



Governance in brief

The new “Strategic Report”

Headlines

The Financial Reporting Council (FRC) has released a consultation “Guidance on the new Strategic Report”:

- All companies, except “small companies”, will be required to prepare a Strategic Report for periods ending on or after 30 September 2013.
- Structured around guiding principles, the guidance aims to serve as a best practice statement rather than a mandatory reporting framework.
- The guidance is useful background reading as it sets out the FRC’s vision of the annual report and brings together into one document previously separate elements introduced by the FRC and BIS.

Background to the Strategic Report

On 8 August 2013 new narrative reporting requirements for UK companies were finalised. These new requirements mean that, all UK companies, whether listed or unlisted, must prepare a Strategic Report in place of the current business review, applicable for periods ending on or after 30 September 2013. Only “small companies” have an exemption from the requirement.

(A “small company” for this purpose is any company entitled to prepare accounts for the year in accordance with the small companies regime, or would be so entitled but for being or having been a member of an ineligible group. *(Section 382 of the Companies Act 2006 defines a small company as having a turnover not exceeding £6.5m, a balance sheet total not more than £3.6m, and less than 50 employees. The exemption includes small companies and companies who would be eligible to prepare accounts under the small companies’ regime if not part of an ineligible group)*).

FRC Guidance on the Strategic Report

On 15th August 2013 the FRC issued a Consultation Draft “Guidance on the Strategic Report” to assist companies in fulfilling the new narrative reporting requirements. The consultation closes on 15 November 2013.



The guidance is intended to encourage preparers to consider how the Strategic Report fits within the annual report as a whole and to enhance the quality of narrative reporting to assist in meeting the needs of shareholders. The framework encourages experimentation and innovation with the structure of the annual report and promotes cohesiveness through linkage between the various elements of the annual report.

The guidance provides a framework or best practice aid and although written with listed companies in mind, the FRC stresses that it is very relevant to all other companies required to prepare a Strategic Report.

What is the purpose of the annual report?

The guidance explains that the annual report should provide shareholders with “relevant information which is useful for making resource allocation decisions” and “assessing management’s stewardship”. The guidance splits the structure of the annual report into three separate, though interlinking components – Narrative Reporting, Corporate Governance Statements and the Financial Statements. The guidance details the objectives of each component as follows:

Component	Objective
Narrative reporting	<ul style="list-style-type: none">• To provide information on the entity and insight into its main objectives and strategies, and the principal risks it faces.• To complement, supplement and provide context for the related financial statements.• Encompasses the Strategic Report and Directors’ Report.
Corporate Governance statements	<ul style="list-style-type: none">• To provide information that enables the assessment of whether the entity has “the right governance to execute its strategies” and “evaluate whether executive remuneration plans effectively incentivise delivery of those strategies”.• Includes the Corporate Governance disclosures, the Audit Committee Report and the Directors’ Remuneration Report.
Financial Statements	<ul style="list-style-type: none">• To present the entity’s financial position, performance and development in accordance with Generally Accepted Accounting Practice on a comparable basis.

Introducing a framework for the Strategic Report

The guidance sets out a number of guiding “principles”:

The purpose of the Strategic Report: The Strategic Report should provide shareholders of the company with the ability to assess how the directors have performed their duty to promote the success of the company for the shareholders’ collective benefit. The stated purpose of the strategic report is to provide context to the financial statements, provide an analysis of past performance and provide insight into the main objectives, strategies, risks – and importantly how these might impact future performance.

Communication principles: The Strategic Report should be fair, balanced and understandable; highlighting relationships and interdependencies between information presented in different parts of the annual report. The report should be tailored to the entity, concise – including only relevant information – and *it should be forward-looking*. Each year, the structure and presentation of the Strategic Report should be reviewed to ensure that it continues to meet its objectives in an efficient and effective manner.

Materiality: The guidance highlights the importance of the consideration of materiality within the Strategic Report. Information should be considered to be material, and therefore included within the Strategic Report, if the omission or misrepresentation of such information might reasonably be expected to influence the decisions shareholders would make on the basis of the annual report as a whole. The guidance also counsels that only material information should be included as the “inclusion of immaterial information can obscure key messages and impair the understandability of information provided in the strategic report”.

A reminder of the contents of the Strategic Report

The required content of the Strategic Report is detailed in the amended s414C of the 2006 Companies Act.

For all preparers, the strategic report must contain:

A fair review of the company’s business.

A description of the principal risks and uncertainties facing the company.

The review required is a balanced and comprehensive analysis of the development and performance of the company’s business during the financial year, and the position of the company’s business at the end of that year, consistent with the size and complexity of the business.

To the extent necessary for an understanding of the development, performance or position of the company’s business, analysis using financial key performance indicators, and where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

For quoted companies (in addition to the above), the 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.

Information about **environmental matters (including impact of the company's business on the environment), the company's employees, and social, community and human rights issues** – including information about any policies of the company in relation to those matters and the effectiveness of those policies.

If the report does not contain this information, it must state which of those kinds of information it does not contain.

In addition quoted companies must include:

A description of the company's **strategy**.

A description of the company's **business model**.

Per the FRC Guidance, the business model should provide shareholders with an understanding of how the entity is structured, the market in which it operates, and how the entity engages with that market. It should also describe the nature of the relationships, resources, and other inputs necessary for the successful continuation of the business.

Further guidance on this topic can be found in our Governance in Focus publication "Describing your strategy and business model" at <http://www.corpgov.deloitte.com/site/uk/centre-for-corporate-governance/>.

A breakdown of **the number of persons of each sex** who were directors of the company, the number of persons of each sex who were senior managers of the company, and the number of persons of each sex who were employees of the company.

To the extent that there are matters which are considered to be of strategic importance to the entity, the Strategic Report should also include information which would otherwise be disclosed in the Directors' Report.

Pulling it all together

The Guidance to the Strategic Report aims to give context on how companies can successfully create a well structured and cohesive annual report. Whilst components of the Annual Report are individually useful, greater insight – and therefore increased value to shareholders – can be gained from highlighting relationships/interdependencies, which the FRC describes as "linkages" between each component.

Many illustrations of where linkages could be achieved in the Strategic Report are included within the guidance. Such examples include:

- **Business model:** the description of the business model should be used to signpost other relevant information included within in the Strategic Report. For example, it could highlight certain principal risks impacting upon a specific part of the business model.
- **Influence of trends:** principal risks, or opportunities, resulting from strategies adopted in response to a trend or other internal/external influences can be effectively highlighted in the Strategic Report.
- **Corporate governance:** discussion of the risk monitoring process, including how risks are mitigated, could be used to enhance corporate governance reporting such as the audit committee report – which requires the discussion of such information.
- **Cross referencing:** the Strategic Report could include the funding of a large defined benefit pension scheme deficit as a principal risk. The Strategic Report itself would include only a high level description of this risk, but cross-reference to further detail contained within the notes to the accounts which contain enhanced detail should the readers choose to delve further.
- **Linkage to KPIs:** the Strategic Report could highlight KPIs utilised in director incentivisation to provide insight into the relationship between business performance and executive remuneration.

Next steps

The requirement to prepare a Strategic Report is applicable to periods ending on or after 30 September 2013. Companies should already be considering how they are responding to the changes.

For many quoted companies, the introduction of a Strategic Report may not be all that significant as much of the content is the same as is currently presented in the business review. Though the content itself may be familiar, in some cases, considerable rearrangement and design of the layout of material will be required to ensure the information is presented in the best possible way.

More information

A copy of the consultation paper can be obtained from the FRC website at <http://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Exposure-Draft-Guidance-on-the-Strategic-Report.aspx>. The comment period closes on 15 November 2013.

The Deloitte publication 'Need to know' addressed at preparers on the new narrative reporting regulations can be accessed at www.deloitte.co.uk/auditpublications

We will be publishing a practical guide to approaching the Strategic Report later this month.

The Deloitte Academy

The Deloitte Academy has been designed for main board directors of listed companies. The Deloitte Academy provides support and guidance to boards, individual directors and company secretaries of listed companies through a programme of briefings and update sessions. Bespoke training for the whole board or individual directors is also available.

If you would like further details about the Deloitte Academy, including membership enquiries, please email enquiries@deloitteacademy.co.uk

Deloitte View

- The FRC guidance is useful background reading as it draws together the vision of the annual report and sets the elements that have been introduced separately by the FRC and by BIS in context in one document. The guidance illustrates how the requirements can be approached, provides examples of how the various elements link together; and helpfully suggests how to determine which disclosure might be material. Useful background reading for those who want to improve the quality of corporate reporting in a thoughtful manner.
- The BIS Strategic Report broadly speaking draws together elements that are already required but adds requirements to include information around the company's strategy, diversity considerations, and human rights. Some of this will require additional thought and procedures. For listed companies, rather than "comply or explain", there is now the specific requirement in law to include a description of the company's business model, previously just set out in the UK Corporate Governance Code.
- Whilst considering the contents of the Annual Report thoroughly this year directors may wish to consider whether elements should be assured by either internal or external auditors – particularly the effectiveness of implementation of policy statements (e.g. human rights) or assurance over the definitions and computations of key performance indicators, or non-financial social impacts.
- Directors should consider how they evidence the considerations that underpin their statement that the annual report is "fair, balanced and understandable" and "provides all of the information necessary for shareholders to assess the company's performance, business model and strategy". Perhaps a short note forming part of the board papers is sufficient to document the framework and considerations. We believe a document of record is a useful reference point.

Contacts – we value your feedback

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If you find our publications useful or would like to see other topics covered please provide your feedback.

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UK Centre for Corporate Governance

For further information on corporate governance matters please click here

<http://www.corpgov.deloitte.com/site/uk/>

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