Grant Thornton
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Dear Ms Raval

Guidance on the Strategic Report

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) consultation "Guidance on the Strategic Report" (Guidance).

We strongly advocate attempts to improve the quality of narrative reporting and support the FRC in being mindful of the developments in integrated reporting in this area. In a world of increasing cross border interaction it is important that international developments are fully considered when formulating guidance to be applied in the United Kingdom (UK).

The Accounting Council set three objectives for the production of this guidance. The objectives were that strategic reports and annual reports more generally:

- are focused on the needs of shareholders
- tell a cohesive story of the business, and
- make full use of the flexibility that exists within the regulatory framework.

We believe that the first objective is met but the other two objectives have not been clearly addressed. For unquoted companies, we do not believe the strategic report legislation has any fundamentally different requirements to those currently required. However, in formulating the guidance, the FRC has a tremendous opportunity to produce an innovative document that takes the legislation and shows preparers how a cohesive story could be told that would improve narrative reporting. The guidance could also make use of the flexibility within the regulatory framework while ensuring the legislative requirements are still met. The launch of the Strategic Report should, therefore, be used as a platform to encourage all companies to significantly improve their narrative reporting.

Instead, while the guidance is sensible and includes a number of sound principles, it appears excessively long and prescriptive. We are concerned that the length of the guidance and the fact that it is not mandatory will result in the guidance being overlooked and any good that may come out of it being lost. We believe that the guidance alone will neither result in any step change in the way companies report nor provide auditors with any leverage to encourage companies to report in a different manner.

In our view, continual improvements in technology are opening many doors that should allow companies to report innovatively. We believe that investors want companies to tell their story and to use this as a basis for interacting with the company. As written, we consider that the guidance alone will not provide companies with any improved literature that is not currently available. However, we acknowledge that the guidance is part of the continued push to improve narrative reporting and as noted above contains sensible suggestions.

We note that in order for the guidance to be truly effective, the message from the FRC when launching the guidance will be key. When launching the guidance, the FRC must emphasise that the strategic report represents a catalyst for change and encourage all companies to use the guidance in order to review how the quality of their narrative reporting can be improved further.

A further principal concern is that the guidance is written for all companies that need to prepare a strategic report but has been written with "quoted companies in mind". The result of this is that unquoted companies need to try and discern which parts of the guidance apply for them. In our view, this will further reduce the attraction of the guidance to those companies. We recommend that the FRC should clearly split the guidance into the aspects that apply for quoted companies only and those that apply to all companies that prepare a strategic report.

Finally, we believe that whatever form the final guidance does take, the Financial Reporting Lab should conduct a post implementation review of the guidance. That review should highlight areas of best practice or areas for improvement and lead to revisions to the guidance in the future. The FRC's Conduct Committee's annual report could also highlight similar points.

If you have any questions on our response, or wish us to amplify our comments, please contact Jonathan Shaw (tel: 020 7728 2576, email: jonathan.shaw@uk.gt.com) or Peter Leadbetter (tel: 020 7728 2977, email: peter.leadbetter@uk.gt.com).

Yours sincerely

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Question 1: Do you think that Illustration 1 is helpful in achieving this objective?

The objective of the illustration is to help those preparing annual reports to make judgements regarding where information would be best placed in the annual report. We believe the illustration is helpful in detailing the different legislative requirements that preparers are required to comply with. However, as detailed in our response to the FRC's consultation "Thinking about disclosures in a broader context", we believe that the annual financial report should not be viewed as containing distinct components. Instead, we believe the three components should be viewed as running throughout the annual report concurrently and when taken together, they form the annual report. We believe this approach aids cohesiveness and avoids duplication. In our view, the illustration may counter this aim and reinforce the view that the annual report consists of distinct components resulting in a lack of cohesiveness and duplication.

Further, as noted elsewhere, the illustration does not clearly distinguish the requirements that apply to quoted companies and those that do not. As a result, the requirements may appear confusing to those outside the quoted arena.

Finally, as has been acknowledged in section 3.3(b), larger quoted companies typically will include other statements within the annual accounts (eg chairman's statement, corporate responsibility reports, chief finance officer's report etc.). Whilst Illustration 1 is of help as a simplistic overview to the annual accounts, in practice current methods of reporting information are more complex.

Question 2: Do you agree with the objectives of each component and section of the annual report which are included in Illustration 1?

We agree with the objectives of each component.

Question 3: Do you think the guidance on the placement of information in the annual report in paragraphs 3.10 to 3.14 will have a positive influence in making the annual report more understandable and relevant to shareholders?

The principle in section 3.10 does not provide a step change in comparison to previous literature such as "Cutting clutter" and "Thinking about disclosures in a broader context." As a result, it is not clear how the principle will have a positive influence in making the annual report more understandable and relevant to shareholders. In particular, we note that the principle does not explicitly state who the annual report is aiming to communicate with. However, we note that the guidance in section 3.11 is useful in discouraging preparers not to produce a 'checklist style' report.

Section 3.12 discusses a 'core and supplementary approach.' We believe that this approach would be useful in encouraging entities to be innovative and perhaps move long standing information such as directors' biographies outside of the annual financial report. However, the concept may be interpreted differently with different entities interpreting the meaning of 'core' and 'supplementary' in a different manner. This may reduce comparability between entities.

Further, as noted in the Accounting Council's advice to the FRC (point 25) where information is 'scattered', care will be needed to ensure that it is clear which parts are audited and which are not. Finally, we note that the guidance could discuss the application of the S463 Companies Act 2006 "Safe Harbour" provisions where a core and supplementary approach is being taken. The guidance could highlight how the safe harbour provisions are applied where information is contained in a supplementary section or is cross-referenced from the strategic report.

Question 4: Do you agree with this approach? Is the level of guidance provided on the subject of materiality appropriate?

The guidance states that the concept of materiality is based as faithfully as possibly on the definition of materiality in International Financial Reporting Standards (IFRSs). It is not clear why IFRS has been used rather than extant UK GAAP or FRS 102 – although this is not expected to result in any significant differences. The FRC is to be applauded for continuing to attempt to discuss materiality in the context of narrative reporting, as this is an inherently difficult topic.

As noted in our response to "Thinking about disclosures in a broader context", the IIRC prototype considered the definition of the concept of materiality more broadly than that included in the guidance. In order for an item to be material under the IIRC prototype, the item must be of a nature to substantively influence the assessments and decisions of both the organisation's highest governing body and the intended user. The inclusion of those charged with governance in the definition of materiality in the prototype may provide more of a focus in helping entities determine what is material from a disclosure point of view. In other words, what matters are of importance/significance to the board? We would welcome further consideration of this idea in reviewing the concept of materiality for the strategic report.

Outside of the definition of materiality, we note that paragraph 5.4 may create confusion. Paragraph 5.4 in explaining the terms 'principal' and 'key' explains that they are items that are considered to be 'important' – this will lead a user to ask the question of what does 'important' mean? It also appears to suggest that 'principal,' 'key' and 'important' are material items. However, this understanding appears confused when compared with paragraph 6.66 that states that if information is not material but is important it should be contained elsewhere such as the sustainability report. In paragraph 6.66 'important' appears to apply to information that is not material, whereas in paragraph 5.4 the word 'important' appears to mean that information is material. The position is not, therefore, clear.

Finally, the definition of material appears to be extended beyond a current understanding - the definition states "Information is material if its omission from or misrepresentation in the strategic report might reasonably be expected to influence the economic decisions shareholders make on the basis of the annual report as a whole." The result of the definition is that all material information must be discussed in the strategic report and as a result, any information not discussed in the strategic report is not material. It is not clear if this was an intended consequence. We note that the Reporting Statement: Operating and Financial Review described principal risks as being those that affect the entity's strategies and development of the entity's value.

Question 5: Do you agree with the proposed 'communication principles', set out in paragraphs 6.5 to 6.27 of the draft guidance, which describe the desired qualitative characteristics of information presented in the strategic report? Do you think that any other principles should be included?
Except as outlined below, we agree with the proposed communication principles.

Paragraph 6.6 requires the strategic report to be "understandable" but this only applies to quoted entities. As discussed in our covering letter, the guidance does not distinguish clearly between the requirements applicable only for quoted companies and those that are not. For preparers that are not quoted companies, this will mean an exercise will need to be undertaken to establish which parts of the guidance are applicable and which are not. We believe that this could be addressed by having distinct sections for quoted companies and those that are not quoted companies.

Paragraph 6.11 requires the strategic report to be concise. In our view, this principle when read in isolation may lead to the strategic report being too brief and not offering the level of detail required to explain material items.

We believe the guidance should also have as a principle that the strategic report should tell the entity's story. We believe that this will help to engage investors.

Question 6: In this draft guidance, we have aimed to strike a balance between the need to ensure that the structure and presentation of the strategic report is sufficiently tailored to the entity's current circumstances and the need to facilitate comparison of the strategic report from year to year. Do you think the guidance in paragraphs 6.26 and 6.27 achieves the correct balance?
Paragraph 6.26 encourages preparers to review the information included in the annual report and so is a valuable inclusion. We believe that constant reviewing of the way information is reported is critical to improving narrative reporting.

However, paragraph 6.27 uses the word "improved" when explaining how preparers should assess whether change is required. We do not believe the word 'improved' alone will be helpful for a user in determining whether change is required. Effectively the guidance in these paragraphs is considering when a change in the structure and presentation of the strategic report is recommended. We believe the guidance in accounting standards when changing an accounting policy would be useful in this regard. IFRS allows a change in accounting policy in the financial statements where that change will provide reliable and more relevant information. We therefore believe that the words 'more relevant' could usefully be incorporated in the guidance in paragraphs 6.26-6.27. Guidance could also be added to illustrate that in some instances, a change in structure of the strategic report may provide more relevant information rather than a change in content.

Question 7: The 'content elements' in bold type described in paragraphs 6.28 to 6.73 do not go beyond the requirements set out in the Act, although the precise wording may have been expanded to make them more understandable. Do you think this is appropriate? If not, what other 'content elements' should be included in this draft guidance?

We agree that expanding the legal requirements is appropriate and indeed is the purpose of this guidance. However, the guidance again does not distinguish between requirements for quoted companies and those for other entities as noted elsewhere in our response.

The FRC may also wish to address in the guidance whether the strategic report should consider discussion of critical accounting policies, including those requiring significant judgement and those which are most sensitive to change. The guidance could also give some prominence in relation to capital management objectives. In this regard, the Accounting Standards Board's report on "Financial Capital Management Disclosures" in December 2010 stated that disclosures about capital and how it is managed are necessary for a balanced and comprehensive business review.

Question 8: Appendix I 'Glossary' uses the same definition of a business model as the Code ('how the entity generates or preserves value'). Is the level of guidance provided on the business model description in paragraphs 6.38 to 6.41 sufficient?

Yes we agree that the level of guidance provided about the business model is sufficient for quoted companies. However, we believe that this guidance represents an opportunity to make a step change in narrative reporting. The guidance could usefully discuss whether companies that are not quoted should ever discuss their business model and whether this may lead to improved narrative reporting for companies that are not quoted. We do not recommend encouraging more reporting where it is not unnecessarily required. However, there may be situations such as where the business model is fundamentally changed, where discussion of the business model by companies that are not quoted would be useful for a user.

Question 9: Do you think that this draft guidance differentiates sufficiently between the concepts of business model, objectives and strategies? If not, why not and how might the guidance be improved?

The guidance defines the concepts as follows:

- Business model: How the entity generates or preserves value over the longer term
- Objectives: specific goals describing what the entity wishes to achieve
- Strategy: A plan or approach which is intended to help the entity achieve an objective or objectives.

The three concepts appear to be clearly linked. In other words, an entity wishes to generate or preserve value over the longer term and will set a strategy to achieve this – the strategy will involve specific objectives. In our view, the guidance should not attempt to differentiate between the three concepts but rather should show how they are interlinked.

Question 10: This draft guidance includes illustrative guidance (the 'linkage examples') on how the content elements might be approached in order to highlight relationships and interdependencies in the information presented. Are these linkage examples useful? If not, what alternative examples or approach should be used?

The examples appear to be more of a common sense approach and in our view, will not result in any step change or significant improvement in narrative reporting. One or two specific examples of more complex areas where linkages may be used may be appropriate. For instance, an example could show links between the business model and strategy, KPIs and principal risks. We understand a reluctance to provide detailed examples for fear of the examples being used as pro-formas by companies. However, we believe that illustrative examples of good practice will aid those companies that wish to highlight relationships and interdependencies.

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