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Our ref: 72/JMAW/Strategic  
report

Please ask for James Roberts  
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Dear Deepa

**Consultation document: Guidance on the Strategic Report**

We are pleased to have the opportunity to comment on the above consultation issued by the Financial Reporting Council.

We support the guidance provided by the Financial Reporting Council and are pleased to see that the FRC is encouraging experimentation and innovation in respect of the drafting of annual reports.

We welcome the fact that the guidance is exactly that, guidance, and is not a template to follow which invariably would result in boilerplate (and less meaningful) disclosures. The guidance provides companies with a starting point for their Strategic Report but allows them the flexibility to write a report that is bespoke to investors' needs. We think that this flexibility is critical to ensure that narrative reporting evolves in a positive manner.

We have concerns over the guidance in respect of materiality, which we have detailed in our answers to the specific questions overleaf. In addition we feel there should be further guidance, for example on the identification of the audience of the strategic report as the needs of different investor stakeholders are different if they are an institutional or retail equity investor or a debt provider.

We would be very happy to discuss our response to this consultation with you should you require. Please contact James Roberts, Partner (on 01293 591 000 or at [james.roberts@bdo.co.uk](mailto:james.roberts@bdo.co.uk)) should this be the case.

Yours sincerely

James Roberts  
Partner  
For and on behalf of BDO LLP

72/JMAW/Strategic report  
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**Section 3 The annual report**

Section 3 of this draft guidance includes an illustration (Illustration 1) which is intended to clarify the purpose of each part of the annual report and help those that prepare annual reports to make judgements regarding where information would be best presented.

**Question 1**

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

The illustration is useful as it provides a snapshot of what should be included in the different sections of the financial statements. However we felt it would be more useful if it included the Chairman's statement, Audit Committee Report and the Audit Report (i.e. those items that will feature in all relevant annual reports) and showed the link between these and the financial statements as a whole, particularly in light of the 'fair, balanced and understandable' disclosure.

It is important to include the Auditors' Report in this illustration to clarify the auditors' remit and therefore what parts of the financial statements are audited. It is really important that the 'expectation gap' is not widened further, when the current changes provide an opportunity to narrow it.

**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 and section of the annual report but would like to see the Audit Committee Report and the Audit Report included in the illustration.

**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 guidance on placement of information could imply that what will be left in the director's report is nothing more than legal niceties and not worth reading. The implication may be well founded. Consideration should be given to suggesting that standing data is included on a company's website and does not need to be included in an annual report.

**Section 5 Strategic reports and materiality**

Section 5 of this draft guidance addresses the application of the concept of materiality to the strategic report, remaining as faithful as possible to the definition of materiality used in International Financial Reporting Standards (IFRSs).

**Question 4**

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

We do not feel that the guidance on this subject is comprehensive enough as the decision as to what is material or not is key to the success of the strategic report and can be a difficult judgement call. Directors are likely to need further guidance to give them the confidence to leave out the immaterial items, otherwise nothing will be done to reduce clutter. The worst

scenario is that directors take a 'better to be safe than sorry' approach and include everything in the report as that would defeat the object.

We would like to see the definition extended to largely reflect the audit definition of materiality to ensure that the company and the auditors take the same approach when identifying material issues for disclosure. This is particularly important given the extension of the audit report under the revised ISA 700 as the annual report is not going to make sense if the directors and the auditors' bases for adopting materiality levels significantly differ.

The directors (or the audit committee) should disclose the considerations they bore in mind in adopting and applying materiality, and how it has been applied throughout the Annual Report.

In addition the guidance refers to the definition in IFRS but does not refer to UK GAAP. We appreciate that this guidance is for listed companies only but it does not make sense to ignore UK GAAP as there are still single PLC entities that apply UK GAAP, and as it is our experience that best practice tends to trickle down to smaller companies eventually.

## Section 6 The Strategic report

### 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?

We agree with the proposed 'communication principles'. The only comment we have is that the more that companies can say about their future plans the better for the investor. However consideration needs to be given to whether safe harbour provisions can be put in place to encourage more constructive disclosures.

### 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?

Consistency and ease of comparison either year on year or with peers should not be the driver of the contents of the annual report. The content should be expected to change as different matters will be material in different companies and from year to year. No peer equivalence is the price that has to be paid to ensure quality reporting that is bespoke to the 'substantial investor group'

### 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?

Yes

**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

**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?

We do not feel this is a concern and as long as companies are 'telling their story' concisely and informatively it doesn't really matter whether it is defined as the business model, the business objectives or business strategies.

**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 linkage examples are useful but they might be better if they followed a 'theme', for example you could pick a type of entity and give an example of what might be relevant.