

Deepa Raval
Financial Reporting Council
Aldwych House
71-91 Aldwych
London
WC2B 4HN

Submitted by email to: narrative@frc.org.uk

15 November 2013

Dear Deepa

ICSA response to Exposure Draft: Guidance on the Strategic Report

We welcome the opportunity to comment on the Exposure Draft of the FRC Guidance on the Strategic Report.

As you will know, the Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies Chartered Secretaries. As company secretaries, many of our members have overall responsibility for the production of their company's annual reports and most will have first-hand experience of drafting the non-financial sections, including responsibility for drafting the new strategic report. As such, our members are well placed to understand the practical issues around producing the strategic report.

ICSA is at the forefront of innovation in narrative reporting and recognises excellence in reporting through its annual Transparency in Governance Awards. These Awards promote best practice in narrative reporting. Since the Awards began in 2009 the overall standard of reporting by companies has increased substantially and the winners of ICSA's Transparency in Governance Awards are now regarded as having achieved the 'gold standard' in reporting.

In our response we have some general points, in addition to our responses to your specific questions. We have included these comments with our responses to your questions, under the sections to which they relate

Section 3: the annual report

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

Yes. We agree that an illustration such as that set out in illustration 1 is useful, however we have some comments on illustration 1 as it is set out in the draft guidance. Please see our comments under questions 2 and 3 below.

2. Question 2 Do you agree with the objectives of each component and section of the annual report which are included in Illustration 1?

Broadly yes, but please see our detailed comments on the strategic report under question 3 'the placing of information'. We have some observations on the other parts of Illustration 1 are set out below.

2.1 Document purpose

Whilst we agree that annual reports are written primarily for existing shareholders, we think this statement is a little narrow. We would suggest the wording -

'The purpose of the annual report is *primarily* to provide shareholders *and potential shareholders* with relevant information that is useful for making *investment* decisions and assessing management's stewardship.'

2.1 Corporate governance report

We think it is important that the illustration includes a second bullet point covering the requirements for companies to report on their compliance with the UK Corporate Governance Code, such as:

- To provide information on how the entity has applied the main principles of The Code and complied with its provisions.

It would also be helpful to make it clear in the box below that the source is the UK Corporate Governance Code, rather than stating 'The Code'. It would also be helpful to state The Companies Act 2006 rather than 'The Act' under the column for the Strategic Report. We are aware that the Code and the Act are defined in the Glossary at Appendix I but it is likely that this Illustration will be used in the future as a 'stand alone' document.

3. Question 3: Do you think the guidance on the placement of information in the annual report in paragraphs 3.10 to 3.14 will have a positive influence in making the annual report more understandable and relevant to shareholders?

We agree with the statement at 3.10 that 'the placement of information in the annual report should facilitate the communication of the information contained in it'. However we have concerns that some of the guidance is likely to frustrate this aim.

3.1 Ordering of information

The order in which information appears in the strategic report is vital to communication of the contents. Well written reports begin with a summary of all the most important information, set out on the first one or two pages. This summary will comprise the most important facts and figures from the rest of the report and will provide all the key information 'at a glance'.

The following pages should then set out all the important strategic information – but *only* information that is strategic; other 'supplementary' information should appear elsewhere in the annual report. The strategic report should set out the company's objectives, strategy and business model. It should include key strategic issues facing the company and how the company is responding, together with critical risks associated with the company's strategy and its operations. KPIs should demonstrate links to strategy, risks

and variable elements of remuneration. Where a company has business area(s) that are strategically important to the Group, this information should be included.

3.2 Duplication on information

Paragraph (iii) of the summary on page 6 of the draft Guidance states that the aim is to 'promote cohesiveness and enable related information to be linked together'. We are therefore concerned that the draft guidance states at paragraph 3.14 that duplication of information should be avoided. It is our experience that some repetition of information across sections of the annual report is both desirable and necessary. The structure and presentation of the annual report is crucial to producing a report which is both cohesive and easily understood. This is acknowledged in the draft guidance under paragraph 6.9 and an example of best practice in presentation is the inclusion of an initial summary of key information which all well-written reports contain. We do not agree that duplication of essential information leads to unnecessary volumes of disclosure. Some duplication is vital to producing a report that makes it easy for shareholders to find important information easily and it ensures each section of the report can be understood by the reader.

3.3 Integrated reporting

We also note the remarks in paragraphs (v) and (iv) of the Introduction to the guidance at page 3. Paragraph (v) encourages preparers *'to consider how the strategic report fits within the annual report as a whole and help enhance the quality of narrative reporting more generally.'* At (iv) the Introduction states *'in contrast to an integrated report, the strategic report is required as part of the annual report in the UK, with its purpose and content largely determined by legislation'*.

In our view integrated reporting and the strategic report are not mutually exclusive. Well-structured annual reports should include cross referencing to further information (or 'linkages') throughout. Many companies already produce integrated reports and the best examples of ICSA Award-winning annual reports are integrated reports, albeit not necessarily exactly in line with the IIRC draft framework where that does not work for the company concerned. We consider this to be best practice for all annual reports.

Section 5 Strategic reports and materiality

4. Question 4: Do you agree with this approach? Is the level of guidance provided on the subject of materiality appropriate?

- 4.1** Yes. We support the approach taken to the concept of materiality. It is important that only 'key' performance indicators and 'principal' risks and uncertainties are included in the strategic report. However, as discussed in 3.1 above, it is important that *all* strategically important information is included with a presumption that in the case of doubt, information should be consigned to the directors' report. The definition of materiality under IFRS is useful as a starting point, but narrative reporting frequently requires additional information for shareholders to gain a full understanding of the company's strategy, and we do not think such information should be excluded in the pursuit of brevity. The inclusion of any additional information should be left to the judgement of the company, rather than limited to what can be objectively identified as 'material to shareholders'. The need for the strategic report to be comprehensive is acknowledged at paragraph 6.15 of the draft guidance and we think this emphasis on 'comprehensive' and the ability of the company to cross-refer to the directors' report and

financial statements for further detail should be recognised within the guidance on materiality. Where companies are obliged under the laws or regulations of other jurisdictions to provide more detailed information then, unless this is actually strategic for that company, this should generally be included in the directors' report. We would welcome clarification of this point in the guidance.

Section 6 The strategic report

5. Question 5: Do you agree with the proposed 'communication principles', set out in paragraphs 6.5 to 6.27 of the draft guidance, which describe the desired qualitative characteristics of information presented in the strategic report? Do you think that any other principles should be included?

5.1 Summary financial statements

Our primary concern over section 6 of the guidance relates to the lack of any guidance in relation to summary financial statements (SFS). Although this is not included in the consultation questions, we think it would be helpful for additional guidance to be provided under paragraph 6 in relation to SFS. We note that 6.2(a) the draft guidance states that the first of the three main content-related objectives of the strategic report is 'to provide context for the related financial statements'. Section 426 of the Act provides that SFS are to be replaced by a copy of the strategic report, with supplementary material. However this supplementary material is limited to statements on the status of the auditor's report and, in the case of a quoted company, a copy of the 'single figure table' contained in the directors' remuneration report. The previous content of the SFS relating to information on income, expenditure, revenue etc is no longer required, but it is difficult to see how the strategic report can replace SFS and 'provide context for the related financial statements' without any financial information. We therefore think it would be helpful to provide additional guidance to help companies who currently produce an SFS and wish to continue to do so in the future. Without this, there is a real risk that some companies will seek to protect themselves by providing much of the financial information formerly contained in the SFS, with a significant increase in the size of the strategic report. We would suggest that, for many companies, highlights of the P&L statement, balance sheet and cashflow statement would be all that is necessary.

5.2 With regard to the communication principles set out in paragraphs 6.5 to 6.27, we generally support the qualitative statements. However, we would reiterate our comments on duplication set out in 3.2 above and the need for the guidance to allow for additional information to be included when the company considers it necessary (see 4.1 above). We agree that only strategically important information should be included in the strategy report but think that the emphasis on linkages should include recognition of the need for some duplication of information across the annual report as a whole.

5.3 We think that the inclusion of examples in the guidance is helpful but we think that some of the specific examples given could be improved.

6. Question 6: In this draft guidance, we have aimed to strike a balance between the need to ensure that the structure and presentation of the strategic report is sufficiently tailored to the entity's current circumstances and the need to facilitate comparison of the strategic report from year to year. Do you think the guidance in paragraphs 6.26 and 6.27 achieves the correct balance?

We agree with the statement in paragraph 6.26 that the structure and presentation of the strategic report should be reviewed annually. However, paragraph 6.27 would appear

unnecessary as it is hard to imagine a circumstance when a company would choose to change the structure or presentation of its strategic report so as *not* to improve the quality of the information provided.

7. Question 7: The ‘content elements’ in bold type described in paragraphs 6.28 to 6.73 do not go beyond the requirements set out in the Act, although the precise wording may have been expanded to make them more understandable. Do you think this is appropriate?

7.1 Yes. We agree that the contents elements shown in bold type do not go beyond the requirements of the Act and we agree that it is helpful to include the additional wording.

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

7.2 We would reiterate our comments on the ‘ordering of information’ set out in 3.1 of our response above. We think it is important that the first one or two pages of the report sets out an ‘at a glance’ summary of all the key information and is followed by further detail and explanation.

Paragraph 6.28 states that the strategic report should not be addressed in isolation and that there are numerous relationships and interdependencies between elements and other disclosures in the annual report. However, we think it is important that the guidance also notes the importance of the company demonstrating the links between strategy, principal risks, KPIs and the variable elements of remuneration, within the strategic report, even if only at a high level. This gives a coherent picture of the company’s prospects which can be easily understood and the company is free to include more detailed commentary in the directors’ report if appropriate.

7.3 Although not a specific question set by the consultation, we would highlight the definition of ‘senior manager’ under paragraph 6.69. We are aware that some concern has been expressed over how companies will decide which employees to include within the definition and the extent to which information provided will be comparable between companies. We think it would be helpful if the guidance encouraged companies that were having difficulty reporting under the definition in the Act, to provide an explanation of how they had defined ‘senior manager’ for this purpose. It is likely that through these explanations common practice would emerge over time, in the same way it did for the concept of PDMRs. Disclosure of this information will provide important insights into gender diversity at all levels within companies although, until common practice emerges, information disclosed may only be comparable within the same company year on year. Once accepted practice in defining ‘senior manager’ emerges, the data will become comparable between companies.

8. Question 8: Appendix I ‘Glossary’ uses the same definition of a business model as the Code (‘how the entity generates or preserves value’). Is the level of guidance provided on the business model description in paragraphs 6.38 to 6.41 sufficient?

Yes. We agree that it is appropriate to use the same definition of business mode as that used in the Code.

9. Question 9: Do you think that this draft guidance differentiates sufficiently between the concepts of business model, objectives and strategies? If not, why not and how might the guidance be improved?

Yes. We very much support the inclusion of the diagram under 6.29 and the explanatory text. As part of our annual review of company reports for ICSA's Transparency in Governance Awards, we have seen some confusion in the understanding of objectives, strategy and business model. However, we would suggest that this would be enhanced if the wording in paragraph 6.30 appeared before the diagram. We would also suggest that the wording in bold type under 6.31 should appear at the beginning of this section so that an explanation of objective and strategy follow.

Question 10

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

We agree that examples of linkage are useful but we are concerned about the over use of 'linkage' references where some repetition of information would be preferable. This would be detrimental to the quality of reports. Please see our comments under 3.2 above.

We hope the above comments are helpful and if you would like to discuss any of our comments in further detail, please contact me. We would welcome an opportunity in the future to highlight annual reports that have included excellent strategic reports as part of ICSA's Annual Transparency in Governance Awards,

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Swabey', written in a cursive style.

Peter Swabey
Policy & Research Director
Phone: 020 7612 7014