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24 October 2017

Dear Ms Raval,

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

We welcome the opportunity to respond to the FRC's draft amendments to Guidance on the Strategic Report – Non-financial reporting. The Quoted Companies Alliance Corporate Governance and Financial Reporting Expert Groups have examined your proposals and advised on this response. A list of Expert Group members is at Appendix A.

We have responded below in more detail to the specific amendments from the point of view of our members, small and mid-size quoted companies.

As a general comment, we would highlight that – as is noted in paragraph (vii) of the Exposure Draft – the government issued a response to its Green Paper on corporate governance reform in September 2017. Its current timetable indicates draft legislation will be published in March 2018, which will be finalised in time for it to be effective for periods beginning on or after 1 July 2018. If the draft legislation includes proposals affecting the Guidance, the FRC should issue another draft of the Guidance, taking into account the government's full set of proposals.

Responses to specific questions

I. Approach to update

Q1 Do you agree with the approach for updating the Guidance for the changes arising from the implementation of the non-financial reporting Directive?

We recognise the increasing importance of corporate transparency and welcome any effort to provide proportionate guidance on improving narrative reporting. However, as a general comment, we do not believe the term "best practice" to be either helpful or appropriate, as it is subjective. The Guidance is what the FRC considers to be appropriate in most circumstances, through the lens of the Non-Financial Reporting Directive requirements. However, much depends on the particular factual position in relation to a particular company. We prefer the language inserted by the FRC with respect to "encouraged content elements".

II. The purpose of the strategic report and section 172

Q2 Do you support the enhancements that have been made to Sections 4 and 7 of the Guidance to strengthen this link?

Yes, we support the enhancements that have been made to Sections 4 and 7 of the Guidance to strengthen the link between the strategic report and directors' duties under Section 172. As mentioned in our answer to Q1, we consider the use of "encouraged content elements" to be appropriate.

Q3 Do you have any suggestions for further improvements in this area?

We would emphasise that the inclusion of more emphasis on directors' duties under Section 172 should not induce more boilerplate disclosures. For example, the new paragraph 4.7 should be expanded to note that the requirements of Section 172 should not be repeated in the strategic report. A company should focus on what it has done in the previous reporting year and what it intends to do in the future, not on repeating requirements.

III. Materiality

Q4 Do you agree with the draft amendments to Section 5?

Overall, we believe that Section 5 should provide a greater level of clarity regarding qualitative materiality. Similarly, the new paragraph 5.6 states that the disclosure of the auditing materiality figures in the audit report "may" focus attention on the quantitative aspect of materiality. We believe this should be changed to "will". The FRC may also wish to include an "example" box to provide guidance on what this assessment could look like and how it could be reported/what it would include.

With respect to the new paragraph 5.15, the draft Guidance implies, without specifically stating, that material commercially sensitive information must be disclosed where it is not subject to impending developments or ongoing negotiations. We would encourage the FRC to provide clarity in this regard, particularly given the remarks in paragraph 21 of the Corporate Reporting Council's advice to the FRC to issue the draft amendments. We note that small and mid-size quoted companies are already required to reveal a disproportionate amount of information about their commercial activities compared to larger companies, for example under the requirements of IFRS 8 *Operating Segments*, and to require the disclosure of information which puts them at a further competitive disadvantage is, in our view, even more damaging.

IV. Linkage

Q5 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?

Paragraph 6.14 indicates that companies should look beyond the strategic planning horizon for factors that might have an effect on the long-term success of the business but does not elaborate on this statement by setting boundaries on this expectation or providing any examples of factors that the FRC has in mind. We believe that this places a disproportionate burden on small and mid-size companies, as they would be uncertain about how far ahead they are expected to be looking in order to prepare the disclosures in their strategic reports.

Content elements

Q6 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?

We note that much of Section 7's structure starts with a subsection with a bold content element that directly links to a disclosure which is a formal requirement in the Companies Act (albeit not necessarily mandatory for all companies preparing a strategic report). However this structure has not been retained for the new subsection on "sources of value". We would suggest that a consistent structure is used throughout the Guidance. Under the approach currently adopted, particularly in the "sources of value" section, the encouraged content elements resemble guidance that would be labelled as examples in other subsections.

Paragraphs 7.20 and 7.21 of the draft Guidance should be combined as they explain the problem and provide a solution respectively.

Paragraph 7.24 states that "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". However, if a risk does not threaten an entity's business model, future performance, solvency or liquidity, then we would contend that it is neither material nor a principal risk. The FRC should therefore provide much greater clarity as to what they consider to be a 'principal risk'. This could be done by providing examples of the sorts of risks that the FRC considers could be "principal" despite them not threatening an entity's business model, future performance, solvency or liquidity.

Furthermore, we believe that the Guidance should state that the business model contains the objective(s) of the board as we believe that the reader should be able to easily identify how the board intends to achieve its stated objective(s).

Q7 Do you consider that disclosures on how value is generated would be helpful?

Yes, we consider that disclosures on how value is generated would be helpful.

In many cases business model disclosures address the areas set out in paragraph 7.13 and 7.14 of the guidance with far greater detail and emphasis than the areas set out in paragraph 7.12 – particularly with respect to aspects of the business model that differentiate it from its peers and the basis on which it competes. We consider these aspects of the business model to be highly relevant to the generation of value and the FRC should be encouraging greater focus in this area.

Q8 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?

Section 414CB (1) introduces a requirement for an entity to include information on the "impact of its activity relating to, as a minimum" the matters specified in the legislation. The draft Guidance uses the term "impact" in numerous places throughout Sections 4 and 7 but does not provide guidance on what is meant by the term in the context of the overall purpose of the strategic report. Providing information on the specified matters in the context of explaining an entity's development, performance and position is a well-established practice, which has a clear investor focus. However, it is less clear whether "impact of its activity" is also intended to be discussed from an investor-relevance perspective or from a wider stakeholder perspective. We believe that the guidance should provide more clarity in this regard, given that the "impact of its activity" requirement is a newly introduced context that is open to widely differing interpretations.

Paragraph 7.35 states that 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. We consider this to be too strong and would recommend that the Guidance is adjusted to suggest that it "may be used to" provide signposting; the annual report is not intended to be a directory for all corporate reporting to all individual stakeholder groups.

Regarding paragraph 7.43, we question how the understanding of the users of the annual report and financial statements would be enhanced if the board referred to a source of guidance or a voluntary framework that provides advice on how the entity should conduct its business.

V. Other

Q9 Are there any other specific areas of the Guidance that would benefit from improvement?

In addition to our comments above, the following areas of the Guidance would benefit from improvement:

i. **Definitions** – "Regulated markets" should be clearly defined within the Guidance, as it has caused confusion when considering the Ethical Standard and ISAs definitions.

   An "unquoted company" should also be defined, with a clarification that, for these purposes, this category would include companies admitted to trading on markets such as the AIM.

ii. **Appendices III, IV and V** – We would encourage the FRC to clarify where companies listed on NEX Exchange (Growth Market) fall within these tables.

iii. **Paragraph (iii) of the Summary –** We believe it would be useful to insert "now the Department for Business, Energy and Industrial Strategy (BEIS)" after the reference to the Department for Business, Innovation and Skills (which no longer exists).

iv. **Paragraph (xii) of the Summary and the new paragraph 5.6 in Section 5 *The strategic report: materiality* –** We do not think that the deletion of the word "only" is a positive step forward as to do so seems to contradict the FRC's initiative of clear and concise reporting.

v. **Deletion of paragraph 2.3 in Section 2 *Scope* –** We believe that this should be retained as part of a more complete explanation which encourages good narrative reporting. It should indicate that the Non-Financial Reporting Directive only applies to some companies; a wider group of companies are required to deliver a strategic report; and that some narrative reporting can be good for other companies, even though it is not required.

   Furthermore, it should cross-reference Appendix III – The Companies Act 2006 strategic report disclosure requirements – so that companies consider the table's content. We believe that this would better meet the Corporate Reporting Council's stated belief (in paragraph 12 of their advice to the FRC to issue the draft amendments) that "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."

vi. **Paragraph 3.5 in Section 3 *The annual report* –** This new paragraph should be expanded to provide a better example of presentation of other sources of information.

vii. **Paragraph 6.8 in Section 6 *The strategic report: communication principles*** – We would rephrase so that it reads "The strategic report should be clear, concise and comprehensive."

viii. **Paragraph 7.26 *The strategic report: content elements* –** This paragraph reproduces the disclosure requirement set out in s414CB (2) (d) which introduces the term "where relevant and proportionate" in the context of an entity's business relationships, products and services. The term "where relevant and proportionate" is new in the context of the strategic report but there is no guidance either in paragraph 7.26 or in Section 5 *The strategic report: materiality* that explains how that phrase might be interpreted. The FRC must provide clarity in this regard, as understanding this phrase is particularly important in the context of the expectation embodied by the reference to "business relationships" that the strategic report should look beyond the boundaries of the company itself and down into the supply chain.

ix. **Paragraphs 7.28 and 7.29 *The strategic report: content elements* –** These paragraphs relate to the main content element set out in paragraph 7.22, not that set out in paragraph 7.26. These two paragraphs should be placed before paragraph 7.26.

x. **Paragraph 7.30 *The strategic report: content elements*** – This is a communication principle, not a content principle.

xi. **Paragraph 7.34 and 7.35 *The strategic report: content elements* –** There is considerable overlap in these two paragraphs and they should be combined.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Corporate Governance Expert Group

Will Pomroy (Chair)	**Hermes Investment Management Limited**
Colin Jones (Deputy Chair)	UHY Hacker Young
Anita Skipper	Aviva Investors
Jonathan Compton David Isherwood	BDO LLP
Sanjeev Verma	Beaufort Securities
Dan Jarman Kalina Lazarova	BMO Global Asset Management (EMEA)
Nick Graves	Burges Salmon
David Hicks	Charles Russell Speechlys LLP
David Fuller	CLS Holdings PLC
Nicholas Stretch	CMS
Louis Cooper	Crowe Clark Whitehill LLP
Nick Gibbon	DAC Beachcroft LLP
Tracy Gordon	Deloitte LLP
Daniel Redman	Design Portfolio
James Lynch	Downing LLP
Melanie Wadsworth	Faegre Baker Daniels LLP
Rory Cray	FIT Remuneration Consultants
Richie Clark	Fox Williams LLP
Nigel Brown	Gateley Plc
Alexandra Hockenhull	Hockenhull Investor Relations
Julie Stanbrook	Hogan Lovells International LLP
Darshan Patel	Hybridan LLP
Carmen Stevens	Jordans Limited
Peter Kohl	Kerman and Co LLP
Darius Lewington	LexisNexis
Peter Fitzwilliam	Mission Marketing Group (The) PLC
Damien Knight	MM & K Limited
Jo Chattle	Norton Rose Fulbright LLP
Amanda Cantwell	Practical Law Company Limited
Philip Patterson	PricewaterhouseCoopers LLP
Kerin Williams	Prism Cosec
Marc Marrero	Stifel
Edward Craft	Wedlake Bell LLP
Edward Beale	Western Selection Plc

Quoted Companies Alliance Financial Reporting Expert Group

Matthew Howells (Chair)	**Smith & Williamson LLP**
Matthew Stallabrass (Deputy Chair)	Crowe Clark Whitehill LLP
Jonathan Compton	BDO LLP
Peter Westaway	Deloitte LLP
Gary Jones	Grant Thornton UK LLP
Anthony Carey	Mazars
Rochelle Duffy	PKF Littlejohn LLP
David Hough	RSM
Neil Armstrong	Unattached
Edward Beale	Western Selection Plc