

Chapter 3

Strategic report

	Page
Introduction and legal framework	3001
Good practice reporting	3002
Integrated reporting – an overview	3003
FRC's exposure draft: Guidance on the strategic report	3005
Scope and definitions	3005
Objective	3006
Principles	3010
Principle 1 – Fair, balanced and understandable	3010
Principle 2 – Concise	3016
Principle 3 – Forward-looking orientation	3019
Principle 4 – Entity specific	3023
Principle 5 – Highlight linkages	3024
Principle 6 – Annual review	3027
Content elements	3028
Detailed guidance within the disclosure framework	3031
The entity's principal objectives and strategies	3031
The entity's business model	3041
Trends and factors likely to affect the future development, performance and position of the business	3052
Principal risks and uncertainties	3058
Financial and non-financial key performance indicators (KPIs)	3071
Reporting KPIs – a model for effective communication	3071
Analysis of the development and performance of the business	3077
Cash flows	3078
Capital structure and treasury policies	3081
Liquidity	3084
Going concern	3091
Current and future developments and performance – development and performance in the year	3091
Acquisitions and disposals	3096
Accounting policies	3100
Environmental and social matters	3103
Diversity	3108

Strategic report

Introduction and legal framework

3.1 This chapter deals with the voluntary and good practice corporate reporting often set out in the front section ('front half') of a company's annual report. Over the years, this narrative reporting has gone by many names (such as 'operating and financial review', 'business review' and 'management's discussion and analysis'). The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 introduced a new requirement for all companies, other than small companies, to prepare a strategic report to replace the business review that was required previously.

3.2 Section 414A of the Act requires a strategic report to contain:

- A fair, balanced and comprehensive review of the development and performance of the company's business during the financial year, and its position at the end of the year. Large companies should include both financial and non-financial key performance indicators (KPIs) in their review whereas medium-sized companies are exempt from the requirement to include non-financial KPIs.
- A description of the principal risks and uncertainties facing the company.

3.3 There are additional disclosure requirements for a quoted company, including a description of its strategy and business model and disclosures concerning the environment, employees, social issues and gender diversity. Further description of the legal requirements for a strategic report is included within chapter 2.

3.4 To assist directors in preparing a strategic report, the FRC has released draft non-mandatory guidance supporting the strategic report requirements in the new regulations. This guidance is intended to encourage 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.

3.5 The FRC's guidance is, at time of writing, in draft form. The consultation period is due to end in November 2013, after which the guidance will be revised, if necessary, and then finalised.

3.6 This chapter considers best practice in narrative reporting as it may be applied by a quoted company preparing a strategic report. It draws on the FRC's draft guidance, which is also written with quoted companies in mind. As a description of best practice, the chapter may be relevant to unquoted companies. However, given the Act's requirement for much of the information in a strategic report to be given 'to the extent necessary for an understanding of the development, performance or position of the company's business', and the specific references to quoted companies in some of the requirements, many unquoted companies may find the levels of disclosure described in this chapter excessive. Reference should be made instead to chapter 6, which sets out the requirements applicable to unquoted companies.

3.7 Further PwC publications that may provide additional guidance to companies in preparing a strategic report include the following:

Title of publication	Description
Practical guide to corporate reporting – Narrative reporting changes 2013 – Implementing the strategic report	This guide provides a practical overview of reporting in line with the new regulatory requirements of the strategic report. It also offers a clear insight into the spirit of the regulations and into new directors' report requirements.
Guide to forward-looking information – Don't fear the future: communicating with confidence	This guide provides practical guidance on how the reporting of forward-looking information can be achieved, together with examples from progressive companies, both in the UK and elsewhere, who are already adopting a forward-looking orientation in their narrative reporting.
Guide to key performance indicators – Communicating the measures that matter	A practical publication that has been developed to highlight the increasing demand for reporting of key performance indicators (KPIs). It addresses many of the questions posed by these demands and demonstrates what good reporting of KPIs looks like with a collection of examples drawn from the UK and elsewhere.
Report Leadership: Tomorrow's reporting today	Provides a framework, strategic thinking and practical ideas for improving the content of annual reports, including the narrative section.
Integrated reporting: What does your reporting say about you?	Sets out a picture of the information that can help present a cohesive and persuasive picture of a business, including the way it is managed and governed.
12 Reporting Tips	Simple actions and examples of best practice to make company reporting more accessible and to ensure effective communication.

All of these publications can be found at www.corporatereporting.com, which also provides further examples of good narrative reporting. The publications are located under the 'Toolkit' and the 'Research and insights' tabs. Many illustrative examples of narrative reporting can be found on inform.pwc.com.

Good practice reporting

3.8 Users of financial statements can benefit enormously from accompanying narrative reporting that explains the company's performance, cash flows and financial position in the context of its objectives, strategies and future prospects. Financial statements are mainly backward-looking, reflecting what has already happened. Although the financial statements give important information, particularly in judging the quality of management's stewardship, they do not fully explain why the entity's performance was what it was or what is likely to happen next.

3.9 The global financial crisis has raised questions about the adequacy of corporate reporting in its broadest sense. Investors want to know, not just what the company does and how it performed, but also whether that performance is sustainable, given the risks and market conditions that face it. Our ongoing research programme with investors has shown that they often have insufficient contextual and non-financial information to enable them to model future cash flows. Good narrative reporting is intended to meet the shortfall between the information provided by financial statements and the information sought by investors.

3.10 In recent years, narrative reporting has come to be viewed as increasingly important, providing an opportunity to present integrated and comprehensive information about a company to the capital markets and other user groups. The strategic report gives management an opportunity to present a complete picture of the company to the outside world. Management need to consider whether their external communications describe fairly and comprehensively the company's value (however measured) and their ability to increase that value. Investors need to know the ways in which the entity and its management is organised, and the actions they will take, to ensure that value-creation actually happens.

3.11 The corporate reporting agenda is broadening. In 'Tomorrow's corporate reporting', the May 2011 report of a collaborative research study undertaken by the Chartered Institute of Management Accountants, the UK firm of PwC and the London-based think-tank Tomorrow's Company, Prof Mervyn E. King states:

"The world has accepted that people, planet and profit are inextricably intertwined, and nowhere was this better illustrated than in July last year in London, when the International Integrated Reporting Committee was formed. The disparate bodies sitting round the table, such as AAS, GRI, the FASB of America, IASB, IFAC, IOSCO, WWF, Big Four etc., established within one hour an identity of purpose, namely that financial reporting was not sufficient to make an informed assessment about the sustainability of a business in the new economy. It was accepted that the annual report had to be an integrated one, that is one where there is a holistic representation of the financial and non-financial performance of the company. In short how the financial impacted on the non-financial and vice-versa."

Integrated reporting – an overview

3.12 Effective reporting presents information about a company in a logical and connected way. When this information is presented externally, it answers the questions investors want answered and excludes information that is irrelevant. The type of information and the method of presentation will vary between companies, depending on the nature and organisation of the business. For example, businesses comprising various segments should explain the objectives, strategy, performance and risks for each segment.

3.13 Effective reporting integrates the information presented by linking the various pieces of information together so that the user gains an understanding of the entity as a whole. There are various ways in which this integration can be achieved. An integrated approach connects not just the various elements of the narrative reporting, but also connects the information in the financial statements with the 'front half'. So, for example, the explanation of performance in the strategic report should be linked to the performance statements in the financial statements.

3.14 Integrated reporting should seek to answer the following questions (by segment, where appropriate):

- What is the nature of the entity's business? In which industries does the entity operate? (See para 3.100 onwards.)
- What are the entity's objectives? What are the entity's strategies for achieving its objectives? (See para 3.71 onwards.)
- What is the entity's business model? How does the entity create value? (See para 3.86 onwards.)
- What are the resources and relationships that are essential to the achievement of those objectives? (See para 3.91 onwards.)
- How does the entity measure the extent to which it has achieved its objectives? (See para 3.125 onwards.)
- How has the entity performed in the current year compared with the objectives it set in previous periods? (See para 3.82 onwards.)
- Is that performance sustainable? What are the risks that will affect the sustainability of the performance? To what extent is the performance based on recurring transactions or 'one-off' events? (See para 3.108 onwards.)
- What are the entity's future prospects? What will the entity do to ensure it meets its objectives? What constraints exist that may hamper the entity's plans? (See para 3.73 onwards.)

3.15 The model in the diagram set out below highlights the scope of the information set that we believe companies need to have at their disposal if they are to be on top of the dynamics of a modern business. Communication of clear and focused management thought processes to the outside world is essential for companies to build trust with their stakeholders. It is these communications that are at the heart of strategic reporting.

investment chain. Later in 2012 the government endorsed Kay's principles and the directions for market participants, and undertook to have regard to the principles in the future development of policy and regulation; it was also to work with the relevant regulatory authorities to explore Kay's directions for regulatory policy. The government is to publish an update in Summer 2014 on what progress has been achieved, by government and by others, to deliver the Kay recommendations.

4.295 Subsequently, in May 2013, the European Commission issued a Green Paper on the 'Long-term financing of the European economy'. This considered the role that financial institutions and financial markets can play in enhancing long-term financing and the importance of the ease with which small and medium enterprises (SMEs) can access bank and non-bank funding. Proposals for SMEs include developing venture capital, dedicated markets and networks for SMEs, new securitisation instruments, and standards for credit scoring.

4.296 The Green Paper focused mainly on giving respondents the chance to challenge the Commission's analysis of the problem and on potential measures in a number of specific areas, including:

- Balancing prudential regulation and liquidity requirements for banks and institutional investors with encouraging long-term investment.
- Getting intermediaries in the capital markets to facilitate the flow of funds to long-term investment.
- Developing savings and investment vehicles to allow short-term funds to be transformed into long-term finance.
- Corporation and income tax reforms, including rebalancing the treatment of debt and equity investments.

4.297 The paper also looks at the role of financial and non-financial information in allowing a long-term view, and at aligning the incentives of asset managers, investors and companies and improving engagement between them.

4.298 Although these two papers did not address identical areas of concern, they are undoubtedly related and they are indicators that fundamental changes to regulatory frameworks are still being considered that could radically affect the future for many market participants.

Directors' remuneration – quoted companies

Introduction	5001
Scope of this chapter	5001
Approval of the remuneration report	5001
Quoted companies	5002
Definition	5002
Disclosure rules applying to quoted companies	5002
Directors' and auditors' duties	5003
Location of disclosures in the annual report	5003
Notes to the financial statements	5003
Directors' remuneration report	5003
Principles applying to all disclosures required by law	5003
Qualifying services	5003
Apportionment of remuneration	5005
Disclosure in which year	5005
Substantial completion of performance measures and targets	5007
Payments made by another party to the director	5009
Exclusion of specified sums	5009
Payments to persons connected to the director	5009
Director's tax paid liability paid by the company	5009
Signing-on bonuses ('golden hellos')	5010
Disclosures required in the notes	5010
Aggregate remuneration	5011
Benefits in kind and expense allowances	5011
Gains on share options	5012
Amounts receivable under long-term incentive schemes	5013
Pension contributions	5013
Comparative information in the notes to the financial statements	5015
Directors' remuneration report	5016
Overview	5016
Interaction with the Listing Rules	5017
General rules	5017
Annual statement by remuneration committee chairman	5017
Annual report on remuneration (Implementation report)	5019
Single figure of remuneration for each director	5019
Listing Rules requirements	5022
Salary and fees	5023
Taxable benefits	5023
Annual bonus	5024
Long term incentive plans	5025
Clawback and malus provisions	5026
Pension related benefits	5026
Types of pension scheme	5027
Calculation of pension input amounts	5028
Comparatives for the single figure table	5029
Total pension entitlements	5030
Scheme interests	5034
Long-term incentive scheme for an individual	5036
Payments to past directors	5037
Payments for loss of office	5039
Statement of directors' shareholding and share interests	5040
Connected persons	5043
Share interests	5043
Other disclosures	5043
Performance graph	5044

Directors' remuneration – quoted companies

CEO remuneration.....	5047
Relative importance of spend on pay.....	5049
Statement of implementation of policy.....	5050
Consideration by the directors of matters relating to directors' remuneration.....	5051
Statement of voting at general meeting.....	5053
Directors' remuneration policy.....	5054
Introduction.....	5054
Approval of the directors' remuneration report (advisory vote).....	5054
Approval of the directors' remuneration policy (binding vote).....	5054
Revised directors' remuneration policy.....	5055
Inclusion of the policy report in the directors' remuneration report.....	5055
Future policy table.....	5056
Approach to recruitment remuneration.....	5062
Service contracts.....	5063
Policy on payment for loss of office.....	5065
Non-executive appointments at other companies.....	5067
Illustrations of remuneration policy application.....	5067
Statement of consideration of employment conditions elsewhere in the company.....	5070
Statement of consideration of shareholder views.....	5071
Further guidance.....	5072
AIM companies.....	5072
Legal disclosure requirements.....	5072
AIM Rules disclosure requirements.....	5072
Audit requirements.....	5072
Annex 1 – UK Corporate Governance Code ('the Code').....	5075

Chapter 5

Directors' remuneration – quoted companies

Introduction

5.1 Directors' remuneration is one of the most sensitive and closely regulated aspects of financial reporting. In recent times, directors' pay levels have been the subject of much discussion in the media and elsewhere, prompting a change in legislation both to increase the power of quoted company shareholders in determining directors' pay and to encourage a stronger link between pay and long-term performance.

5.2 Section 420 of the Companies Act 2006 requires all quoted companies to prepare a directors' remuneration report. Legislative changes to the disclosure requirements in the directors' remuneration report are effective for financial years ending on or after 30 September 2013. These changes are made in 'The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations' (SI 2013/1981). This statutory instrument amends Schedule 8 to SI 2008/410, 'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations' (SI 2008/410), the schedule that deals with the directors' remuneration report. No amendments have been made to Schedule 5 to SI 2008/410, the schedule that sets out disclosure requirements for the notes to the financial statements.

5.3 In August 2013, the FCA issued proposals to amend the Listing Rules to make them consistent with the new legal requirements. The effect of these proposed amendments would be to delete most of the Listing Rules disclosure requirements on directors' remuneration. The proposals, if implemented as drafted, would apply for financial years ending on or after 1 January 2014. This would mean that listed companies preparing annual reports for the year ending between 30 September and 31 December 2013 would have to comply with the unamended Listing Rules and the new legislation.

5.4 As well as changes to the disclosures required in the remuneration report, legislation now requires that shareholders have a binding vote on a resolution to approve the remuneration policy (see para 5.259). Such a resolution is required at least every three years and every time there is a change to remuneration policy.

Scope of this chapter

5.5 This chapter deals with the requirements for quoted companies in reporting on directors' remuneration in annual reports for financial years ending on or after 30 September 2013. The requirements for unquoted companies are dealt with in chapter 6, which is available online on inform.pwc.com.

5.6 Quoted companies are required to make disclosures on directors' remuneration in both the notes to the financial statements and in the directors' remuneration report. This chapter deals with definitions and principles applying to all legal disclosure requirements. It then describes the disclosures required in the notes, followed by those required in the directors' remuneration report.

5.7 Companies listed on AIM are not quoted companies for the purpose of directors' remuneration disclosure. The few specific requirements relevant for AIM companies are discussed in paragraph 5.308, but AIM companies should otherwise refer to chapter 6.

Approval of the remuneration report

5.8 Section 447 of the 2006 Act requires that the directors' remuneration report is approved by the board of directors and signed on behalf of the board by a director or the secretary of the company. [CA06 Sec 447(3)]. Also, companies are required to seek shareholder approval of the implementation part of the directors' remuneration report (an advisory vote)(see para 5.258) and of the remuneration policy (a binding vote)(see para 5.259).

Quoted companies

Definition

5.9 A quoted company is:

“...a company whose equity share capital –

- (a) has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000; or
- (b) is officially listed in an EEA State; or
- (c) is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq;

and in paragraph (a) ‘the official list’ shall have the meaning given it by section 103(1) of the Financial Services and Markets Act 2000.”

[CA06 Sec 385(2)].

5.10 So ‘quoted’ means having ‘equity share capital’ listed on the London Stock Exchange or officially listed in the European Economic Area (which includes EU Member States plus Iceland, Norway and Liechtenstein) or admitted to dealing on the New York Stock Exchange or on Nasdaq. A company whose equity share capital is not listed on any of these exchanges but has other securities so listed is not quoted. Similarly, companies listed on AIM are not quoted. The requirements for unquoted companies are dealt with in chapter 6, which is available online on inform.pwc.com. The AIM rules regarding directors’ remuneration are discussed from paragraph 5.308 onwards.

Disclosure rules applying to quoted companies

5.11 Disclosure of directors’ remuneration for quoted companies is governed by:

- The Companies Act 2006.
- Part 1 of Schedule 5 to ‘The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008’ (SI 2008/410). This is unaffected by the changes to legislation that apply for financial years ending on or after 30 September 2013.
- Schedule 8 to ‘The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008’ (SI 2008/410). This is affected significantly by the changes to legislation that apply for financial years ending on or after 30 September 2013.
- The Listing Rules of the FCA.
- The UK Corporate Governance Code (‘the Code’).

5.12 The 2006 Act clarifies that “a company is a quoted company in relation to a financial year if it is a quoted company immediately before the end of the accounting reference period by reference to which that financial year was determined”. [CA06 Sec 385(1)]. The status of the company at the end of the financial year determines whether the disclosure requirements in law and accounting standards that are applicable to quoted companies are given. If the company ceases to be quoted during the financial year, such disclosure requirements do not apply. On the other hand, if a company ceases to be quoted after the year end, these disclosures are given.

5.13 The position is different for Listing Rule disclosure requirements. Here, it is the status of the company when the financial statements are authorised for issue that determines whether these disclosures are required. Where a company delists after the year end, it is not required to comply with Listing Rule disclosure requirements.

5.14 Where a company is quoted on an overseas exchange, but has debt or fixed income shares listed in the UK, it has to comply with the directors’ remuneration disclosure requirements contained in Part 1 of Schedule 5 and in Schedule 8 to SI 2008/410. The Listing Rule disclosure requirements on directors’ remuneration apply only to companies that have an FSA premium listing of equity shares. [LR 9.1.1].

5.15 For companies that are preparing their financial statements in accordance with IFRS or FRS 102, accounting standards require disclosure of ‘key management personnel compensation’ in the notes to the

financial statements. The requirements of IAS 24 and FRS 102 differ from those contained in both the law and the Listing Rules. The requirements are considered in chapter 29 of the Manual of Accounting – IFRS for the UK and in chapter 33 of the Manual of Accounting – new UK GAAP.

Directors’ and auditors’ duties

5.16 A company’s directors have a duty to give information about their remuneration (including pensions, compensation for loss of office and sums paid to third parties) to the company so that the information can be disclosed in the financial statements. This requirement also applies to a person who has been a director of the company within the preceding five years. Any director failing to give notice of the required information to the company is liable to a fine. [CA06 Sec 412(5)(6)].

5.17 If the required information is not disclosed in the financial statements or if information subject to audit that is required to be included in the directors’ remuneration report of a quoted company is not disclosed in that report, the auditors have a duty to include the information (so far as they are reasonably able to do so) in their audit report. [CA06 Sec 498(4)].

5.18 Some, but not all, of the information included in the directors’ remuneration report is subject to audit. The audit requirements are explained from paragraph 5.315 onwards.

Location of disclosures in the annual report

Notes to the financial statements

5.19 SI 2008/410 requires that the disclosures under Schedule 5 are given in the notes to the financial statements. [SI 2008/410 para 8(1)]. These are described from paragraph 5.56 onwards.

5.20 The Schedule 5 requirements are dealt with in one of two ways: either they are given in the notes to the financial statements or the disclosures are given in the directors’ remuneration report with a cross reference to that report included in the notes. This cross-reference should be to the particular page or section of the directors’ remuneration report where the disclosure is given; it is not sufficient to cross-reference to the directors’ remuneration report as a whole.

Directors’ remuneration report

5.21 Schedule 8 of SI 2008/410 sets out the disclosures required in the directors’ remuneration report. The Listing Rules do not specify the location of its required disclosures; they can be given anywhere in the annual report. Typically, companies deal with the Listing Rule disclosure requirements in the directors’ remuneration report. The disclosure requirements for the directors’ remuneration report are described from paragraph 5.90 onwards.

Principles applying to all disclosures required by law

5.22 There are some common principles that apply in making the disclosures under Schedule 5 and Schedule 8 of SI 2008/410. These are discussed below.

Qualifying services

5.23 Most of the disclosure requirements apply to amounts or benefits received or receivable for qualifying services. Qualifying services means:

- Services as a director of the company.
- Services at any time while a director of the company:
 - as a director of any subsidiary undertaking of the company at that time;
 - as a director of any other undertaking of which he/she is a director by virtue of the company’s nomination (direct or indirect); and
 - in connection with the management of the affairs of either the company or any such subsidiary undertaking or any such other undertaking.

[SI 2008/410 5 Sch 14(1)(2), 15(1); 8 Sch 44].