Think Ahead ACCA

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

Exposure Draft issued for comment by the Financial Reporting Council in August 2017

Comments from ACCA
October 2017

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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the FRC's draft amendments on the Guidance to the Strategic Report ('the Guidance'). This response reflects the views and experience of the members of ACCA's Global Forums for Sustainability and for Corporate Reporting.

We agree with the FRC's view that the strategic report should continue to provide a cohesive narrative, subject to an entity-specific assessment of materiality. We also welcome the timely emphasis placed on directors' duty under section 172 of Companies Act 2006 ('the Act'). We're pleased to see further amendments to the Guidance to reflect innovations in corporate reporting practice, notably encouraging companies to consider value generation more broadly.

The changes to Section 7 of the Guidance (Content Elements) are extensive, and it has sometimes been difficult to assess the overall effect of the amendments without a comprehensive comparison with the current Guidance. Our comments below are based primarily on a review of the Exposure Draft of the revised Guidance as a standalone document.

Although not addressed in any of the consultation questions, we welcome the specific reference made to the ESMA Guidelines on Alternative Performance Measures in new paragraph 7.57. This reinforces the message, already expressed in existing guidance, that the reporting of performance should be reliable and consistent.

If further information is needed on any aspects of our response, please get back to us.

AREAS FOR SPECIFIC COMMENT

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?

We agree with the approach proposed. In particular, ACCA welcomes the FRC's aim to keep the strategic report as a single cohesive document, into which the new disclosures arising from the Directive are incorporated subject to materiality.

We note, however, the presentation of new and existing requirements relating to the Directive could be made more user-friendly. Amended paragraph 2.1 of the guidance (Summary of legal requirements) should refer to Appendices III and IV separately, so that entities within scope of the Directive are directed to Appendix IV, and all other entities that prepare Strategic Reports to Appendix III. In addition, the effective date of the Directive – 1 January 2017 – should be specified within Section 2.

The *EU Commission's Guidelines on non-financial reporting (methodology for reporting non-financial information)*, while referred to in paragraph (xv) of the Summary, could be incorporated more fully into the Guidance where relevant. One area where this can help is around reporting on policies in relation to non-financial matters. The updated examples under paragraphs 7.14 and 7.27 illustrate this to an extent; however, there is an opportunity to further emphasise the role of the board with regards to environmental, social and human rights policies, as highlighted in the example in section 4.2 of the EU Commission's *Guidelines*.

Further, more specific examples in Section 7 around how outcomes around human rights, anti-corruption and bribery should be reported would be beneficial. New paragraph 7.37 and its associated example helpfully refer to the UN Guiding Principles on Business and Human Rights. However, further relevant guidance on these new thematic aspects would be welcome – particularly around how outcomes, rather than policy, may be reported on in a meaningful way.

Question 2: Do you support the enhancements that have been made to Sections 4 and 7 of the Guidance to strengthen this link?

We support the enhancements that have been made to Sections 4 and 7 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. In the light of falling public trust in businesses, the FRC is right to highlight the duty of directors to consider long-term outcomes and the interests of and relationships with a broad range of stakeholders, in promoting the success of the company. We also believe that it's appropriate at this time for members to remain the primary audience of the strategic report, as Section 4 of the revised Guidance makes clear: it is to members that directors explain how they have performed their duty under section 172.

However, the proposed amendments to Section 4 have given rise to some inconsistency in terminology: paragraphs 4.1 and 4.3 refer to 'shareholders,' while paragraph 4.7 refers to 'members.' The two terms are not synonymous in law. On the basis that sections 172 and 414c of the Act make reference to members, the audience of the strategic report should be identified as members and not shareholders. We would recommend that the FRC reviews Section 4 and if necessary, the Guidance as a whole, to ensure that members are referred to throughout. It may, in addition, be helpful to include the definition of members under the Act.

In addition, new paragraph 4.4 highlights the need for the board to 'consider the impact of the entity's activities on stakeholders as a whole, including the impact on society more widely.' Some more guidance is needed in Section 7 to illustrate what relevant reporting of external impact may look like. The example following paragraph 7.10 is helpful in terms of linking impact reporting through to stakeholder identification, but more detail around how impact could be captured would be welcome, as businesses have reported that external impact may be very difficult to quantify.

Question 3: Do you have any suggestions for further improvements in this area?

ACCA welcomes the emphasis placed in Section 4 on the importance of considering the longer-term consequences of board decisions. Different timeframes are appropriate for different entities, depending on the nature of the business, so a degree of flexibility is needed. To ensure that such considerations are reflected in reporting practice, it may be helpful to link the encouragement to consider longer future timeframes specifically to risk reporting and viability statements. In doing so, the need for consistency between the risk discussion in the strategic report and the viability statement should be highlighted.

Further emphasis in Sections 4 and 7 that reporting on impact should be entity-specific, as explained in Section 5, would also be helpful.

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

We agree that materiality should remain entity-specific. However, this approach may be perceived to be at odds with the requirements of the EU Non-financial reporting Directive ('the Directive'), which requires information on specific categories of non-financial issues to be disclosed 'as a minimum.[1]' Although ACCA supports the FRC's view that material non-financial information should be incorporated within the strategic report as a single cohesive document, the FRC needs to consider how companies should resolve situations where information considered immaterial is nevertheless required to be disclosed under the Directive.

Some companies may also find the entity-specific lens of materiality difficult to reconcile when reporting the external impact of their activities. We do not believe that entity-specificity is at odds with reporting on impact, because the wider impact of a business's activities is likely to affect its success in the long term. However, it may be helpful to recognise a potential tension in this respect, and provide an example of how external outcomes could have a tangible impact on the entity.

New paragraph 5.6 refers to auditing materiality. This could be misinterpreted as suggesting that directors could rely upon the auditors' assessment of materiality for the purposes of financial reporting. Directors should be aware that it is their responsibility to assess materiality independently of the auditors for the purpose of corporate reporting in general. We would recommend that this paragraph be deleted.

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[1] Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, Article 19a paragraph 1

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?

The linkage examples in the Guidance provide clear, pertinent guidance about the potential interconnections between different matters and aspects of the strategic report.

The Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) Final Recommendations Report, and its related Annex, contains useful illustrations about how climate change can have tangible impacts on entities' development, performance, position or future prospects. Although focused on climate change, they provide a framework for considering the entity-specific impacts of other non-financial matters. It would be beneficial for the Guidance to refer explicitly to the TCFD's work in this context.

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?

We welcome the new focus on the generation of value. The relevance of this value focus to the description of the business model is clearly articulated in paragraph 7.13. However, what value means in this context could be more clearly explained. Given the strong alignment between the Guidance and the International <IR> Framework, we would recommend that the FRC makes an explicit reference to the Framework as a source of further guidance.

In addition to value preservation and generation, an understanding of how value may be eroded would be equally relevant: stranded assets in the mining industry is one example. The FRC may wish to consider encouraging companies to consider the process of value erosion, alongside value generation and preservation.

Question 7: Do you consider that disclosures on how value is generated would be helpful?

Although it is beneficial for strategic reports to provide an understanding of how value is generated, we do not believe that mandating or promoting further disclosures about value generation would be helpful at this stage.

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?

Please refer to our responses to questions 3 and 6 above.

Question 9: Are there any other specific areas of the Guidance that would benefit from improvement?

There may be an opportunity to link the Directive's reporting requirements in relation to human rights to anti-slavery matters, given the Government's current focus on combatting modern slavery.