UK Strategic reports: a gold standard for corporate reporting?

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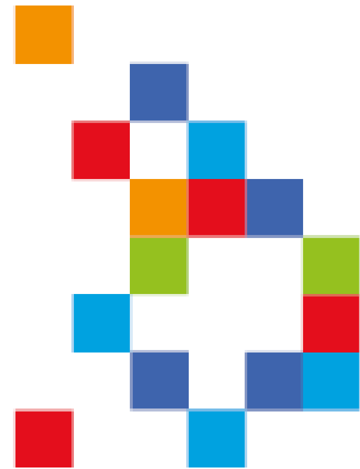
A study of British reports in the perspective of the French practice and the IIRC's framework



Report prepared by Matthieu Rispoli for Afep – August 2019

Summary

The Strategic and Director's report correspond to the United Kingdom's transposition of the Accounting Directive. Often heralded as a symbol of good reporting practices, they contain a wide range of information, both financial and extra-financial. The content elements to be disclosed in the reports can be split into two categories: information required by the Accounting Directive and additional information required by British law. The study of the former is informative of the difference and similarities in the way companies contend with a similar set of constraints, while the latter is a valuable way to get acquainted with a different perspective on certain reporting matters.

In pursuance of that goal, **the first chapter of this study deals with the information not required by the Accounting Directive** but demanded by British law:

- Strategic reports must include a Section 172 statement, which should explain the ways in which directors consider all stakeholders. **It is a sign of the ever-increasing importance of stakeholder consideration and has driven some companies in the panel to outline their stakeholder consideration process in every decision taken.**
- 90% of reports examined include one or two sections dedicated specifically to strategy. They link strategic drivers with the business model and the industry trends and factors **and serve the purpose of bridging the gap between the long-term company ambitions and the short-term business decisions.**
- British law also requires some very specific disclosures with regards to employee information and CO_2 emissions. This information is often poorly presented and sometimes located in odd places, making it harder to access. A few companies do include scope 3 measures despite not being required to do so.
- Finally, starting next year, reports will also include mandatory remuneration ratios between the CEO total compensation packages and employees' remuneration at three different levels.

The second chapter of the study explores the way companies deal with the requirements of the Directive and includes a comparison with selected French companies on several noteworthy points:

- The presentation of business model left room for improvement as far as detailing the way companies conduct their business both in France and the United Kingdom. **A recurring theme was the idea that the company's purpose is to create value not just for the shareholders but for society as a whole**.
- As regards the different risks companies are exposed to, including ESG risks, **the study found that French companies listed 50% more risks than their British counterparts.** British reports fared much better presentation-wise and included interesting information such as the macro-trend or a post-mitigation exposure assessment while French companies' description of the risks and the risks management process were more fleshed out.

- Regarding the use of Financial KPIs the study concluded that there was a relative lack of uniformization on both sides of the channel, with many companies using indicators that are industry-specific or play to their strengths. **They are however presented differently and are given more importance in British reports which most often dedicate a section to putting them into context and link them with the overarching strategy.**
- Non-Financial KPIs are used in British reports to get a grasp on specifics of a company that escape purely financial metrics. As such the dominant category found in the reports were industry specific KPIs. French reports include many more, but they are scattered across the report and not brought together in a single section. **Only 30% of British companies examined linked executive variable pay directly with a non-financial KPI against 67% of French companies in the panel.**
- Another content requirement faced by companies is the explanation of the trends and factors affecting their business. In the British companies' panel 80% had a clearly identified dedicated section relating to this disclosure obligations. The two most common recurring themes were the macro-economic outlook (and its logical effect on demand) and the geopolitical outlook**. The trends and factors are to be taken in conjunction with the company strategy to give shareholders an idea of the likely future development of the company**.

The third chapter examines the influence in the United Kingdom of integrated reporting. The International Integrated Reporting Council's (IIRC) framework was published in 2013, the same year the Accounting Directive came into force.

The UK Financial Reporting Council (FRC) notes in their guidance on the Strategic and Directors' report that "**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.** This fact notwithstanding, **the International Integrated Reporting Framework and the Guidance on the Strategic Report encourage similar qualitative characteristics and content".**

However, **not a single company in the panel** uses the format suggested by the IIRC's framework nor makes any reference to it, despite being legally required to disclose if their reports were prepared in accordance to a specific framework. **The conclusion drawn by the study is therefore that the IIRC's framework was not much of a factor in the reporting practices of the ten British companies included in the study.**

The main take-away of this study is that the current reporting framework stemming from European legislation allows for flexibility to adapt the reporting requirements to national concerns and to take into account sectoral issues. Companies strive to connect, when and where appropriate, financial and non-financial information. Moving forward, reflections to modernise reporting to ensure that it delivers relevant information would be welcome but imposing additional layers of disclosure without ensuring that the existing requirements are fit for purpose would be counterproductive.

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I. Introduction

Every year all medium and large UK companies must produce a series of reports to inform their shareholders of the performance and position of the business. Among these reports can be found the strategic report which has the purpose of providing shareholders with information that will enable them to **assess how the directors have performed their duty to promote the success of the company for the benefit of shareholders, while having regard to a series of matters**. This report provides essential context to the financial statements as well as additional insight into the company's business. It is always found at the beginning of the annual report, which highlights its key importance. It is accompanied by the directors' report, on which this study will also delve, a document that gives directors the opportunity to explain their decisions to stakeholders. Together, they comprise a wealth of information that can provide stakeholders with a clear snapshot of a company's state at a given point in time.

A comparative angle was chosen for this study. As a result, and because a large proportion of what can be found in the reports is also found in French documents, this study will not go linearly through each different parts and subparts of the documents. Instead, the focus will be on the specific parts which are of higher comparative interest, either due to the choice of presentation and content or simply because they are not in French documents. For the purpose of this study only listed companies were considered and as such the version of the reports presented are those demanding the most extensive disclosure.

❖ Legislative context

i. At European level

In 2013, the European Parliament and the Council of the European Union adopted Directive 2013/34/EU (the Accounting Directive)[1]. This directive sets the rules on the annual financial statements, consolidated financial statements, and related reports of certain types of undertakings. It introduces new standards for financial and non-financial reporting[2], which all Member States have had to transpose into their respective national law.

In articles 19; 19(a); 29; 29(a) the Accounting Directive defines the "management report".The management report's contents range from a description of the business model to both financial and non-financial key performance indicators in order to allow stakeholders to grasp the company's matters and corporate governance.

ii. In the United Kingdom

The basis for company law in the United Kingdom is the Companies Act 2006. It regulates every aspects of a company's life cycle from its inception to the possible ways for its existence to come

[1] *Amending Directive 2006/43/EC and repealing Council Directive 78/660/EC and 83/349/EC.*
[2] The Accounting Directive was amended by directive 2014/95/EU to include in the management report a non-financial statement.

to an end. As a result of the Accounting Directive coming into force it was amended to make sure UK companies were compliant with European legislation.

Parliament chose to split[3] the requirements relating to the management report set out in the directive between a document entitled the "Strategic Report" and a document entitled the "Directors Report". In accordance with the Accounting Directive, the requirement to prepare these documents applies to all medium and large companies with varying levels of stringency and disclosures requirements. Small companies are exempted from this requirement.

Both documents also contain extraneous information not required by the directive, which makes the parallel with the French practices in this realm all the more interesting. Reports are to be submitted to Companies House alongside with annual accounts for a company to remain on the registrar. A company that fails to send its accounts and reports to Companies House risks being stricken off the registrar, which would dissolve the company and make its assets Crown property. Companies must also publish the reports on their website and send it, either electronically or physically, to all shareholders and bonds holders.

Guidance on the Reports is provided by the Financial Reporting Council (FRC), an independent regulator whose task is to enforce high standards of transparency and good corporate governance to ensure a steady flow of investments into UK companies. They oversee the accounting standards by which companies operate and regulate auditors, amongst other things.

❖ Structure and Content of a Strategic Report

The exact format followed by a strategic report varies depending on the company and what it would like to underline but there are a number of common threads that can almost always be found. Lengthwise strategic reports from companies scrutinized for this study ranges from around 40 pages to over 90 depending on quantity and presentation of information. In the panel of reports the average length is 60 pages.

In terms of contents one can observe that some similar categories are almost always present:

- Reports often begin with **selected financial highlights** or "Company XYZ" at a glance. Figures from the past year are presented in the form of colorful and neat visuals with comparisons to the numbers from the last year.
- This tends to be followed by **an introduction in the form of a letter or a review by either the Chairman of the Board or the Chief Executive Officer** of the company. It is frequent to find a few statements by key persons in the company (officers, company secretary and such) throughout the strategic report.

The order of the parts that follow depends on the report and sometimes two discrete categories are conflated into one for the sake of brevity. Generally there is:

- a part dedicated to the financial performance of the company (sometimes entitled financial review) ;

[3] Prior to 2013, Annual reports already comported a Directors' report, which included a "business review" in which most of the information was included. This explains why the elements of the management report are split between the two, as some of them were already being disclosed in the director's report.

- a series of key performance indicators – both financial and non-financial ;
- a description of the company's business model ;
- an explanation of the company's strategy and objectives ;
- a list of the principal risks faced by the company (accompanied by the policies for tackling those risks) ;
- and a part relating to the employees of the company and its corporate culture.

In addition, companies often add a section on their sustainability practice.

Strategic report

Who we are	
Our business at a glance	02
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Group financial highlights	06
Operational and strategic highlights	08
Chairman's letter	10
Chief Executive's review	13
Group strategic framework	18
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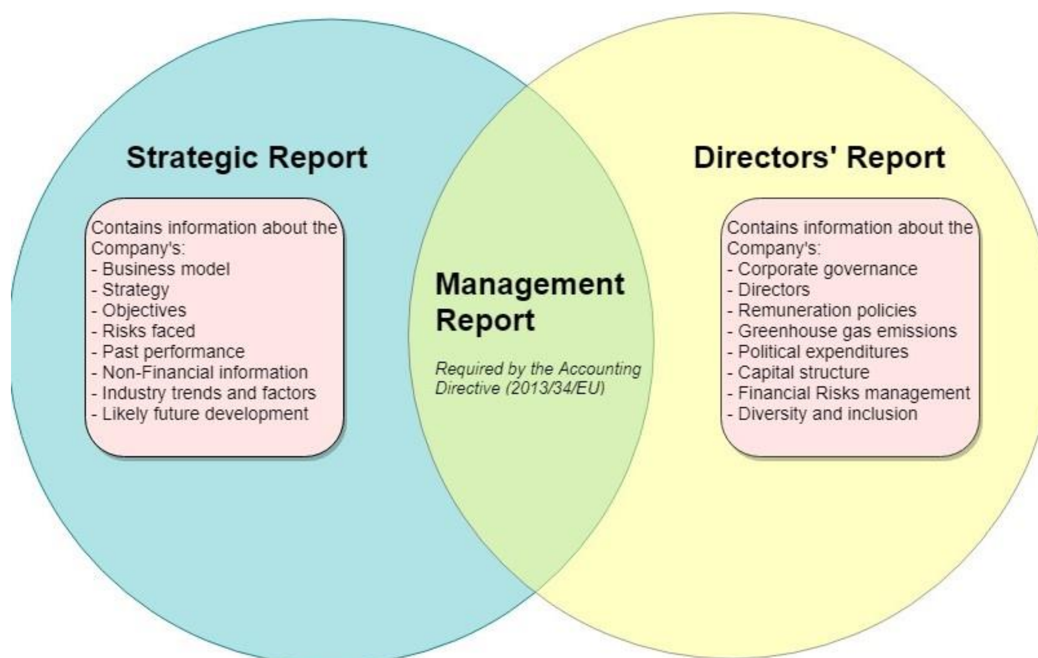
The legal requirements regarding the Strategic Report can be boiled down to **five main content-related aims**:

1) **Provide insight** into the company's business model, its strategy and objectives ;
2) **Describe the principal risks** faced and how they might affect its future prospects ;
3) **Provide relevant non-financial information** ;
4) **Provide an analysis of the entity's past performance** ;
5) Allow shareholders to **assess how directors have had regard to their duty** to promote the success of the company while taking into account environmental, social, and governance matters.

❖ Directors' report

The directors' report is always included in the governance report which follows the strategic report. Its length varies depending on how one chooses to measure it because a lot of the information that is required also appears elsewhere and as such it is not unusual to incorporate other parts of the annual report into the directors' report by reference. Thus in one instance the whole of the financial review was classified as part of the directors' report which made it around 200 pages long whereas in most cases it is somewhere between 1 and 6 pages with large sections in the rest of the report being added by reference to it.

A key point to understand is that the directors' report is to be taken in conjunction with the strategic report and in doing so forms the management report which the Accounting Directive imposes. This is illustrated in the diagram below. At a minimum it states or incorporates from elsewhere in the report the names of all the directors of the company in the past year, the dividends directors have decided (or not) to declare, a statement engaging the directors' liability if the report were to be misleading, details about the structure of the capital of the company (significant holders, special voting rights etc.), share buyback programmes, directors' interests and indemnities, political contributions by the company, activities in research and development, likely future development, diversity and inclusion policies, greenhouse gas emissions, use of financial instruments and financial risk management, significant events after the balance sheet date, and corporate governance.



Source Afep

II. Methodolody

❖ Purpose of the study and presentation of the panel:

The idea underpinning this study is to find out to what extent a similar set of constraints (i.e. the Accounting Directive) to two countries with large business sectors such as France and the UK will prompt them to come up with varying implementation. By examining a panel of large UK companies across a variety of sectors this investigation seeks to understand what the current state of praxis with regards to the obligations set out in the aforementioned directive is and how it compares with what similar companies in France, namely Afep's members, are doing. By taking a comparative approach across sectors and between countries the study will highlight similarities and differences in the approach to compliance and hopefully gain some insight that is relevant to large French companies.

In addition, close attention will also be paid to the additional information required by the Companies Act 2006. This will allow readers to get the British perspective on financial and non-financial disclosure regulations as well as a clearer picture of how companies cope with different regulatory burdens. In order to do so this study examines several UK-specific disclosure obligations.

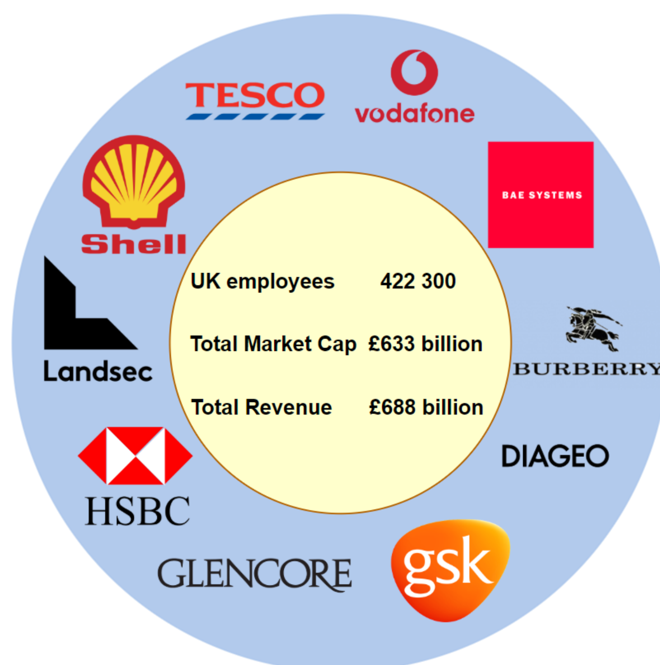
For the purpose of this study a panel of ten major listed UK companies was chosen. **They are the companies facing the highest disclosure requirements, which means that their reports will be the most thorough and informative, and they have a similar profile to that of the majority of Afep's members.** Moreover, a wide variety of sectors was included to make the study more representative.

The ten selected UK companies are :

Company	Market Cap (£, bn) July 31st, 2019	Employees (UK)	Revenue (£, bn)
BAE Systems	15,8	34 100	16,8
Burberry	9,5	5 000	2,1
Land Security	6,3	700	0,7
Diageo	81,3	8 000	12,2
GlaxoSmithKline	80	15 000	30,8
Glencore	38,2	1 000	175
HSBC	135,5	39 000	43
Shell	209,5	6 500	312
Tesco	22,8	300 000	57
Vodafone	34,4	13 000	39
Total	633,3	422 300	688,6

Source: Annual Reports[4] for Employees and Revenue and London Stock Exchange for Market Cap

[4] *Annual reports published between May and September 2018 for all companies except for Landsec, Tesco and Vodafone who filed between May and September 2019.*



Source Afep

Taken together these ten companies have a total market capitalization of over 600 billion pounds and employ almost half a million people in the UK alone. Their total revenue is close to 700 billion pounds.

❖ French companies selected for the purpose of making comparisons

While this study is far from a point-by-point comparison of the current state of practice in France and in the UK, it was written with a comparative perspective in mind. As such, some sections will be followed with a short, albeit hopefully informative, comparison with what French companies of a similar size to those in the panel are doing. The companies used to make the comparisons are not singled out in the comparative sections but for the purpose of transparency it appears important to disclose them. **To avoid detracting from the focus of the study, namely the practice of the Strategic Report, the panel of French companies selected is smaller :**

Company	Market Cap (€, bn) May 31st, 2019	Employees (France)	Revenue (€, bn)
LVMH	171	31 156	46,8
Pernod Ricard	41,8	2 687	8,9
Safran	48	44 492	21
Sanofi	90	25 215	34,4
Société Générale	18	57 639	25,2
Veolia	11,7	50 480	25,9
Total	380,5	211 669	162,2

Source: Documents de reference 2018 for Employees and Revenue and Euronext Paris for Market Cap

III. The Strategic and Directors' report: a different model of corporate reporting?

In this chapter the study will examine some of the notable information found in the British reports but not explicitly required in the accounting directive: explanation of company strategy; information on company governance and executive pay ratios; statistics on the company's workforce; political expenditure disclosures; mandatory metrics for emissions disclosure.

The responsibility to prepare these reports lies with the directors. Some cultural differences do exist however with the French *administrateurs*, and the two terms are not exactly synonymous. Every single company that is registered in the UK is required by law to have at least one director if it is private or two directors if it is public. In addition, the duties of the director are laid out explicitly[5] to a degree of legal rigidity that is not found in French law. Chief among these duties are care and loyalty. The directors are beholden not only to the shareholders, but to the whole of the company members, which includes employees as well as other stakeholders.

British law states that it is a duty of directors to prepare a strategic report **if the company they are a director of is not exempted under the small company provision**[6]. Failure to comply is an offence which makes every director who failed to take all necessary steps to produce the required report liable. This liability can translate into an unlimited fine[7], meaning the amount is to be decided by the judge on summary conviction. Moreover, if a report is found to contain material misstatements that are the result of negligence on the part of a director and that create a loss for the company, **the director can be liable to reimburse the company for the losses incurred.**

❖ Section 172 statement

A new regulation[8] was approved by Parliament in 2018 and is coming into force for financial periods starting on January 1st, 2019. As such it will apply to reports published in 2020 but some companies have chosen to comply a year early. It requires boards of directors to make a statement acknowledging their regard for their duty under section 172 of the companies Act 2006. This requirement applies to all large companies, whether privately held or publicly listed, and to public interest entities.

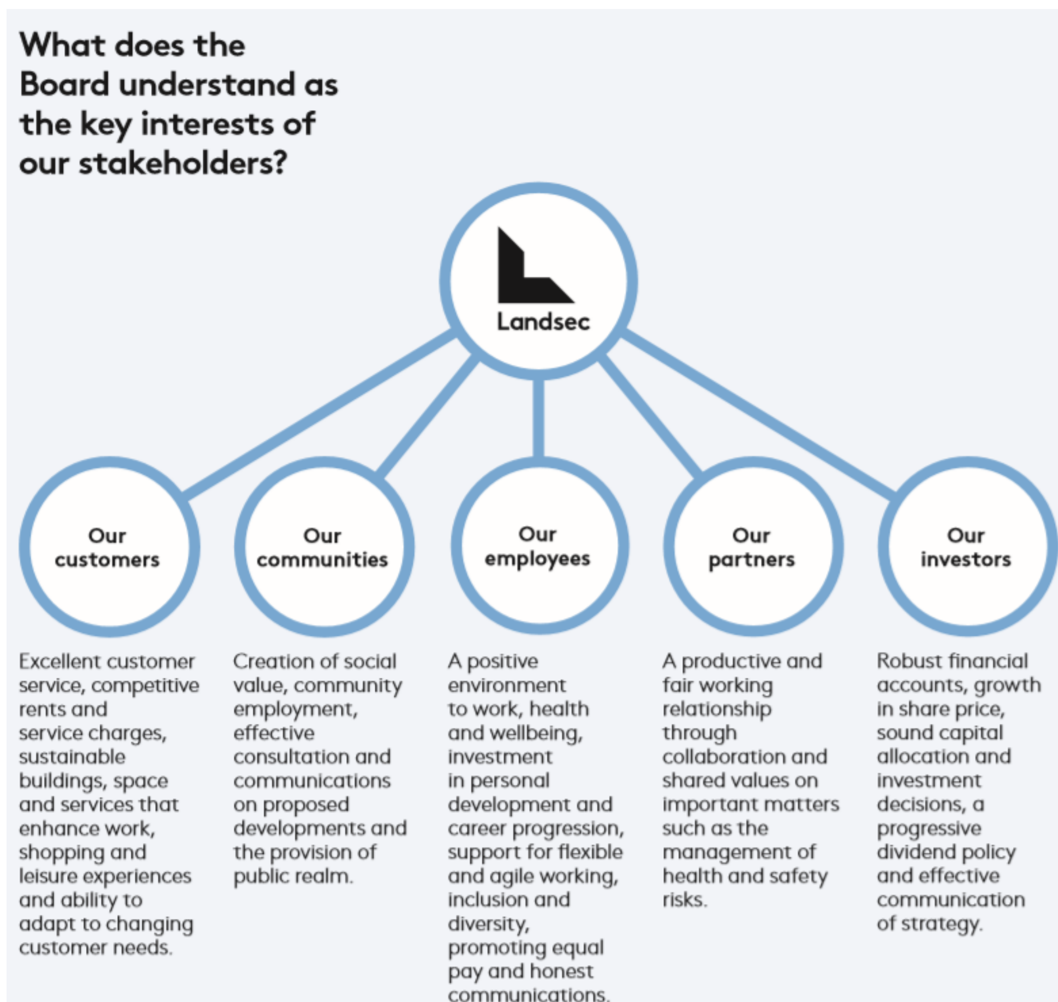
"***A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole,*** *and in doing so have regard (amongst other matters) to –*

- *the likely consequence of any decision in the long term*
- *the interests of the company's employees*
- *the need to foster the company's business relationships with suppliers, customers and others*

[5] *Companies Act 2006, section 171 to 177*
[6] *Companies Act 2006, 414A*
[7] *Companies Act 2006, 414C ; 414D*
[8] *The Companies (Miscellaneous Reporting) Regulations 2018*

- *the impact of the company's operations on the community and the environment*
- *the desirability of the company maintaining a reputation for high standards of business conduct*
- *the need to act fairly as between members of the company."*

This clearly illustrates that the directors in the UK are seen more and more as having a duty towards society as a whole and not merely the shareholders. It fits within the general trend of pushing for more and more corporate social responsibility from corporates and the preference for long-term thinking. Interestingly in the panel **Landsec chose to take on this requirement one year in advance** and has devoted a section to explaining how the directors have fulfilled their section 172 duty. This two-page section is full of information on the actions taken by the board to inform members of the company of news that are relevant to them as employees or stakeholders. It encompasses a wide range of stakeholder engagement such as consultations and meetings with members of the company. Landsec clearly aims to be a leader in this regard and now includes a section on stakeholder consideration in every paper presented to the board, to investment committees, or published by the company. Both management and the board are also receiving training on corporate purpose and stakeholder consideration in the decision-making process.



Landsec taking into consideration all stakeholders

❖ Strategy

Part of the info required to be disclosed according to the Companies Act 2006 relates to company strategy. In practice companies have interpreted this requirement in a variety of ways. In the panel for instance, 10% chose not to have a specific part outlined for this purpose in the table of content, 60% had one dedicated part, and 30% had two. It can also be noted that the name choice for the section (or sections) that relates to strategy is very telling of the content. In many cases it is conflated with the likely future development of the company to paint a picture of the firm's objectives for the near future and how the directors plan to reach them. GlaxoSmithKline, the lone company which did not have a section for the purpose of explaining company strategy, took the opposite approach and developed its strategy in their industry trend section.

In other cases, it is used to showcase the strategic drivers (also called growth engines), the different axis around which the business is built and thrives. This approach is complementary with the presentation of the business model and of the markets that is often also included in the strategic report. This second dimension is why three companies in the panel had two whole sections dedicated to their strategy. It allows them to flesh out their operations in more concrete terms and to provide examples of past achievements in line with the company strategy. Investors, prospective or current, and stakeholders are the target audience that companies seek to impress with these examples. Diageo will be used to illustrate this point. **In its report the alcoholic beverages company puts forward a multifaceted strategy that touches upon both business and ESG matters.**

1: Diageo's strategy in action - business matters

Diageo's strategy in action - ESG matters

It tends to be integrated very well with the rest of the report as companies use their strategic orientation as a framework within which to operate. As a result**, it often serves the purpose of bridging the gap between the long-term company ambitions and the short-term business decisions**.

It is also interesting to note that **only some companies chose to supplement their strategic aims with precise metrics to measure their success**. Those that did simply provided figures that supported their strategy and underpinned it with facts and figures. In this case this information serves as a complement to provide some context. Alternatively, some companies chose to disclose the thresholds they are trying to attain with their strategy. In this case the figures are objectives and allow for an assessment of the extent to which strategy implementation has been successful.

	STRATEGIC PILLARS AND HOW WE WILL ACHIEVE THEM		AMBITION	KPIS AND OTHER MANAGEMENT MEASURES
REVENUE DRIVERS	PRODUCT	• Create a new, strong, fashionable product offer • Transform leather goods • Continually engage the customer • Develop outfitting • Rebalance the price architecture	• High single digit top-line growth* • Vast majority of sales from luxury distribution channels	• Revenue growth*^ • Comparable sales growth*^ • Product sales growth* • Geographic sales growth* • Channel sales growth* • Number of outlets • Adjusted operating profit growth^* • Adjusted profit before tax growth^* • Adjusted diluted EPS growth^ • Adjusted retail/ wholesale ROIC^
	COMMUNICATION	• Product first • Content revolution • Focus on experiences		
	DISTRIBUTION	• Enhance the luxury store experience • Elevate customer service • Grow proportion of image-driving luxury doors		
	DIGITAL	• Content curation and storytelling • Personalised luxury services • Seamless omnichannel experiences • Accelerate digital partnerships		
	OPERATIONAL EXCELLENCE	• Simplification and efficiency • Adapting our supply chain • Investments in technology • Drive procurement savings	• Meaningful operating margin expansion*	• Adjusted operating profit margin^ • Achieved cost savings • Adjusted opex to sales ratio

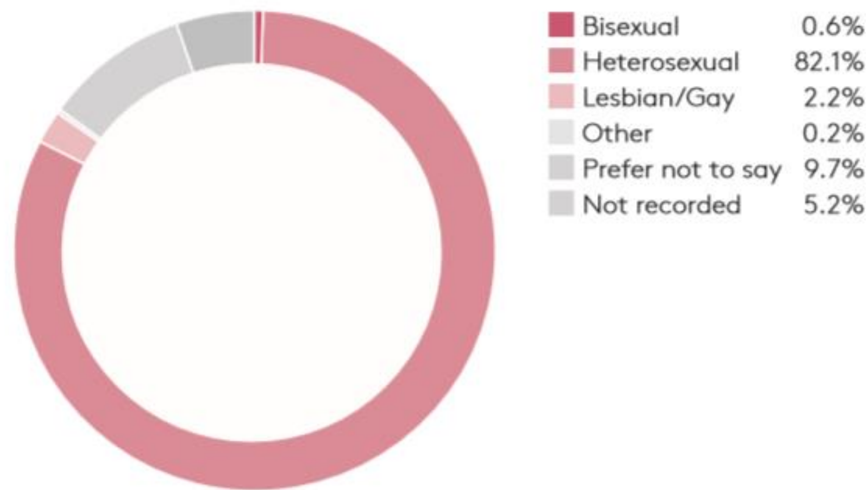
Integrating Strategy with long term goals and KPI - Burberry

Out of the panel, 30% chose to include metrics right in the strategy section, 50% chose to follow it immediately with the KPI section and provide the indicators used by management internally to assess success in the areas of greater strategic importance. This is yet another instance of good integration between different sections of the strategic report and serves to link strategic objectives with tangible achievements or aims.

Burberry is the only company in the panel that decided to justify its strategy by explicitly fleshing out its rationale.

❖ Employee information

The Companies Act 2006 makes it mandatory for companies to disclose information relating to their employees and notably a breakdown by gender of the employee population at different seniority level. As of yet there is no consensus between companies on how to deal with this requirement and as such this information is disclosed in very different ways. Half of the companies in the panel have a section entitled something akin to "our people" where they share information about the employees of the company. This is used to broadcast the good practices put in place to guarantee an inclusive workplace and can in some occasions include fairly personal information that one would not expect to find in such a document. One illustration of such information about employees can be found in Landsec's report as seen in the following illustration.



Example of employee information – Source Landsec

In other reports, the presentation of gender repartition at different seniority level is found in less intuitive places. One example, among several in the panel exhibiting comparatively lower maturity in that respect, is Tesco. Their breakdown is located in a section entitled "Little Help Plans" and under a subsection not indicated in the table of contents. Perhaps one explanation is the awkward makeup of their more senior level employees, which they are not looking to publicize.

Gender diversity (based on actual year-end headcount)	Male		Female	
Board of Directors	10	77%	3	23%
Senior managers – Directors	353	75%	117	25%
Senior managers – Directors and managers	2,646	63%	1,524	37%
All employees	189,097	43%	251,561	57%

Gender diversity at Tesco

Despite a majority of employees being women, they make up a quarter or less of the most senior positions and the board.

At the other end of the spectrum, a company like Burberry has elected to disclose this information in their governance report. They are the company in the panel where women are the most represented, being the majority at both employee and senior employee level and having four out of ten board seats.

The most natural place to report this information would be a section devoted to the employees of the company, which half of companies in the panel have chosen to do. One can note that the companies that place this information in different sections are not always those that have the most unbalanced figures.

Companies also take different approaches to explain the discrepancies in gender representation at different seniority levels. For Shell, Tesco or HSBC no justification at all is provided, whereas BAE systems explained the chasm as being the result of difficulties to recruit women from a STEM (science, technology, engineering, math) background to senior positions. Glencore is incorporated in Jersey and as a result did not need to disclose that information and decided not to do so.

❖ Political expenditure

By law the directors' report must contain a subsection outlining the political donations and expenditures incurred by the company. The definition given by the Companies Act 2006 of what constitutes a political donation is very broad and as such it is common practice amongst large corporations to seek board approval for political donations in order to be covered in case an "accidental" donation were to happen. However, in practice large companies rarely make political contributions and out of the ten companies only Diageo had made one in 2018. Even then it was rather small (less than half a million dollars) and to American politicians where the practice is much more prevalent.

It is also interesting to note that out of ten companies only GlaxoSmithKline chose to disclose its lobbying activities in Washington D.C and Brussels. The total amount disclosed between the two cities totaled over 5 million dollars spent to represent their interests. This is likely to be due to the pharma industry's very high exposure to regulations, which can significantly impact a firm's revenues.

Even during years of greater political significance, such as when a general election occurs, companies in the panel almost never made any political contribution to political parties. The only political expenditures that can be found tend to relate to the sponsorship of non-partisan events and are rather negligible sums.

❖ Mandatory metric for disclosure of annual emissions

The Companies Act 2006 was amended in 2013 to introduce a regulation on mandatory emissions disclosure in the strategic report[9] . The new regulation makes it compulsory for large companies such as those in the panel to calculate and report on two different metrics known as scope 1 and scope 2 emissions. These two metrics are calculated in metric tons of carbon equivalent, which is the amount of carbon necessary to produce a given volume.

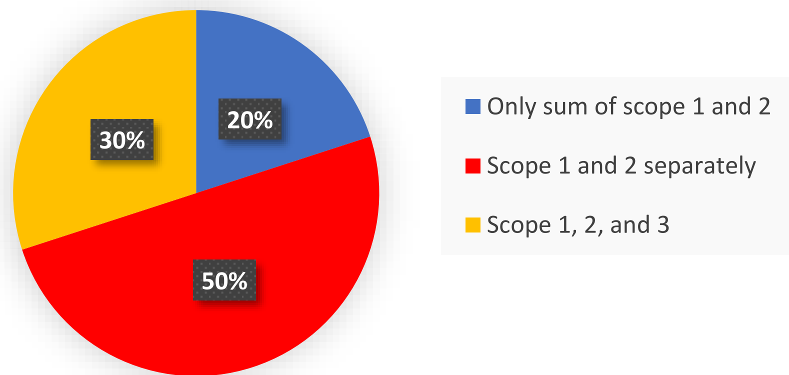
Scope 1 emissions relate to the combustion of fuel and the operation of facilities. They are what is traditionally associated with companies emitting pollution.

Scope 2 are electricity, heat, and cooling bought for own use. It is a broader category that helps represent the emissions caused by less carbon intensive businesses. The two scopes need to be presented independently and as a sum. The figures from the current year are to be compared with the figures from the past few years in a chart.

[9] The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013

Scope 3 is more and more often included as well but is not yet mandatory. It covers all other indirect emissions that occur in a company's value chain. As it is not mandatory (and thus disclosures are not regulated), companies are free to choose which of the 15 categories of Scope 3 emissions they would like to include. In the panel this is most often the emission of carbon dioxide related to business travel by employees.

Guidance on these different scopes is given by the Greenhouse Gas Protocol but not all companies in the panel have chosen to explicitly reference it, despite the GHG Protocol being cited as the model to follow in the Companies Act.

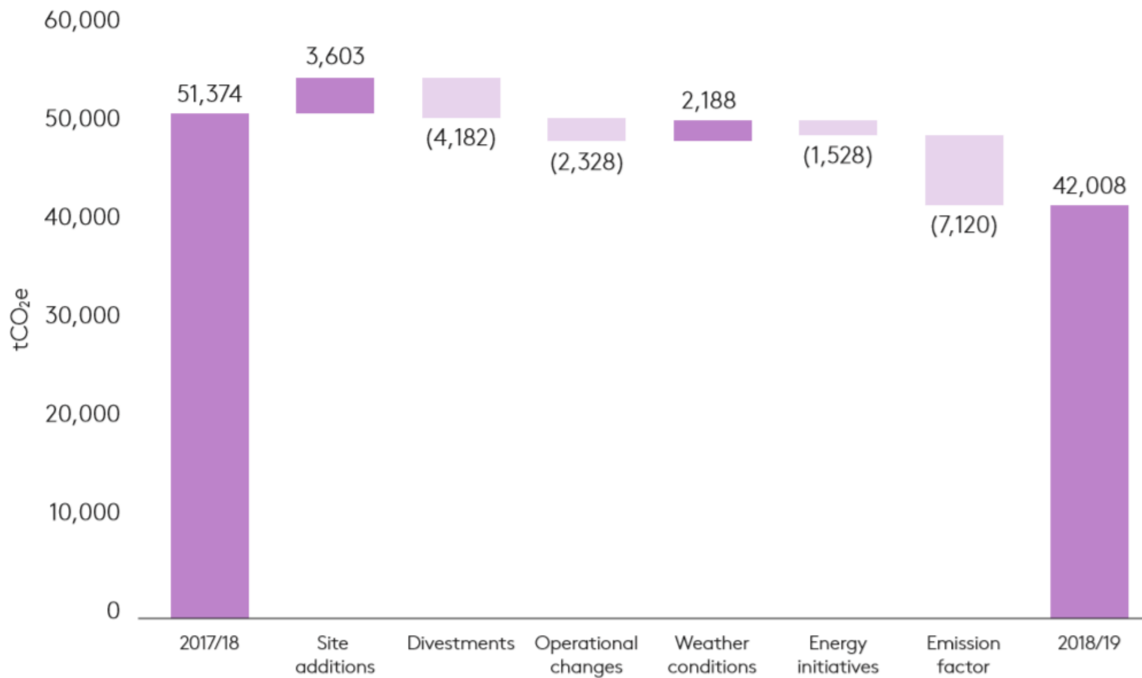


Breakdown of CO_2 emissions disclosure in the panel – Source Afep

By adding up all this information and dividing it by the number of employees one can have a clearer idea of the extent of a company's greenhouse gas emissions but this particular metric is not always disclosed. As an example, in the panel it can allow for a comparison between companies, such as Bae Systems and HSBC. The quantity of metric tons of carbon emitted by employee is a tad under 2.5 for HSBC and at a massive 14 for BAE systems. This is of course logical considering their respective economic activities, but it is still an interesting metric and allows even a complete layman to make comparisons. This information allows stakeholders to easily understand that a company like BAE systems for instance, is disproportionately polluting relative to its size, whereas HSBC benefits from having a large workforce in many countries where energy is cheaper. To put BAE systems in perspective, the amount of gas emitted per employee by this company is much higher than the average carbon footprint of a French citizen at 5.1 metric tons.

This information can be displayed in different parts of the report and almost never receives its own section, despite being a legal requirement. Some opted to only include it very briefly in the description of the business model or at the end of the strategic report by specifying that it is a mandatory disclosure requirement. HSBC is alone in putting it in the directors' report and gives very little context to its figures apart from explaining their methodology. Only three companies have made the logical choice to include this chart in their sustainability review section. The logical conclusion is that companies are allowed a lot of latitude when it comes to this requirement, something that goes against its purpose and allows for a degree of obfuscation.

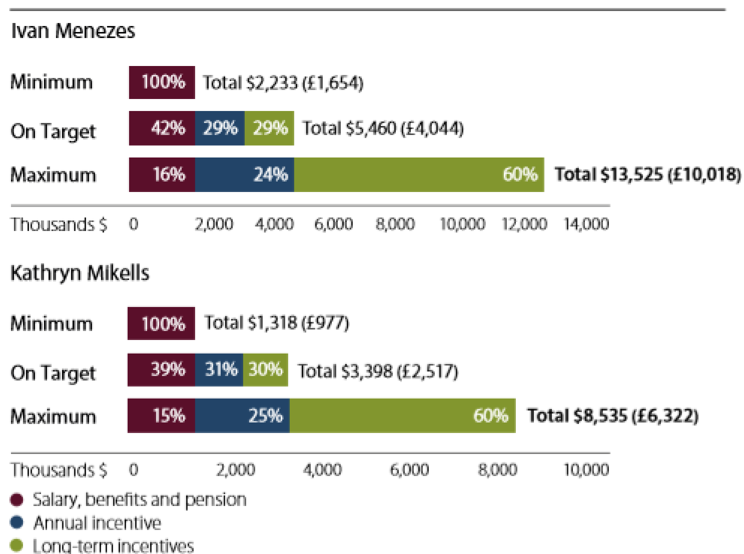
The most detailed information is provided by LandSec who not only disclosed the required information but provided context and insight into the evolution of its figure. One good example is the graph we've included below that explains where the firm managed to reduce emissions and where on the contrary emissions increased.



Landsec is a leader in GHG reporting

❖ Directors' remuneration report

Every year publicly listed companies in the UK must include a directors' remuneration report in their annual report. This section gives the detail of the remuneration of directors, which is to be voted on every three years at the latest, and of the most senior executives in the company (generally the CEO and the CFO). It breaks down the different fees to be paid to directors and specifies the amount paid out to every single one of them during the year. For executives it explains which part of the remuneration is fix and which part is variable and links the variable part with the tangible objectives to be achieved.



2: impact of 3 scenarios on the remuneration of Diageo's top executives

One can see that for the most senior positions the results of the company have a tremendous impact on total remuneration. The reasoning being that those in leadership positions should have the remuneration that is most linked with company performance as their decisions have the most critical impact.

Changes introduced by the recent Companies (Miscellaneous Reporting) Regulations 2018

For reports to be published starting in 2020, the remuneration report will now have to comport ratios comparing the pay of company employees at three different remuneration levels and that of the chief executive. **The value taken for the chief executive is the total single figure, which considers the fixed and the variable part of the remuneration package, as well as the benefits (healthcare, retirement and so on)**. This is compared with an employee representing the first quartile of remuneration in the United Kingdom, an employee at the median, and an employee at the 3rd quartile (25%, 50%, 75%). In order to do this, companies are allowed to choose between three authorized calculation methods but must in any case compute their employees' remuneration in full time equivalent (meaning that part time employees' remuneration is recalculated to correspond to what they would earn working full time). Companies will henceforth have to include these 3 ratios and a comparison year-on-year that will eventually go back a decade. Any changes in these ratios will have to be explained. A few companies have taken it upon themselves to comply with this requirement a year early and as such an example from the panel is included for illustration's sake:

The total pay and benefits of UK colleagues at the 25th, 50th and 75th percentile and the ratios between the CEO and these colleagues, using the CEO's single total remuneration figure for 2018/19 of £4,600,000, are as follows:

	25th percentile pay ratio	50th percentile pay ratio	75th percentile pay ratio
Total pay and benefits (FTE)	£18,646	£20,364	£21,982
CEO pay ratio	247:1	226:1	209:1

Tesco pay ratio voluntary disclosure

One can wonder how informative this new disclosure requirement really is. Most of a CEO's remuneration comes in the form of various bonuses and incentives which are linked with the performance of the company as a whole. **It follows that not only these ratios do not tell one much about the gap in remuneration between top executives and the rest of the workforce as their compensation are structure very differently, but also that it risks being misleading.** For instance, if a company has a good year then it is likely to hire more staff to keep up with demand, which drives the average employee pay down (as most new hires will make less than the company's average salary), and to give large bonuses to the CEO thus embiggening the pay ratio. On the other hand, if a company has a bad year, they will have to close down stores or factories and let employees go, which drives the average salary in the company up (assuming most employees being let go make less than company average which seems reasonable). The CEO, however, will not receive bonuses and incentives and his total remuneration will come crashing down. Thus, one can reasonably expect the chasm in remuneration to grow during good years and narrow during bad years despite one's first instinct to believe that a trend of reduced ratios year-on-year would be a good thing.

IV. The Strategic and Directors' report in perspective

In this chapter the study will examine some differences and similarities with the French practice in fulfillment of requirements of the Accounting Directive.

❖ Description of the Business Model

According to the Accounting Directive the management report, and as such the UK strategic report, must contain a brief description of the entity's business model. This requirement entails for companies to explain to stakeholders at large a general picture of what services or goods they produce and in what sectors. In order to understand the avenues through which the company earns its income a certain number of key information are disclosed. Generally, this includes at a minimum an overview of the different sectors in which the company does business, sometimes accompanied by a breakdown of revenue coming from each different segment.

A recurring theme in the presentation given by companies of their business model is the idea that the company's purpose is to create value not just for the shareholders but for society as a whole. 80% of companies in the panel cited stakeholders such as the consumers or the suppliers when describing who their business model worked for. One simple explanation is the general trend in the recent years of associating companies to the larger environment within which they operate to reconcile economic and ESG objectives and promote long-term thinking. In addition, the FRC amended the guidance on Strategic Report in the last edition to encourage corporates to present their business model from more than the purely financial vantage point. This is also seen clearly in the section 172 requirement on which a different section of this study delves into more detail.

This content objective of the Companies Act leaves a lot of room for improvement. No real insight is given into how companies actually operate, and it comprises mostly boilerplate statements on the different economic activities that make up a company's business.

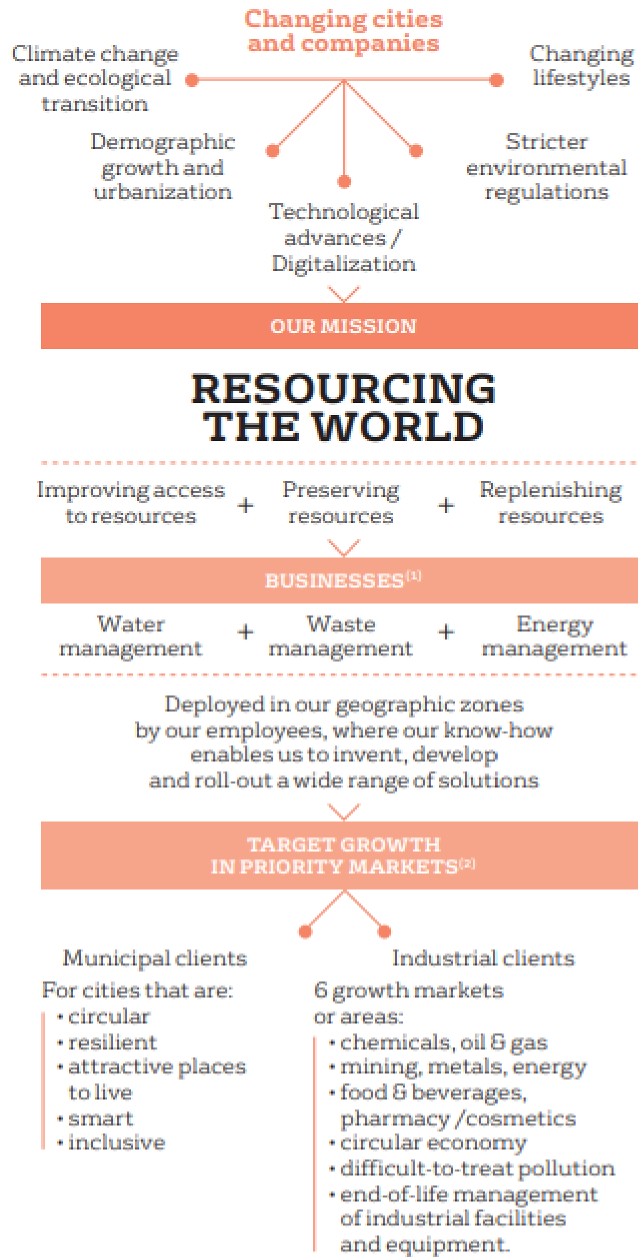
In 80% of the panel this section contains references to the company values, which underpin the business model. However, these values are not informative because all companies across the panel refer to the same few values: innovation, consumer loyalty, service, trust and so on, which are staples of good business practices but not very telling of the circumstances of any particular company.

Vodafone's business model

❖ Comparison with France – Business Model

In French reports examined for the purpose of this comparison, a section specifically outlined as describing the business model could only be found in a third of the panel. Indeed, what most companies tend to do is have a presentation of the key activities from which they create value followed by or conflated with a general overview of company strategy. These business reviews were well done and give a clear picture of the different ways a company generates income but cannot be said to be a description of the business models *per se*. This is a similar outcome to what came out of the British panel where only some of the companies truly tried to present their "model" rather than just list their different activities. What was lacking was the rationale linking the ways these companies make money and the strategy. Those companies also tended not to include their ESG objectives or their views on stakeholder considerations in the presentation of their economic activities, unlike their British counterpart.

Two companies however did attempt to present their business models in a different way. Like their British counterparts both companies made references to working for all the stakeholders and not merely their shareholders and employees, as well as claimed to be inspired by very general and positive values. The most salient difference was that these principles were actually supported by an actual explanation of the way these companies conduct business. Clear links were established between the overarching strategy of the company, the different sectors it is involved in, and the organizational structure in which the decision-making process takes place. Another welcome bit of information subsumed under the presentation of the business model presented the different markets and clients in connection with the different approaches tailored by the company to service them.



Veolia is one of the few French companies to explicitly detail their business model

❖ Risks

The Accounting Directive requires companies to disclose "*a description of the principal risks and uncertainties that it faces*"[10] , as well as the steps they take to mitigate them. By looking at the panel one can see that **large British companies have taken this obligation to heart and disclose an average number of 10.88 risks**. They have chosen a variety of different approaches to this exercise and this investigation will now take a closer look at the different practices within the panel.

As a rule of thumb, companies tend to begin this section of their report with an overview of the different risks they are facing. Almost always this also includes a note on the trends relating to those risks in the context of the past year and of the foreseeable future. Categories like financial risks can be drastically influenced by the broader geopolitical context (i.e. Brexit) affecting the exchange rate of the Sterling. This makes assessing their evolution over time much easier than with categories like people risks which are basically unaltered by external factors. All but one company in the panel have chosen to present the risks in the form of a list in some sort of chart accompanied by mitigating actions or factors. It is also interesting to note that two main approaches seem to coexist in the organization of the information. **Half of the panel has chosen to group the risks by categories with themes like internal risks; external risks; financial risks; sustainability risks; compliance risks; operational risks**. HSBC uses an internal/external distinction whereas Burberry and Vodafone use a four-category approach. **Apart from Shell, the other half of the panel has matched identified risks with their strategic drivers to better highlight how the risks are being considered in strategic decisions**. This is also sometimes accompanied by a risk management framework that goes into greater length about the different existing safeguards in the company. When that is the case each risk presented is accompanied by an assessment of the impact of the mitigating actions on the severity of the risk. The companies in our panel did not match the risks identified with opportunities.

[10] Directive 2013/34/EU article 19

Word cloud of Burberry's risk section, weighted by occurrence

One more compelling aspect of the risks presentation in British report is the assessment of risk trends. **In 70% of the reports in the panel companies have estimated whether the severity of the risks had increased, remained stable, or decreased**. For example, most companies now believe that the macroeconomic risks are higher now than they were in previous years due to rising political instability in the UK.

Principal risk	Risk movement	Key controls and mitigating factors
Brexit.† Failure to prepare for the UK's departure from the EU will cause disruption to and create uncertainty around our business, not least our ability to recruit and supply to our customers. Any disruption or uncertainty could have an adverse effect on our business, financial results and operations. 1 2 3 4	Uncertainty around our departure from the EU has continued to grow as a result of the political deadlock.	With the UK's future trading relationship with the EU still to be determined, we continue to contribute to important public policy discussion and engage with government, regulatory bodies and industry. During this process, we will continue to assess and monitor the potential risks and impacts on Tesco customers, colleagues and shareholders, while taking appropriate mitigation measures to address challenges including logistics, staff and supply. This year we put in place a detailed Brexit contingency plan against political and macro-economic changes that could have a material impact on our market and customer proposition.
Tesco Bank. Tesco Bank is exposed to a number of risks, the most significant of which are operational risk, regulatory risk, credit risk, funding and liquidity risk, market risk and business risk. 1 2 3	The Bank continues to actively manage the risks to which it is exposed.	The Bank has a defined risk appetite, which is approved and reviewed regularly by both the Bank's Board and the Tesco PLC Board. The risk appetite defines the type and amount of risk that the Group is prepared to accept to achieve its objectives, and forms a key link between the day-to-day risk management of the business and its strategic priorities, long-term plan, capital planning and liquidity management. Adherence to risk appetite is monitored through a series of ratios and limits. The Bank operates a risk management framework that is underpinned by governance, policies, processes and controls, reporting, assurance and stress testing. There is Bank Board risk reporting throughout the year, with updates to the Tesco PLC Audit Committee by the Bank's Chief Financial Officer, Chief Risk Officer and Audit Committee Chairman. A member of the Tesco PLC Board is also a member of the Bank's Board.

Risks presentation can include both macro-trends and post-mitigation exposure assessment - Source Tesco

i. ESG risks

Very surprisingly only 60% of the panel chose to disclose risks related to the environment. In addition, out of the average 10.88 risks disclosed less than 1 relates to this topic. Even if when the study excludes from the calculation the 40% of companies that do not present sustainability related risks the average number of ESG risks presented is only of 1.33. These numbers are very low when one considers that both the Directive 2013/34/EU and the Companies Act 2006 explicitly demand that the principal risks related to ESG in connection with company operations be disclosed. Social and Governance matters are only mentioned by a measly 30% of the panel, with GlaxoSmithKline being the only company that identifies a governance risk (corruption and bribery).

These figures can be explained by companies choosing to focus on material risks with actionable, pragmatic solutions for which they can present straightforward mitigation processes. Often, they choose to tackle ESG topics in different parts of the annual report such as in the governance section or in the business model description. This allows them to present these matters not as risks to the business but rather as important issues that the company is working to tackle. One illustrative instance of this phenomenon can be found in HSBC's annual report. A large part of their business model presentation is devoted to showcasing in great detail how they are actively fighting climate change by providing and facilitating funding for the transition to a sustainable economy, but their risk assessment section does not contain any environmental risks.

The company that chose to disclose the most risks related to the environment is Glencore PLC, a mining company, whose activity has obvious environmental impacts.

ii. Financial risks

100% of the companies in the panel made mention of several financial risks. Being large companies, they conduct business in many different locations that use many different currencies. It follows that they pay close attention to macroeconomic conditions that could influence the exchange rate of the Sterling. All the companies in the panel mention the possibility of Brexit and the adverse impact this could have on the company's material situation (in their risk assessments for example). Interestingly the forecasted impact of Britain's exit from the European Union varies quite a lot depending on the sector in which the company operates. Some companies face operational challenges (detailed in the next section) and others like Diageo or Burberry are most concerned with volatility in the exchange rate which could affect customer spending and their revenues.

Another requirement made in the Directive 2013/34/EU and transposed as is in the Companies Act 2006 is an evaluation of the company's exposure to price, credit, market and liquidity risk. If companies were to follow the legal texts strictly, they would have to include this information in the strategic report but strict adherence to this varies.

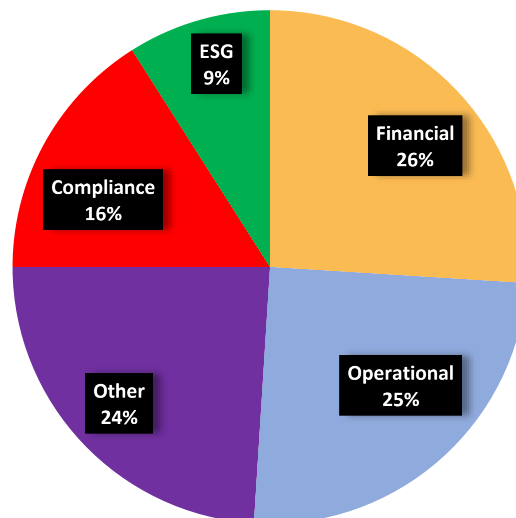
Some have chosen to fulfill this requirement inside of the risk section of the strategic report whereas other companies incorporate by reference to the strategic report information given in the notes to their consolidated financial statements.

No matter which approach is favored all the companies in the panel have produced a very similar output when it comes to presenting the risks. Companies must also present their financial risk management strategy with regards to the four risks already mentioned. In this regard their approach is also similar and mostly only varies on the mix of financial instrument used to hedge the financial risks (maturity etc.)

iii. Other risks

Other risks represent at least half of the risks listed for all the companies in the panel. They encompass a broad variety of **operational** and **compliance** risks. Among these a few are recurring such as the exposure to cyber-crime or people risk. Companies use this occasion to promote their internal risk management system and investments. One can also note that some companies that operate in particular industries have risks of their own that are more acute for them than for most companies. Burberry, for instance, being a luxury fashion house must pay very close attention to its intellectual property upon which the value of its brands is founded. Another interesting example is BAE systems which is particularly sensitive to the political situation in all the countries where it operates. A change in leadership in any country where it has manufacturing facilities or where it imports parts from could prevent BAE systems from conducting business with Saudi Arabia by suspending their export license. Finally, Brexit comes with its share of operational quandaries, Tesco or Vodafone for example are worried about disruption in their supply chain as they import a lot of goods and parts from the continent.

Risks disclosed - UK



Source Afep

❖ Risk management policies and due diligence

Companies also have the duty to explain to their stakeholders how they manage these different risks and the due diligence processes involved in that regard. To fulfill this requirement, two different and complementary approaches can be identified. Companies tend to integrate the mitigating actions they take to counter the risks they are exposed to directly in their risk disclosure sections. Each different risk identified is matched with the actions taken by the company to minimize the potential impact. In some cases, such as with Glencore, an assessment of the threat level posed by the risk before and after mitigation is even offered. The actions undertaken by the companies vary greatly as to how tangible they are. In the realm of financial risks companies' disclosure are very material and concerns things such as the different maturity level of their liabilities or their hedging strategies for things such as varying interest rates. **It is mandatory to include market risk, credit risk, cash flow risks, and liquidity risks.**

However, when it comes to risks that are less material, companies tend to disclose risk management policies which are not very practical. In areas such as people risks, or compliance risks the policies have more to do with restating that the board and executives pay great attention to these matters or that they care about good corporate governance. As a result, they are not very informative.

The second prong of the risk management disclosures framework employed by most companies is to present their risk management due diligence. This allows them to showcase the processes in place at the senior leadership level to assess what is going on in the company's environment. **At the very least, risk management typically entails identifying the risks, taking preventive actions or remediating identified weaknesses, and monitoring the outcomes of the risk management process.**

This can be done in a variety of ways. In the panel, 4 companies[11] have a risk committee in their board, which meets several times a year to discuss the threats facing the company. The agenda at these meetings necessarily includes a variety of ESG issues and allows the board to take them into consideration. In addition, they also underline the principles driving their strategic decision making with respect to the risks they are exposed to. This can be useful to assess a company's risk appetite and ascertain how it will conduct future business.

[11] GlaxoSmithKline, HSBC, Tesco and Vodafone

Risk management and principal risks

Our Performance Ambition calls on us to be bold and to act like owners. Well managed risk taking lies at the heart of this. Great risk management drives better commercial decisions, creating a growing, resilient and sustainable business.

Diageo's risk management process

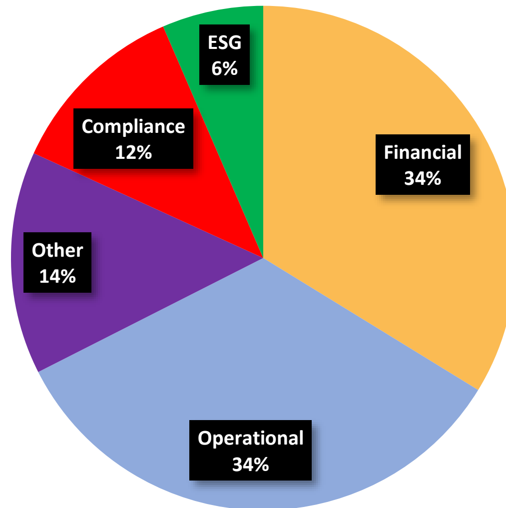
❖ Comparison with France – Risks

French companies have the obligation to disclose their principal risks, much like their British counterparts. By examining a few *documents de référence* from large French companies, it is possible to spot some differences in the way this requirement is being carried out. **Indeed, the general layout and presentation of the risks in French documents is very uniform** and resembles what Shell, the outlier in the panel of British companies, chose to do. The outcome of this presentation is a mixed bag: **on the one hand information could be considered less accessible and easy to understand than what is found in the British reports ; on the other hand, the section devoted to these disclosures is much longer in the French reports and hence the descriptions of the risk are more fleshed out.**

French companies do not use charts or tables to present the risks but rather just format the information in a cascade of paragraphs each dedicated to a specific risk. The paragraphs are split by categories such as **operational risk, financial risk, environmental risks** etc., which makes finding information relating to a specific type of risk easy.

However, they rarely include an assessment of the severity of the risk (or at least not of its evolution over time) something more common in British reports. It can also be noted that the section on risks is not very well integrated with the rest of the report and does not link with aspects such as the strategic drivers or the business model.

Comparing our two panels shows **that French companies disclose 50% more risks with 15,7 risks included on average**. Similarly to the British companies, only 1 relates to ESG matters, and the two biggest categories are financial and operational risks.



Source Afep

It should also be noted that the French documents contain a lot more information on the topic of insurance on the subject of these different risks. 100% of the companies in the panel gave the breakdown of the different insurance policies they were covered under. This included a description of what the policies were for as well as the amounts up to which the company would be covered.

Disclosures about risk management are similar to what can be found in British reports. Financial risks are covered in detail with explanations of the various hedges and procedures in place to minimize them. The other risks are treated in more general terms and **the emphasis is put on the risk management process in general rather than matching discrete risks with distinct solutions**. Although similar in format, French reports tended to go into more detail than their British counterparts on the risk management process. Significant variance still existed in how extensive the section was.

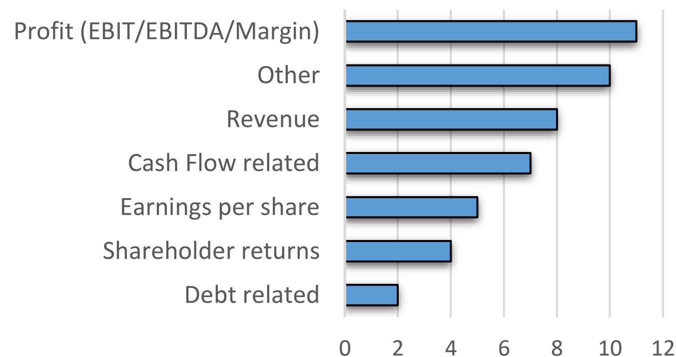
❖ Use of Financial Key Performance Indicators

Per British law, companies have the obligations to use financial key performance indicators (KPI) in their business review to the "extent necessary for the understanding of the development, performance or position of the company's business"[12] . No further guidance is provided as to the choice of KPIs to include in the strategic report. Consequently, companies have taken to this requirement with diverging degrees of **commitment. In the panel, the average number of**

[12] Companies Act 2006 414C (4)

financial KPI included is 4.7 and 9 out of 10 companies have dedicated a specific section to this obligation. Even the companies that do not include a section on this topic in the report on their website tend to dedicate a section to it in the actual document they send to Companies House.

Upon closer analysis of the specific KPIs companies have chosen to include, it appears that no specific metrics have managed to become accepted as the gold standards to add to a strategic report. Of course, there are a number of recurring themes but those are far from being systematically included. The tentative search to identify what these common KPIs would be has made it possible to plot the following graph on which it is easy to see that there is no uniformization of the financial KPIs included. This is likely a reflection of the very different activities of the companies in the panel and would perhaps be less pronounced were the study narrowed down to one specific sector. It should be noted that profit related metrics appear to be the most popular.



Source Afep

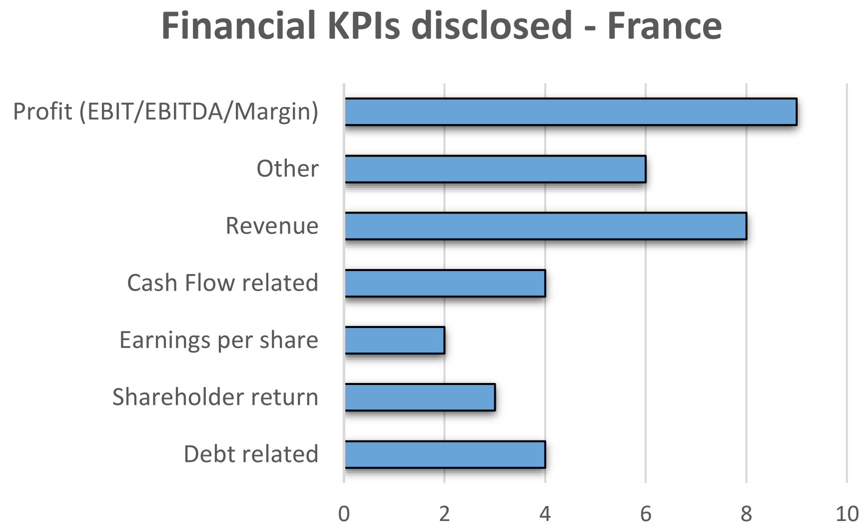
In the panel, only three companies displayed a KPI in which they had obtained a negative result. In addition, in two out of these three cases that KPI had to do with shareholder returns, an information that is readily available by simply looking at a graph and that investors reading the report are very likely to already possess. This is a logical consequence to British law not imposing the KPIs to be disclosed. However, it does take away from the informativeness of this section and paints only a partial picture of a company's position at a given moment

In their guidance to the Strategic report, the Financial Reporting Council suggests that "there should be alignment between the KPIs presented in the strategic report and they key sources of value and risks identified in the business model."[13] Yet, only 30% of the companies in the panel have actually made the effort to create a linkage between company strategy and the different KPIs proposed.

[13] FRC guidance on the Strategic Report p. 35

❖ Comparison with France – Financial Key Performance Indicators

The panel of French companies examined for the purpose of this comparison was smaller than the panel of British companies. This section examines the financial KPIs disclosed by 6 large French companies and plotted the following graph:



3: source Afep

The first thing to be said about this graph is that the dominant category is once again KPIs dealing with profits or profitability, followed by other which shows that companies tend to include KPIs relevant to their industries or that play to their strength. One can also note than in the – admittedly small – panel considered, there is a focus on different metrics compared with what was found in the Strategic Reports. For instance, earnings per share are included in 50% of the Strategic Reports in the panel compared with only 33% or only two of the French companies examined. On the other hand, the focus on debt is much bigger in France than it is in the United Kingdom.

One can also note that the disclosure of financial KPIs is not presented in the same way in France as it is in the United Kingdom. The information is most often given in the very first pages as a part of the general presentation of the company.

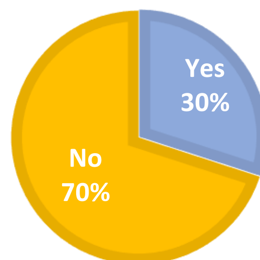
❖ Non-Financial KPIs

In a similar fashion to the Financial KPIs requirement, no consensus seems to have emerged between large companies as to what kind of metrics to disclose. **Non-financial disclosure is a recent development in reporting obligations and as such does not yet have a series of established and commonly accepted metrics.** This poses a challenge to companies that take the spirit of this disclosure to heart because they can struggle to come up with non-financial KPIs that are of interest to stakeholders, and it allows some companies to fulfill this requirement very summarily.

In the panel the number of non-financial KPIs disclosed went from only 1 in two cases to up to 12 for Shell; the average was of 5, which demonstrates the varying degree of importance given to this topic by companies.

While 100% of the companies in the panel linked senior management variable remuneration (i.e. bonus, long-term incentives) with at least 1 financial KPI, only 30% linked variable pay with a non-financial KPI. In these companies the relevant non-financial KPIs were linked with industry specific measures of production in two cases and had to do with employee safety in one case. To be clear this does not mean that variable pay was solely conditioned by financial metrics but rather that in 7 out of the 10 companies in the panel it was not linked with one of the non-financial KPIs they disclosed in the Strategic Report but rather with qualitative assessments of CEO performance by the board.

VARIABLE PAY LINKED WITH A NON-FINANCIAL KPI - UK



4: source Afep

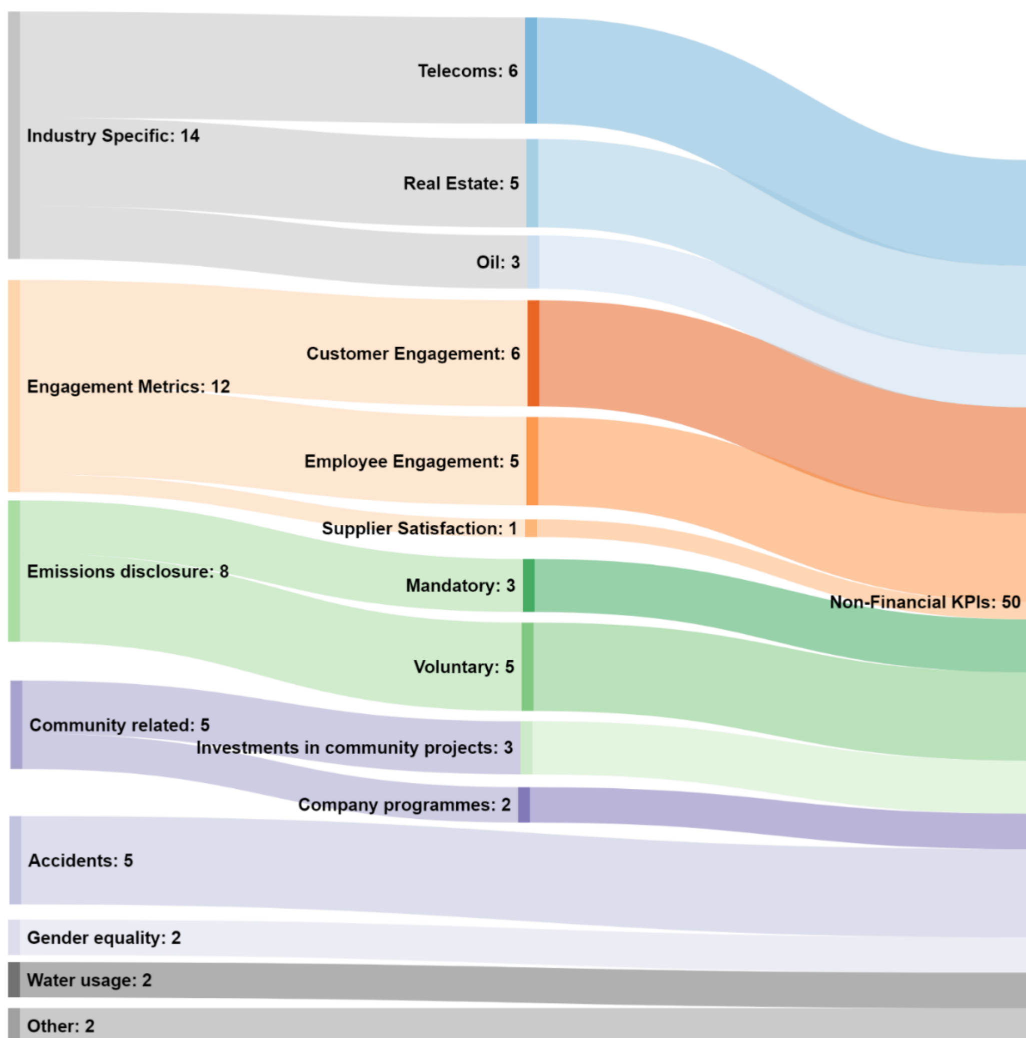
What is particularly interesting with non-financial KPIs is that they can connect the company's business with a multitude of stakeholders. Indeed, some have to do with consumers, some with suppliers, some with employees but they also inform about aspects of the business of the company not captured by the traditional financial KPIs. Two good examples can be found in Landsec's strategic report, which has a metric on construction projects finished within time and budget, and in Shell's strategic report, which comports several metrics on oil production. As a result, this section is very versatile and can be very informative when the KPIs provided are interesting.

Regrettably, it suffers from the same design shortcoming as the financial KPI section, which is that companies have complete freedom over the metrics to include. It follows that it is very rare to find a KPI in which a company is not doing well included in the report.

The Companies Act does specify that non-financial KPIs should be given that relate to "environmental matters and employee matters"[14] but some companies take advantage of the lack of standardization not to include this information where one would expect to find it. In a similar note, some companies try to appear more open about their emissions by including greenhouse gas related disclosures in their KPIs.

The 50 non-financial KPIs chosen by the panel can be classified in 8 categories: Industry specific, Engagement metrics, emissions disclosure, community related indicators, workplace safety, gender equality, water usage, and other. The breakdown of the non-financial KPIs used by the companies in the panel was used to plot the following graph. As one can easily see, the two most important categories are industry specific KPIs and engagement metrics. They are two good examples of the way non-financial KPIs are particularly cogent to some key aspects of a company.

Non-Financial KPIs breakdown by category in British reports



5: Source Afep

[14] Companies Act, 414C

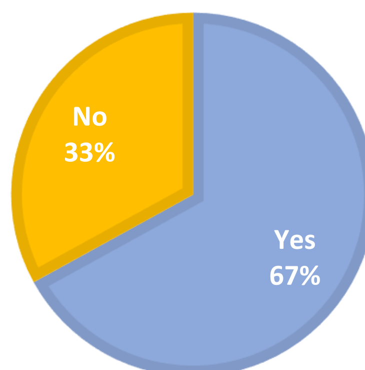
❖ Comparison with France – Non-Financial KPIs

France has long had a reputation for being a leader in the realm of ESG reporting.[15] As such, French law is more stringent and demanding when it comes to ESG related disclosures. It follows that the proportion of the annual report dedicated to ESG matters is bigger in French documents than it is in the British documents examined in this study. To comply with national law, listed companies dispose of 42 standardized indicators covering a wide array of topics ranging from wastewater management to workplace safety. They must report on the KPIs material to their business, which makes the French *documents de reference* more informative on these matters than their British counterparts simply by virtue of its exhaustiveness.

Yet when it comes to the non-financial KPIs, the breadth of information to be included makes it much more difficult to quickly find the important non-financial KPIs. Unlike in the British annual report where the KPIs are all in the same place and clearly indicated in the table of contents, the French report tends to place each individual KPI where it is most relevant. This is a double-edged sword: on the one hand it provides more context to whichever ESG topic the KPI corresponds to, but it also makes it hard to quickly find the non-financial KPIs without reading the entire Corporate Social Responsibility section which can easily exceed 50 pages. One way to improve on this issue would be to clearly signpost the location of the different KPIs, something that done to a limited extent by a couple of French companies in our panel but could easily be made clearer.

Another noteworthy difference between France and the United Kingdom when it comes to Non-Financial KPIs is their integration in executive remuneration policies. As shown above this is only rarely the case in the United Kingdom, whereas it is quite common in France. **Two thirds of the panel linked the variable pay of the chief executive with at least 1 non-financial KPI**. They can help a board set incentives for quantifiable objectives that are outside the scope of purely financial metrics but are still of vital strategic importance such as the integration of a newly acquired subsidiary or improved workplace safety.

VARIABLE REMUNERATION LINKED WITH NON-FINANCIAL KPI - FRANCE



Source Afep

[15] French companies also publish detailed information regarding GHG emissions and directors' compensation policy but since the purpose was not to analyse the differences in terms of reporting as regards these two specific topics, the study does not dwell on that.

❖ Main Trends and Factors, likely future development of the company

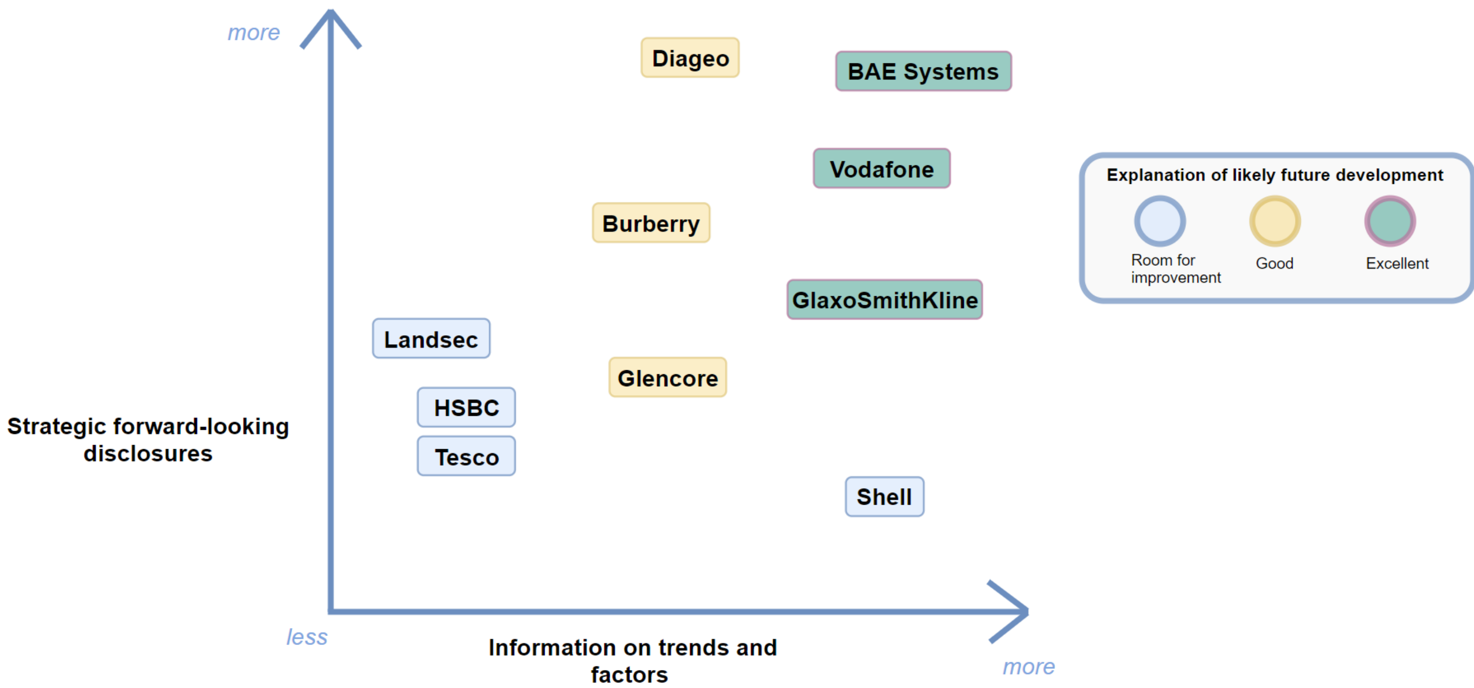
In this segment of the report the company is supposed to disclose its vision of the key trends and factors affecting the industry within which it operates. This requirement is studied in the fourth chapter of this study because although it is not required by the Accounting directive in these words, it goes hand in hand with the obligation to give information on the undertaking's likely future developments.

In addition, one can note that the Companies Act 2006 is very vague in its wording and does not specify what should be included:

"In the case of a quoted company the strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include the main trends and factors likely to affect the future development, performance and position of the company's business"[16]

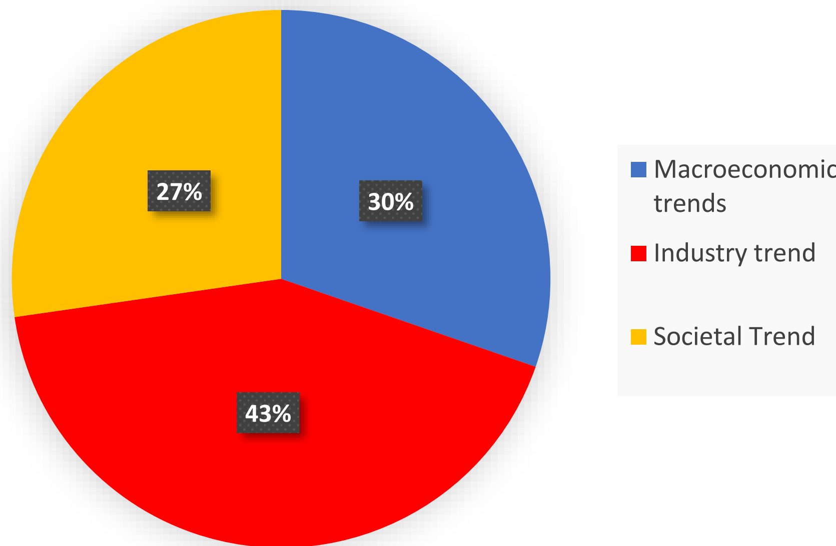
As a result, companies are free to interpret the text to encompass either only information about trends as they have experienced them in the past year or to also go into detail about their expectations for the future. For example, BAE systems has opted to go into great length and detail about each segment of its business by forecasting how current contracts would affect their growth in the following decade. This was in no small way made much easier by the defense industry's particularly long-time horizons for contracts, but it still denotes a willingness to disclose forward-looking information. They have also included information about very recent developments in their business such as a joint venture started only a few months ago. At the other end of the spectrum, a company like Tesco chose to include very little information and did not even dedicate a single part of the report to this topic, choosing instead to pepper some relevant information throughout the rest of the report. **The relatively lax enforcement of the regulatory framework allows for a multitude of approaches to compliance to develop**. A middle ground can even be found with companies like Diageo choosing to highlight the key trends they've identified alongside some practical examples of actions undertaken by the company in the past year to make the most out of those opportunities.

[16] Companies Act 2006, section 414C article 7A



The degree of information provided varies greatly by company – Source Afep

In the ten-company panel 80% had a clearly identified dedicated section relating to this disclosure obligations and 20% chose to include it in in a diffuse manner throughout the rest of the report. **The two most common recurring themes were the macro-economic outlook (and its logical effect on demand) and the geopolitical outlook**. This proved especially true for companies that are heavily impacted by political events such as GlaxoSmithKline, whose business is contingent on regulations, BAE systems, which needs politicians to approve new contracts, and Glencore, which operates in many unstable countries such as the Democratic Republic of Congo.



Source Afep

The trends and factors are to be taken in conjunction with the company strategy to give shareholders an idea of the likely future development of the company.

Companies often choose to evoke their future in very broad and general term. Consequently, the information given often looks like an industry outlook and not a description of the likely future of one single company. It should be noted that this is not always the case and that in the panel Diageo for example gives very precise metrics, examples, and steps they will take in the coming years.

The other outlier in the panel is BAE systems, who thanks to the long-term nature of defense contracts can have a precise idea of the likely future development of the company. Their backlog orders are worth in the billions and they have several ongoing or newly starting contracts with national governments including that of the United States and of the Kingdom of Saudi Arabia. In addition, they have also built a partnership entitled "VISION 2030" to help the kingdom build its infrastructure and divest away from an oil-centric economy.

One can also look at where in the report this section tends to be placed to gain some insight in the thinking of the companies. In 3 out of 8 reports which dedicate a section to this topic it is located either right after or right before the Strategy section as those two naturally go hand in hand. This is an illustration that the British annual report and most notably the Strategic and Director's report are very well integrated documents, something made evident time and again throughout this study.

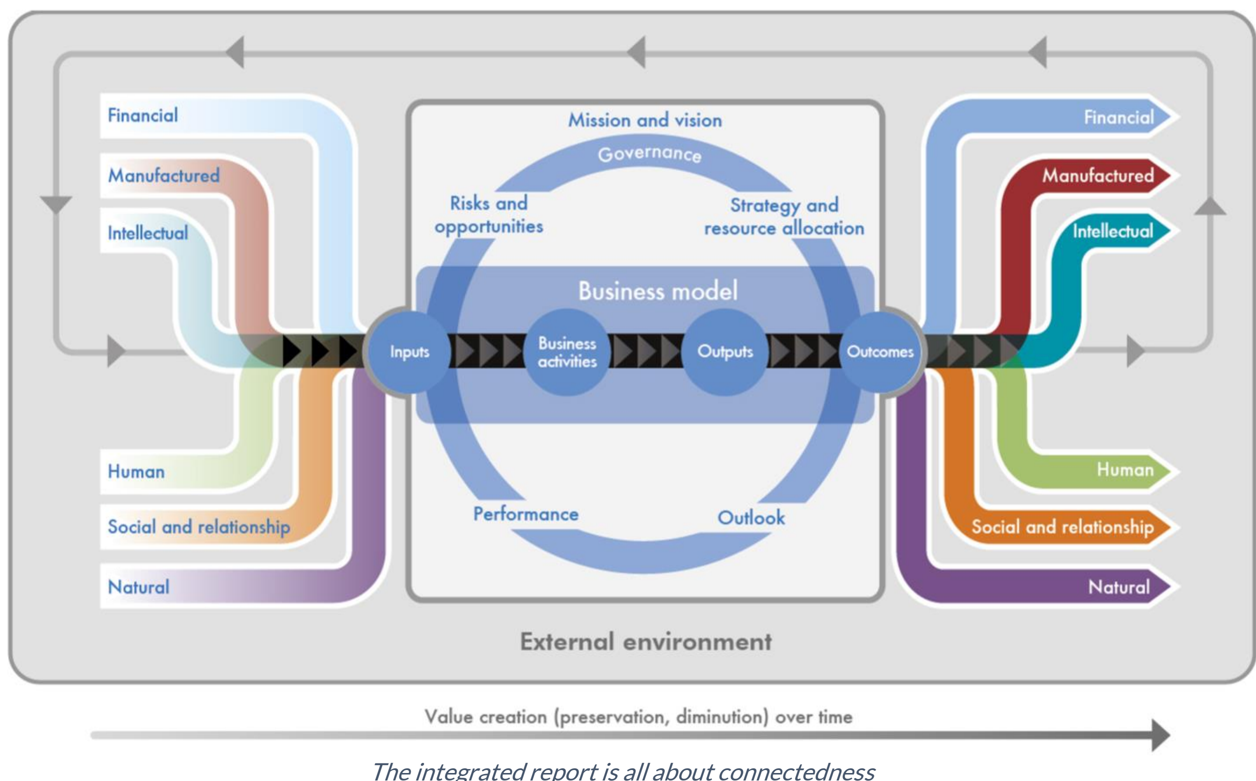
V. Comparison with the IIRC framework

The International Integrated Reporting Council (IIRC) is a not-for-profit organization based in London, which advocates for global adoption of the <IR> standard in corporate reporting. This proposed new standard aims to better connect and organize the information disclosed in corporate reports. According to the IIRC, this allows stakeholders to grasp the value-creation process in its entirety.

The framework is to be taken as guidelines by companies in their compliance with their respective reporting requirements. It comports a list of content objectives to be met, as well as the guiding principles regarding the form the report should take. The guiding thread of the framework is to allow for “integrated thinking”, which involves considering every company resource (employees, relationships, intellectual property, natural etc.) as various non-financial capitals in order to illustrate in a more complete and intelligible way the value creation process.

Integrated reporting is becoming more and more popular amongst large French companies. As of this year, more than half of the CAC40 and 30% of the largest 120 companies by market capitalization touted publishing an integrated report. However, it should be noted **that in many instances these companies did not follow the IIRC framework or only used it to inspire the general principles governing their report**.

One would be remiss not to examine the impact of this reporting trend in the United Kingdom, the very country where the framework was first conceived.



The integrated report is all about connectedness

❖ The Strategic Report and the Integrated Report have very similar principles and content objectives

The IIRC framework was published in 2013, the same year the Accounting Directive came into force. No explicit reference to this fact is ever made by the IIRC in their documents or on the website but by comparing the content objectives one can see that they are similar. An integrated report should present the company's: organizational overview and external environment ; governance ; business model ; risks and opportunities ; strategy and resource allocation ; performance ; outlook ; basis of presentation. **The content requirement of the <IR> framework quite matches what is expected of British companies under the Companies Act 2006.** This is made evident in the following tables which compare the framework to the two regulatory sources and to the FRC guidance on the reports.

Content Elements in IIRC Framework / Legal Source	**Organizational Overview and External Environment** *What does the organization do and under what circumstances does it operate?*	**Governance** *How does the organization's governance structure support its ability to value in the short, medium, and long term?*	**Business Model** *What is the organization's business model?*	**Risks and Opportunities** *What are the specific risks and opportunities that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them?*
Accounting Directive & Companies Act 2006	**Yes**: "the strategic report must, to the extent necessary for an understanding of the [...] company's business, include (a) the main trends and factors likely to affect the future development, performance and position of the company's business"	**Yes**: "Undertakings [...] shall include a corporate governance statement in their management report."	**Yes**: "The information must include (a) a brief description of the company's business model"	**Yes** on Risks: "The strategic report must contain (b) a description of the principal risks and uncertainties facing the company". Opportunities are **not specified** but are part of Trends and Factors
Financial Reporting Council guidance on the Strategic Report	**Yes**: "The internal and external environement in which the entity operates"	**Yes**: " the corporate governance component is usually presented as a separate part of the annual report and included in the directors' report by cross-reference"	**Yes**: "The strategic report has five main content-related objectives: (a) to provide insight into the entity's business model "	**Yes**: The strategic report might highlight the principal risks or opportunities that arise from [...] significant trends and factors identified."

Content Elements in IIRC Framework / Legal Source	**Strategy and Resource Allocation** *Where does the organization want to go and how does it intend to get there?*	**Performance** *To what extent has the organization achieved its objectives for the period and what are its outcomes in terms of effect on the capitals?*	**Outlook** *What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?*	**Basis of Presentation** *How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?*
Accounting Directive & Companies Act 2006	**Yes**: "the strategic report must include (a) a description of the company's strategy"	**Yes**: "The review required is a balanced and comprehensive analysis of (a) the development and performance of the company's business during the financial year,"	**Yes**: "The management report shall also give an indication of: (a) the undertaking's likely future development"	**The Companies Act 2006 and the accompanying FRC guidance are the basis of presentation for the Strategic Reports**
Financial Reporting Council guidance on the Strategic Report	**Yes**: "The strategic report must include a description of the entity's strategy" &"the strategic report will contribute [...] to provide information that is useful for making resource allocation decisions."	**Yes**: The strategic report has five main content-related objectives [...] (d) to provide an analysis of the entity's past performance;"	**Yes**: "the strategic report must include the main trends and factors likely to affect the future development [...] of the entity's business."	**The Companies Act 2006 and the accompanying FRC guidance are the basis of presentation for the Strategic Reports**

The <IR> Framework content elements align with legal requirements - Afep

In addition, the IIRC frequently references the Strategic Report as an example of good corporate reporting practices. They recently welcomed the increased emphasis on the value creation process in the FRC guidelines on the Strategic Report[17] and noted the "alignment between the Strategic Report and integrated reporting". They also note that more and more companies in the UK produce integrated reports, among which HSBC and Diageo, two members of the panel. Indeed one can easily see that the guiding principles of the <IR> framework coincide with what can be found in the law and even more so in FRC guidance.

Legal Source / Principles found in IIRC Framework	Strategic Focus and Future Orientation	Connectivity of Information	Stakeholders relationship	Materiality
Accounting Directive & Companies Act 2006	**Yes**: "strategic report must include - (a) description of the company's strategy" & "shall also give an indication of: (a) the undertaking's likely future development"	**Yes**: "The report must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts"	**Yes**: "A strategic report for a financial year of a company must include a statement (a "section 172(1) statement")"	**Yes**: "The review required is a balanced and comprehensive analysis [...] consistent with the size and complexity of the business"
Financial Reporting Council guidance on the Strategic Report	**Yes**: "The Strategic Report must include a description of the entity's strategy." & "Where appropriate information should have a forward looking orientation"	**Yes**: "The communication principles suggest that the strategic report should have the following characteristics [...] and link related information in different parts of the annual report"	**Yes**: " to provide information to enable shareholders to assess how directors have had regard to stakeholders and other matters when performing their duty under section 172."	**Yes**: "The strategic report and the annual report more broadly should contain information that is material to shareholders, including information that enables shareholders to assess the directors' stewardship"

Legal Source / Principles found in IIRC Framework	Conciseness	Reliability and Completeness	Consistency and Comparability
Accounting Directive & Companies Act 2006	Not explicitly specified.	**Yes**: "The review required is a balanced and comprehensive analysis of— (a) the development and performance of the company's business [...] and (b) the position of the company's business "	**Yes**: similar companies face similar legal obligations and thus prepare consistent and comparable reports.
Financial Reporting Council guidance on the Strategic Report	**Yes**: "The strategic report should be clear and concise yet comprehensive."	**Yes**: " the strategic report should be clear and concise and result in fair, balanced and understandable reporting" & "directors are liable [...] if the company suffers any loss as the result of any untrue or misleading statements in the strategic report"	**Yes**: similar companies face similar legal obligations and thus prepare consistent and comparable reports.

The <IR> principles align with what is found in the law and in FRC guidance - Afep

[17] https://integratedreporting.org/news/iirc-welcomes-strengthened-focus-on-value-creation-in-uk-frc-guidance-on-strategic-report/

❖ Despite these similarities the IIRC's claims on Strategic Reports are questionable

Quite interestingly and despite what is claimed by the IIRC, neither HSBC nor Diageo make any mention of their report being integrated or following the principles set out by the IIRC in their framework. Furthermore, **not a single company in the panel follows the format of an integrated report as it is set out in the framework**. The Financial Reporting Council does briefly mention it in the 104 pages guidance document from which we've already quoted earlier in the study but only to state that: "*In developing the Guidance, the FRC was mindful of developments in Integrated Reporting.* ***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.*** *This fact notwithstanding,* ***the International Integrated Reporting Framework and the Guidance on the Strategic Report encourage similar qualitative characteristics and content.***"[18]

The IIRC's position is that it only boils down to a difference in language and that a good strategic report is no different from an integrated report. **This is partly true to the extent that the information to be disclosed are similar and because as shown throughout this study the different sections of the reports often link with one another**. However, this is also a bit misleading to the public. As the FRC stated the contents of the strategic report are in line with those of the integrated report not because it is perceived as some gold standard to attain but simply because the <IR> framework mirrors what is required by law, namely the Accounting Directive and the Companies Act 2006. No company in the panel makes use of the different capitals suggested by the IIRC to present their resources and no company chooses to identify their report as being inspired by the framework.

For an organization that purports to provide a new and different reporting standard, the internal logic of the framework is puzzling. Organizations are free not to employ the capitals suggested as long as they follow the principles and the content objectives of the framework[19] . **The suggested format of the <IR> is the only difference with the current practice that can be objectively assessed; yet it is not a formal requiremen**t (despite the word "capital/capitals" being the third most common in the framework at a 150 occurrences). Furthermore, the framework states:

"*An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework it can be considered an integrated report*".[20]

This line of thinking allows the IIRC to claim any report they deem in accordance with their principles as an integrated report. Indeed, as highlighted in the graph found above the principles and objectives are basically a paraphrase of the Accounting Directive and as such any management report that follows EU law and displays even a modicum of integrated thinking could be said to be upholding <IR> standard. This goes against British law according to which "***If information required by subsections (1) to (5) to be included in the statement is published by the company by means of a national, EU-based or international reporting framework, the***

[18] FRC guidance on the strategic report p. 89
[19] IIRC framework 2.17 p.12
[20] IIRC framework

***statement must specify the framework or frameworks used**, instead of including that information*."[21] As no reports in the panel specify using the IIRC framework one can conclude that it does not appear to have influenced any of the ten companies in our panel, despite what the IIRC may claim.

VI. Conclusion:

The Strategic and Directors' reports are undeniably the British response to the European Union's management report requirement. As such, they present many familiar characteristics in terms of contents. Hence, studying them can prove an excellent source of insights and inspiration to those facing similar requirements. **Striking the right balance between duly informing all stakeholders and remaining material to avoid encumbering companies lies at the crux of the reporting exercise.**

As seen in the first chapter, the dissimilarities in contents with what is expected of French companies are fairly minimal. Mostly they concern the strategy being outlined in a separate, identifiable section, that is generally distinct from the business model. Furthermore, the CEO pay ratio disclosures and the mandatory hierarchical gender breakdown of the employees are reminiscent of current development in French corporate law and similar requirements regarding the pay ratio will soon enter into force.

When it comes to the information required by the Accounting Directive the comparison with French practice is most interesting. Despite companies trying to abide by the same requirements one can see that comparison makes a number of differences evident**. As a rule of thumb British reports are well-integrated and easier to understand by someone unfamiliar with the company. They are adept at data visualization and one easily knows where to find which information. However, they tend to contain less information than their French counterparts, especially on ESG topics**.

This study ends on a look at the IIRC framework to gauge the influence of the <IR> model this organization promotes. The comparison made it clear that there was a lot of alignment both in terms of principles and content-wise between what the IIRC recommended and British law. Nevertheless, the Financial Reporting Council makes it clear in the official guidance that only British law is binding and that the content of the reports was to be decided by legislation. In this regard, **the conclusion drawn by the study is therefore that the IIRC's framework was not much of a factor in the reporting practices of the ten British companies included in the study or of regulators such as the FRC.**

The main take-away of this study is that the current reporting framework stemming from European legislation allows for flexibility to adapt the reporting requirements to national concerns and to take into account sectoral issues. Companies strive to connect, when and where appropriate, financial and non-financial information. Moving forward, reflections to modernise reporting to ensure that it delivers relevant information would be welcome but imposing additional layers of disclosure without ensuring that the existing requirements are fit for purpose would be counterproductive.

[21] Companies Act 2006 414CB (6)