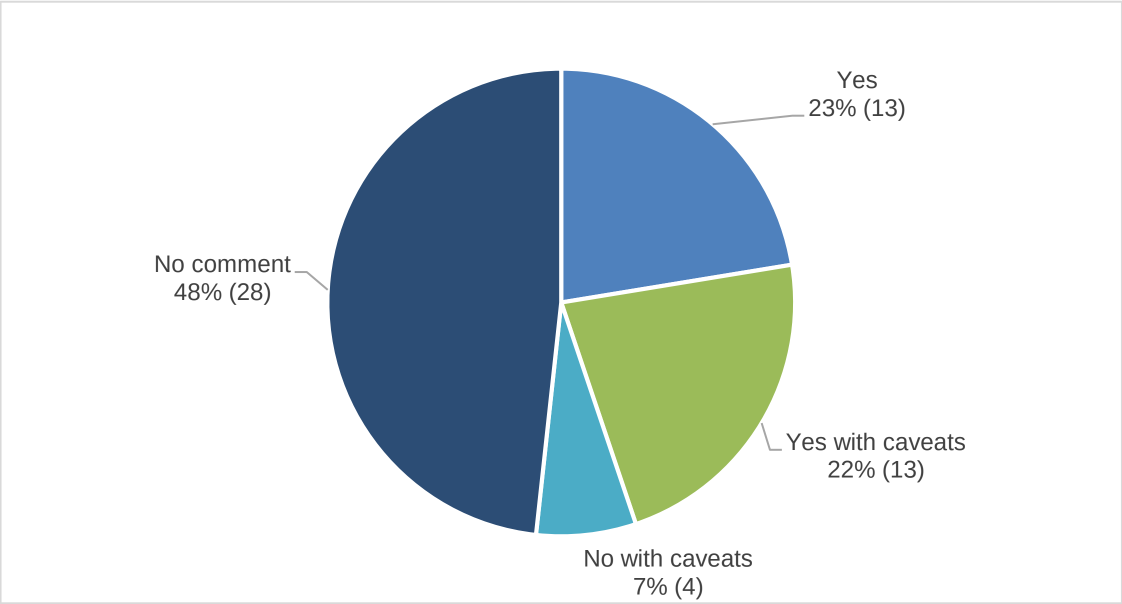
54 35 out of 58 respondents commented on this question.

55 89% of those that commented, agreed that disclosures on how value is generated would be helpful. Some respondents considered that there could be more emphasis on the use of metrics on how value is generated.

56 Some respondents highlighted that this is an area where best practice is evolving and the FRC needs to strike an appropriate balance between encouraging innovation in this area and providing useful examples without encouraging boilerplate.

57 Those respondents who did not consider the disclosures to be useful had concerns that these types of disclosures were being added on a piecemeal basis, were confusing and a step too far for many companies.

Respondents' views on Question 8



58 30 out of 58 respondents commented on this question.

59 87% of those that commented, agreed that the Guidance gives sufficient emphasis on the matters that may impact performance over the longer term and welcomed the integration of non-financial matters within the strategic report.

60 There were a number of comments on specific areas:

- The revised guidance places emphasis on the long-term but it should not focus on a single time frame as information may relate to different time horizons.
- There was caution raised against encouraging companies to include non-financial information where it is not relevant, the Guidance should retain focus on reporting of matters that are of strategic importance.
- The guidance should be balanced between a broad range of non-financial matters and not give prominence to specific aspects e.g. human rights, climate risk.
- In contrast, some respondents felt a need for more focus on specific areas.
- The guidance should focus on the overarching principles, some areas relating to non-financial reporting are prescriptive and could lead to tick-box reporting.
- There were concerns about the insertion of the word ‘impact’ in a number of areas of the Guidance without explanation of its meaning. There could be different interpretations. This term arises in the new non-financial reporting regulations and is not generally used in other parts of the strategic report legislation so it is unclear how it should be applied in other contexts.

FRC response

61 The FRC believes that the concept of generation and preservation of value is important and should be considered as part of an entity’s business model. The drafting in this section has been improved.

62 In view of comments from respondents on the structure and flow of section 7 of the draft amendments, the FRC has retained the basic structure of the 2014 guidance. The encouraged content elements have been more closely aligned to the new reporting

requirements on section 172 which are included in new section 8 *The strategic report: content elements for the section 172 statement*.

63 The FRC has also considered the specific comments on section 7 and made amendments as appropriate.

Question 9: Other

Question 9

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

64 A few suggestions were made on improvements to other areas of the Guidance as follows:

- Reduce the variety of terms used in the Guidance to refer to users, with a recommendation that the term ‘shareholder’ is used to refer to the primary user.
- Provide definitions where non-standard terms are used.
- Re-instate discussion of objectives in discussion of business model and strategy.
- Better linkage and signposting with relevant parts of corporate governance statement.
- Support for use of examples but some may benefit from review and need to ensure that examples are future proof e.g. not just focussing on current topical issues e.g. cyber risk.

FRC response

65 The FRC has received feedback that the 2014 Guidance on the Strategic Report is a helpful document, therefore the draft amendments were not intended to be a fundamental review. We did however, ask for feedback on whether respondents had suggestions for improvements to other areas of the Guidance. We received few comments which indicates that amendments to other areas of the guidance are not needed at this stage. We have considered the comments relating to other specific areas of the Guidance and made amendments as appropriate.

Appendix I – List of respondents

	Respondent	Organisation type
1	Association of Accounting Technicians (AAT)	Accountancy body
2	Association of British Insurers (ABI)	Preparer representative
3	Association of Chartered Certified Accountants (ACCA)	Accountancy body
4	The Association of Investment Companies (AIC)	Investor representative
5	Amnesty International	Civil Society Group
6	Anglo American	Preparer
7	Asesoria Group	Other
8	Aviva	Preparer
9	BDO	Accountancy firm
10	The Purposeful Company	Other
11	Black Sun	Other
12	British Private Equity and Venture Capital Association (BVCA)	Investor representative
13	CFA UK	Investor representative
14	Chartered Institute of Management Accountants (CIMA)	Accountancy body
15	Chartered Institute of Personnel and Development (CIPD)	Other
16	Client Earth	Civil Society Group
17	Climate Disclosure Standards Board (CDSB)	Civil Society Group
18	Deloitte LLP	Accountancy firm
19	Ernst & Young LLP	Accountancy firm
20	Friend Studio	Preparer representative
21	FutureValue	Other
22	GC100 Group	Preparer representative
23	Grant Thornton LLP	Accountancy firm
24	Green Planet Consulting	Civil Society Group
25	Global Reporting Initiative (GRI)	Civil Society Group

	Respondent	Organisation type
26	High Pay Centre	Civil Society Group
27	Institute of Business Ethics (IBE)	Civil Society Group
28	Institute of Chartered Accountants in England and Wales (ICAEW)	Accountancy body
29	Institute of Chartered Accountants of Scotland (ICAS)	Accountancy body
30	Institute of Chartered Secretaries and Administrators (ICSA)	Preparer representative
31	International Corporate Governance Network (ICGN)	Other
32	International Integrated Reporting Council (IIRC)	Other
33	Investment Association	Investor representative
34	Investor Relations Society	Investor representative
35	KPMG LLP	Accountancy firm
36	Landsec	Preparer
37	Law Society of England & Wales	Other
38	Linklaters	Other
39	Local Authority Pension Fund Forum (LAPFF)	Other
40	Maturity Institute (MI)	Civil Society Group
41	Norton Rose Fullbright LLP	Other
42	Oxfam	Civil Society Group
43	Peter Bebb, Perendie	Other
45	Principles for Responsible Investment (PRI)	Investor representative
46	Prism Cosec	Preparer representative
47	Professor Carol Adams, Durham University	Other
48	PwC LLP	Accountancy firm
49	Quoted Companies Alliance (QCA)	Preparer representative
50	RPMI Railpen	Investor representative
51	ShareAction	Civil Society Group
52	Shift	Civil Society Group

	Respondent	Organisation type
53	Social Value UK	Civil Society Group
54	Trade Union Congress (TUC)	Civil Society Group
55	UK Finance	Preparer
56	UK Shareholders' Association	Investor representative
57	UK Sustainable Investment and Finance Association (UKSIF)	Civil Society Group

Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk