Guidance

Accounting and Reporting

Financial Reporting Council

June 2014

Guidance on the Strategic Report

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Contents

Summary

(i) The aim of the Financial Reporting Council (FRC) is to promote high quality corporate governance and reporting to foster investment. The FRC believes that encouraging entities[1] to prepare a high quality strategic report – which provides shareholders with a holistic and meaningful picture of an entity's business model, strategy, development, performance, position and future prospects – is a key part of achieving this aim.

Background

(ii) In August 2013, the Government published new Regulations[2] for the strategic report and directors' report. The Regulations resulted in an amendment to existing company law requirements and became effective on 1 October 2013. The main change was the introduction of a requirement for certain entities to prepare a strategic report as part of their annual report. The requirements apply for periods ending on or after 30 September 2013.

(iii) The Department for Business, Innovation and Skills (BIS) requested that the FRC prepare non-mandatory guidance supporting the new legal requirements for the strategic report. While the changes introduced by the Regulations represent a relatively modest change to the pre-existing legal requirements, the FRC believes that they should act as a catalyst for entities to prepare clear and concise narrative reports that facilitate fair, balanced and understandable reporting. The new guidance is therefore intended to encourage preparers to consider how the strategic report fits within the annual report as a whole with a view to improving the overall quality of financial reporting.

Aims of the guidance

(iv) The FRC has developed guidance that aims to be:

(a) principles-based;

(b) mindful of recent developments in narrative reporting best practice; and

(c) aligned with the requirements in the *UK Corporate Governance Code*.

(v) This guidance replaces the Accounting Standards Board's *Reporting Statement: Operating and Financial Review*.

Overview

(vi) The *Guidance on the Strategic Report* serves as a best practice statement and, as such, has persuasive rather than mandatory force. One of its objectives is to set out high-level principles that enable entities to 'tell their story'.

(vii) The guidance is for directors and is intended to serve as best practice for all entities preparing strategic reports.

(viii) The guidance encourages that the information provided in annual reports should be more relevant to shareholders. With that in mind, the guidance is framed in the context of the annual report as a whole. In practice, an annual report comprises a number of components. The information contained in each of these components has different objectives that should guide preparers to where disclosures could be located. The aim is to promote cohesiveness and enable related information to be linked together.

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1 This guidance uses the broader term 'entity' unless the term 'company' is more appropriate in a specific context.

2 The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the 'Regulations').

(ix) Placement is a key theme in the guidance with a view to providing entities with the building blocks to be innovative in the location of information while working within the regulatory framework. The aims are to ensure that information that is important to shareholders is prominent and improve the accessibility of information. The guidance recommends that information that is not relevant for shareholders should be provided outside the annual report where this is permitted by law or regulation.

(x) The overriding objective of the strategic report is to provide information for shareholders that will enable them to assess how the directors have performed their duty to promote the success of the company.[3] It should reflect the directors' view of the company and provide context for the related financial statements. In meeting the needs of shareholders, the information in the annual report may also be of interest to other stakeholders. The annual report should not, however, be seen as a replacement for other forms of reporting addressed to other stakeholders.

(xi) The guidance includes sections on the application of materiality to the strategic report, communication principles and content elements.

(xii) The guidance recommends that only information that is material to shareholders should be included in the strategic report. Immaterial information should be excluded as it can obscure the key messages and impair understandability.

(xiii) The communication principles suggest that the strategic report should have the following characteristics – be fair, balanced and understandable; be concise; have forward-looking orientation; include entity-specific information; and link related information in different parts of the annual report. There are also principles which recommend the structure, presentation and content of the strategic report be reviewed to ensure that information remains relevant to the current period. The communication principles are intended to emphasise that the strategic report is a medium of communication between a company's directors and its shareholders.

(xiv) The content elements for the strategic report set out in the guidance are derived from the Companies Act 2006, and include a description of the entity's strategy, objectives and business model. In addition, the strategic report should include an explanation of the main trends and factors affecting the entity; a description of its principal risks and uncertainties; an analysis of the development and performance of the business; and an analysis using key performance indicators. Disclosures about the environment, employees, social, community and human rights issues are required when material. There is also a requirement to include disclosures on gender diversity.

[3] Section 172 of the Companies Act 2006.

Section 1
Objectives and how to use this guidance

1.1 The objectives of the *Guidance on the Strategic Report* are to:

(a) ensure that relevant information that meets the needs of shareholders is presented in the **strategic report**;

(b) encourage companies to experiment and be innovative in the drafting of their **annual reports**, presenting narrative information in a way that enables them to best 'tell their story' while remaining within the regulatory framework; and

(c) promote greater cohesiveness in the annual report through improved linkage between information within the strategic report and in the rest of the annual report.

1.2 This guidance is structured as follows:

Boxed text in bold type describes the main principles or, in Section 7, content elements that form the basis of this guidance. References to legislative or other regulatory requirements are given in the footnotes to this guidance.

1.3 The bold text is followed by further supporting guidance explaining how the main principles and content elements might be applied. The supporting guidance is then supplemented by highlighted text as follows:

Summary of legal requirements

Where the law or regulation underpinning the guidance requires explanation or highlighting, this information is included in a 'summary of legal requirements'. This information is intended to summarise important aspects of the legal requirements; it is not intended to be a comprehensive analysis of the law.

Example

Where a specific paragraph warrants further application guidance, practical examples are included. These examples are intended to be illustrative only and may not be appropriate for all entities.

Linkage example

One of the main objectives of this guidance is to encourage the preparation of more cohesive annual reports. The 'linkage examples' illustrate ways in which interdependencies or relationships between strategic report content elements and disclosures placed elsewhere in the annual report might be highlighted or presented. The linkage examples are not intended to be a comprehensive list of all possible linkages in the strategic report, nor are they intended to be a template for the presentation of information.

1.4 Terms defined in the Glossary (Appendix I) are in **bold type** the first time they appear in each section.

1.5 Clarifications of **the Act's** requirements in respect of the strategic report are provided in a letter from BIS that can be found on the FRC's website at https://www.frc.org.uk/Narrative-Reporting.

Section 2
Scope

2.1 This guidance is non-mandatory and is intended to serve as best practice for all entities[4] preparing a **strategic report**.

> ***Summary of legal requirements***
>
> **The Act** sets out different levels of reporting depending on the type of company.
>
> Section 414A of the Act requires all companies that are not small[5] to prepare a strategic report.
>
> For a financial year in which the company is a parent company, and the directors of the company prepare group accounts, the strategic report must be a group strategic report relating to the entities included in the consolidation.[6]
>
> A detailed analysis of the Act's requirements in respect of the strategic report, including information on the application of the statutory requirements to different types of company, is set out in Appendix III.
>
> Section 415 of the Act also requires all companies to prepare a **directors' report** which contains other information specified by the Act and its associated regulations.[7] The extent of disclosure in a directors' report also varies depending on the type of company. An analysis of the requirements of the Act and its associated regulations in respect of the directors' report is set out in Appendix IV.
>
> Both the strategic report and the directors' report are integral parts of the **annual report**.

2.2 As noted in the 'summary of legal requirements' above, the extent of disclosure that is required for a company will vary according to the type of company. However, this guidance does not differentiate on this basis. **Material** information that is necessary for an understanding of the development, performance, position or future prospects of the entity[8] should be disclosed in the strategic report, irrespective of the existence or otherwise of an explicit statutory disclosure requirement.

> ***Example***
>
> Section 414C(6) of the Act has the effect of providing an exemption for medium-sized companies from the requirement to disclose non-financial **key performance indicators (KPIs)**. However, where disclosure of non-financial KPIs is the most appropriate method of providing the information necessary for an understanding of the development, performance, position or future prospects of a company's business, this guidance recommends their use, even if the company is medium-sized.

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4 This guidance uses the broader term 'entity' unless the term 'company' is more appropriate in a specific context.
5 Section 414B of the Act.
6 Section 414A(3) of the Act.
7 In the case of a medium-sized or large company, the 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008'. In the case of small companies, the 'Small Companies and Groups (Accounts and Directors' Reports) Regulations 2008'.
8 This guidance uses the broader description 'development, performance, position or future prospects of the entity' rather than the description 'development, performance or position of the company's business' contained in the Act, unless the latter is more appropriate in a specific context.

2.3 This guidance is written with the requirements for **quoted companies** in mind (and particularly those listed companies that apply **the Code**), the narrative reporting requirements for which are more extensive than those in the law for unquoted companies. However, this guidance still represents best practice for all companies required to prepare a strategic report.

Section 3
The annual report

The purpose of the annual report

3.1 Although this guidance is primarily focused on the application of the **strategic report** requirements, it also addresses the role of the strategic report in the context of the **annual report** as a whole. This recognises that the strategic report does not exist in isolation.

3.2 **The purpose of the annual report is to provide shareholders with relevant information that is useful for making resource allocation decisions and assessing the directors' stewardship.**

3.3 The annual report should provide the information necessary for shareholders to assess the entity's:

(a) development, performance and position;

(b) future prospects;

(c) **strategy** for achieving its **objectives**;

(d) **business model**;

(e) governance; and

(f) directors' remuneration.

3.4 In meeting the needs of shareholders, the information in the annual report may also be of interest to other investors (such as debt investors and potential investors) and creditors. Other stakeholders such as customers, employees and members of society more widely may also wish to use information contained within it. The annual report should address issues relevant to these other users where, because of the influence of those issues on the development, performance, position or future prospects of the entity's business, they are also **material** to shareholders. The annual report should not, however, be seen as a replacement for other forms of reporting addressed to other stakeholders.

3.5 **The annual report as a whole should be fair, balanced and understandable and should provide the information necessary for shareholders to assess the entity's performance, business model and strategy.**[9]

3.6 The directors of companies that are required to report on how they have applied the Code, or to explain why they have not, are required to include a statement in the annual report confirming that they consider it to be fair, balanced and understandable.

[9] **The Code**, Provision C.1.1. This wording is consistent with the wording of the September 2012 Code. In April 2014, the FRC published a consultation 'Proposed Revisions to the UK Corporate Governance Code'. The proposed amendment to Provision C.1.1 refers to the assessment of ''the company's position and performance, business model and strategy''.

Placement of information

3.7 Table 1 provides an overview of the annual report. It identifies the principal **components** of an annual report, sets out their different but linked objectives and highlights the main sources of disclosure requirements. The table is intended to help preparers make judgements regarding where information would be best located. Considering these different objectives when drafting each component of the annual report will help ensure that only relevant and focused information is included in them.

3.8 Law or regulation defines the components of the annual report, but does not dictate a structure. Similarly, Table 1 is not intended to impose a specific structure or order for the annual report or restrict the directors to including only the components it specifically identifies. Other sections that are not required by law or regulation (e.g. a chairman's statement or a chief financial officer's report) may be included in the annual report as a subsection of a mandatory component, or in a separate non-mandatory section, if that is considered the best way of ensuring that the document is both relevant and understandable.

3.9 Table 1 is not intended to stifle innovation or experimentation. This guidance encourages companies to consider and challenge the structure of their annual reports using the flexibility available within the framework.

Table 1

Document	Annual report				
Document purpose	The purpose of the annual report is to provide shareholders with relevant information that is useful for making resource allocation decisions and assessing the directors' stewardship.				
Component	**Strategic report**[10]	**Corporate governance report**[11,12]	**Directors' remuneration report**[13]	**Financial statements**	**Directors' report**
Component objectives	• To provide context for the related financial statements. • To provide insight into the entity's business model and its main objectives and strategy. • To describe the principal risks the entity faces and how they might affect its future prospects. • To provide an analysis of the entity's past performance. • To provide **signposting** to show the location of **complementary information**.	• To provide information necessary to explain how the composition and organisation of the entity's governance structures supports the achievement of the entity's objectives.	• To set out all elements of the entity's directors' remuneration policy and key factors that were taken into account in setting the policy. • To report on how the directors' remuneration policy has been implemented. • To set out amounts awarded to directors and provide details on the link between the entity's performance and directors' remuneration.	• To present the entity's financial position, performance and development in accordance with Generally Accepted Accounting Practice.	• To provide other statutory/ regulatory information about the entity.
Main sources of annual report disclosure requirements for an unquoted UK company[14]	• **The Act** s414C	• n/a	• n/a	• Accounting standards • The Act • SI 2008/410[15]	• SI 2008/410 Schedule 7
Main sources of annual report disclosure requirements for a UK company with a premium listing on the London Stock Exchange	• The Act s414C • The Code, Provision C.1.2 • **DTR** 4.1[16]	• The Code Schedule B • **LR** 9.8.6(5)–(6) • DTR 7.1[17] • DTR 7.2	• SI 2008/410 Schedule 8 • The Code Section D	• Accounting standards • The Act • SI 2008/410	• SI 2008/410 Schedule 7 • DTR 4.1 • DTR 7.2
	• LR 9.8 requires the inclusion of certain specific disclosures in the 'annual report and accounts'.				

10 The objectives of the strategic report are considered more fully in section 4.
11 The corporate governance report is often included as a component of the directors' report by **cross-reference**.
12 The corporate governance report will usually, in accordance with the recommendations of the Code, include separate sections detailing the work of the audit and nomination committees.
13 Separate guidance on the disclosures to be included in the directors' remuneration report has been published by the GC100 and Investor Group: http://uk.practicallaw.com/6-540-9731.
14 Small companies are not required to prepare a strategic report, corporate governance report or directors' remuneration report. Those companies should refer to SI 2008/409 'Small Companies and Groups (Accounts and Directors' Report) Regulations 2008' in respect of the requirements for the financial statements and **directors' report**.
15 SI 2008/410 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008'.
16 DTR 4.1 refers only to a 'management report' which will usually comprise the strategic report and directors' report.
17 LR 9.8.6(5)–(6) requires all of this information to be included in the annual report without specifying the location.

3.10 **The placement of information within the annual report or elsewhere should facilitate the effective communication of that information.**

3.11 The annual report is a medium of communication between the company's directors and its shareholders. Its structure should facilitate that communication while also complying with company law and other regulatory requirements. In general, information should only be placed in the annual report when it is relevant to shareholders. Information that is primarily provided to meet the needs of other users should be placed elsewhere (e.g. online or in another report), where law or regulation permits.

Placement of information in a component of the annual report

3.12 Each component of the annual report should focus on the communication of the information relevant to meeting the objectives of that component.

3.13 The Act envisages each component of the annual report to be a separately identifiable part of the annual report. Therefore, the strategic report, corporate governance report, directors' remuneration report, financial statements and directors' report should generally include only the content that is necessary to effectively communicate the information that is required by law or regulation.

3.14 It follows from paragraph 3.13 that information that is required to meet the requirements of the strategic report should generally be placed in the strategic report.

Cross-referencing within the annual report

3.15 In some instances, it may be helpful to group together similar or related disclosure requirements arising from different legal or regulatory requirements that apply to different components of the annual report. This will reduce duplication and enable linkages to be highlighted and explained clearly in one place.

3.16 Where information satisfying a disclosure requirement that applies to the strategic report is presented outside of that component, cross-referencing must be used in order for the disclosure requirement to be met. Cross-references should be clear and specific. Cross-referencing may also be applied to other components of the annual report.

3.17 The use of cross-referencing should be limited to when a piece of information would tell the company's story more effectively if it were located in another component of the annual report.

Example

Some accounting standards require the disclosure of large amounts of explanatory detail which may remain unchanged year to year. This information, while material to an understanding of particular items in the financial statements, may be of a nature or volume that would interrupt the flow of information in the components of the annual report (e.g. background information on share-based payment arrangements). The directors might consider locating these disclosures in a separate (audited) 'other financial information' section of the financial statements and linking the disclosures by cross-referencing.

> ***Summary of legal requirements***
>
> Section 463 of the Act provides that directors are liable to compensate the company if the company suffers any loss as the result of any untrue or misleading statement in (or any omission from) the strategic report, the directors' remuneration report or the directors' report. The extent of the liability is limited: directors are only liable to the company. Further, directors are only liable to the company if they knew that the statements were untrue or misleading or if they knew that the omission was a dishonest concealment of a material fact. This protection is sometimes known as 'safe harbour'.
>
> Accordingly, provided directors do not issue a deliberately or recklessly untrue or misleading statement or dishonestly conceal a material fact by way of an omission, they will not be liable to compensate the company for any loss incurred by it in reliance on the report. This 'safe harbour' protection applies to the strategic report, the directors' report and the directors' remuneration report.
>
> In order to benefit from this protection, it is generally accepted that directors should ensure that information required in one of the three specified reports is included in those reports, either directly or via a specific cross-reference.
>
> The exact scope and extent of the protection (including whether it extends to information included in a report on a voluntary basis) has not been tested in court and hence the legal position in relation to the inclusion of such information remains uncertain.
>
> Further information on the application of the 'safe harbour' provisions is provided in a letter from BIS which can be found on the FRC website at https://www.frc.org.uk/Narrative-Reporting.

Placement of complementary information

3.18 Complementary information that is not required to be included in the annual report (i.e. it is voluntary), but which the directors wish to place in the public domain, should generally be published separately (e.g. on the company website). The directors may, however, sometimes consider it appropriate to include some of this complementary information in the annual report. In such cases, that information could be included either in a separate, non-statutory section of the annual report or in the directors' report.

Signposting

3.19 The strategic report should be considered as the top layer of information for shareholders. Some users may require a greater level of detail. In this case, the strategic report can be used to signpost to other complementary information.

3.20 Signposting enables shareholders to 'drill down' to detailed complementary information that is related to a matter addressed in a particular component but that is not necessary to effectively communicate the information that is required by law or regulation in respect of that component. This more detailed complementary information should be placed elsewhere in the annual report, or published separately. Signposts to such information should make clear that it does not form part of the component from which it is signposted.

> ***Example***
>
> An entity in the extractive industry may include its total proven and probable reserves within the strategic report as one of its non-financial **key performance indicators (KPIs)**. The provision of the disaggregation of these totals is an example of complementary information that is not required to meet the objectives of a strategic report. Some companies may include this complementary information as part of their annual report within a separate, non-statutory section of the annual report.

3.21 Paragraphs 3.12 to 3.14 notwithstanding, the components of an annual report should not be drafted independently. It is only through an integrated approach to drafting the annual report that relevant relationships and interdependencies between items of information disclosed in it will be properly identified and appropriately highlighted through linkages and signposting.

Assurance

3.22 The source of disclosure requirements, and their location in the annual report or otherwise, will usually affect the level of assurance to which information is subjected (e.g. audit, review or no formal assurance). It is important that, as a minimum, it is clear which information has been subject to audit and which has not. This is particularly the case where the application of the guidance set out in this section has resulted in the splitting of disclosure requirements derived from a single legislative or regulatory source or the combination of requirements derived from different sources.

Structure of information within a component

3.23 Effective communication of the matters required to be addressed in a component will not usually be achieved through the use of a 'checklist style' approach to drafting. This can result in the structure of the component being driven by the order in which disclosure requirements arise and the presentation of more granular detail in such a way that other important information is obscured.

3.24 Each component of the annual report should be structured in a way that allows for a clear narrative flow and cohesiveness in the information that it contains. The ultimate aim of this is to ensure that the component, and the annual report more broadly, is relevant and understandable.

Section 4
The strategic report: purpose

4.1 The **strategic report** should provide shareholders of the company with information that will enable them to assess how the directors have performed their duty to promote the success of the company.[18]

4.2 The strategic report should reflect the collective view of the company's directors.

4.3 Information in the strategic report should complement the financial statements. In doing so, it should enable the **annual report** to be a more cohesive document.

4.4 In complementing the financial statements, the strategic report should provide information about the business and its development, performance or position that is not reported in the financial statements but which might be relevant to the shareholders' evaluation of past results and assessment of future prospects.

4.5 The strategic report should provide additional explanations of amounts recognised in the financial statements and explain the conditions and events that shaped the information contained in the financial statements.

4.6 The strategic report has three main content-related objectives:

(a) to provide insight into the entity's **business model** and its main **strategy** and **objectives**;

(b) to describe the **principal risks** the entity faces and how they might affect its future prospects; and

(c) to provide an analysis of the entity's past performance.

4.7 The strategic report should also provide **signposting** to show the location of **complementary information**.

> ***Summary of legal requirements***
>
> The purpose of the strategic report is to inform members[19] of the company and help them to assess how the directors have performed their duty under section 172 of the Act.
>
> The duty of a director, as set out in section 172 of the Act, is to '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:
>
> (a) the likely consequences of any decision in the long term;
>
> (b) the interests of the company's employees;
>
> (c) the need to foster the company's business relationships with suppliers, customers and others;
>
> (d) the impact of the company's operations on the community and the environment;
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
>
> (f) the need to act fairly as between members of the company'.
>
> The disclosure requirements set out in section 414C of the Act, on which the content elements in Section 7 are based, are intended to ensure that the strategic report achieves its statutory purpose.

[18] Section 414C(1) of **the Act**.

[19] The Act refers to 'members' of the company, however this guidance uses the broader term 'shareholders' unless the term 'members' is more appropriate in a specific context.

Section 5
The strategic report: materiality

5.1 **Information is material if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole. Only information that is material in the context of the strategic report should be included within it.**

Conversely, the inclusion of immaterial information can obscure key messages and impair the understandability of information provided in the strategic report. Immaterial information should be excluded from the strategic report.

5.2 The **strategic report** and the **annual report** more broadly should only contain information that is **material** to shareholders.

5.3 Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the actual or potential effect of the matter to which the information relates in the context of an entity's annual report. It requires directors to apply judgement based on their assessment of the relative importance of the matter to the entity's development, performance, position or future prospects.

5.4 Materiality in the context of the strategic report will depend on the nature of the matter and magnitude of its effect, judged in the particular circumstances of the case. However, due to the nature of the information contained in the strategic report, and the purpose it serves:

(a) qualitative factors will often have a greater influence on the determination of materiality in the context of the strategic report than might be the case when making materiality judgments in respect of items in the financial statements. Both financial and non-financial information could be material; and

(b) the materiality of an item in the financial statements will often be based on its magnitude relative to other items included in the financial statements in the year under review. The potential magnitude of future effects of a matter on the entity's development, performance, position or future prospects should also be considered when determining the materiality of a matter in the context of the strategic report.

5.5 The assessment of materiality for the strategic report should be reviewed annually to ensure that the information included in the report continues to be material over time in light of changes in facts and circumstances affecting the entity.

Materiality and the Companies Act

5.6 Although **the Act** does not use the term 'material', the concept is implicit in many of its requirements. For example, the disclosure of trends and factors (described in paragraph 7.17) is only required to be included in the strategic report '...to the extent necessary for an understanding of the development, performance or position of the company's business'. Where information is required 'to the extent necessary for an understanding', it should be included in the strategic report when it is material to shareholders.

5.7 The terms 'key' (e.g. as used in the term '**key performance indicators' (KPIs)**) and 'principal' (e.g. as used in the term '**principal risks** and uncertainties') refer to facts or circumstances that are (or should be) considered material to a shareholder's understanding of the development, performance, position or future prospects of the business. For example, these could be the performance measures or risks considered by the board.

5.8 The number of items disclosed as a result of the requirements to disclose principal risks or KPIs will generally be relatively small; they should not, for example, result in a comprehensive list of all performance measures used within the business or of all risks and uncertainties that may affect the entity.

5.9 The strategic report should focus on those matters that are material to an understanding of the development, performance, position or future prospects of the entity when taken as a whole. In the annual report of a parent company, for example, the strategic report should be a consolidated report and should include only those matters that are material in the context of the consolidated group.

5.10 The concept of materiality cannot, however, be applied to disclosures that are required by company law or its associated regulations unless explicitly allowed (for example, through the use of the terms '...to the extent necessary for an understanding of...' or 'principal').

> ***Example***
>
> A **quoted company** must provide the following disclosures in its strategic report irrespective of the directors' view of their materiality or strategic importance:
>
> - a description of its **strategy** and **business model** (see paragraphs 7.5 and 7.11); and
> - a breakdown by gender of the number people it employs (see paragraph 7.51).

5.11 Unlike the strategic report, most of the requirements for the **directors' report** are required irrespective of the directors' view of materiality.

> ***Example***
>
> A quoted company must, to the extent it is practicable to obtain the information, provide the greenhouse gas emission disclosures in its directors' report even if the directors do not consider the information to be material to shareholders. In addition, where it is not practicable to obtain the information, a justification of that fact must be included.[20]

Disclosure of confidential information

5.12 There may be occasions when the directors consider that the disclosure of detailed information about impending developments or matters in the course of negotiation would be seriously prejudicial to the interests of the company. In such cases, summarised information that is not seriously prejudicial may meet substantially all shareholder information needs.

> ***Summary of legal requirements***
>
> Section 414C(14) of the Act clarifies that the disclosure of information about impending developments or matters in the course of negotiation is not necessary if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company. This is the case even if that information is considered material.

Addressing the needs of different shareholder groups

5.13 As noted in paragraph 5.2, the strategic report should contain only the information that is material to shareholders. Sometimes, a company's shareholder base will comprise groups with different needs and interests (e.g. retail investors vs. institutional investors); the needs of all significant shareholder groups should be considered when determining if a matter is material.

[20] SI 2008/410 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008': Schedule 7, Part 7.

Section 6
The strategic report: communication principles

6.1 The communication principles provide guidance on the qualitative characteristics of the disclosures included in the **strategic report**. They are also relevant in the drafting of the **annual report** as a whole.

6.2 **The strategic report should be fair,[21] balanced[22] and understandable.[23]**

6.3 The strategic report should address the positive and negative aspects of the development, performance, position and future prospects of the entity openly and without bias. The directors should seek to ensure that shareholders are not misled as a result of the presentation of, or emphasis given to, information in the strategic report, or by the omission of **material** information from it.

6.4 The strategic report should be written in plain language. The excessive use of jargon should be avoided where possible. Where the use of industry-specific terms is necessary for clear communication, they should be clearly defined and used consistently.

6.5 The method of presentation can significantly affect the understandability of information in the strategic report. The most appropriate method of presentation will depend on the nature of the information but may include tabular, graphical or pictorial methods as well as narrative text. A combination of these methods may also sometimes be appropriate.

6.6 The directors should take into consideration the strategic report when ensuring that the annual report, when taken as a whole, is also fair, balanced and understandable.

6.7 **The strategic report should be comprehensive[24] but concise.**

6.8 Comprehensiveness reflects the breadth of information that should be included in the strategic report rather than the depth of information. The strategic report does not need to cover all possible matters in detail to be considered comprehensive. It should include the information that is necessary for an understanding of the development, performance position and future prospects of the entity.

6.9 Conciseness is achieved through the efficient communication of all material information.

6.10 **Where appropriate, information in the strategic report should have a forward-looking orientation.**

6.11 Information on how a fact or circumstance might affect the entity should be included in the strategic report when it is material to an assessment of the development, performance, position or future prospects of the entity. The provision of this information does not require disclosure of a forecast of future results.

[21] Section 414C(2)(a) of **the Act**.
[22] Section 414C(3) of the Act.
[23] **The Code**, Provision C.1.1.
[24] Section 414C(3) of the Act.

6.12 The strategic report should not concentrate solely on a single timeframe. Where relevant to an understanding of the development, performance, position or future prospects of the entity, the strategic report should give due regard to the short-, medium- and long-term implications of the fact or circumstance being described.

6.13 **The strategic report should provide information that is entity-specific.**

6.14 Information on how a particular fact or circumstance might affect, or has affected, the development, performance, position, or future prospects of the entity and how it is responding to that fact or circumstance provides insightful information that can be used in the assessment of the entity's future prospects. The inclusion of generic or 'boilerplate' information on its own is of limited use to shareholders.

6.15 **The strategic report should highlight and explain linkages between pieces of information presented within the strategic report and in the annual report more broadly.**

6.16 Linkages are relationships or interdependencies between, or the causes and effects of, facts and circumstances disclosed in the annual report.

6.17 The Act sets out a list of discrete disclosure requirements which could be met in a series of independent sections in a strategic report. It is often the case, however, that there are relationships and interdependencies between the required pieces of information that, if highlighted and explained, will provide a greater insight into the entity's business.

Linkage example

Separate sections detailing trends in the entity's business environment and the entity's **strategy** may be individually informative. However, highlighting and explaining linkages between these two elements of the strategic report might provide a deeper insight into the reasons for the entity's strategic choices.

6.18 Similarly, there are many examples where separate sources of requirements that apply to different **components** of the annual report result in the disclosure of related information. While each component of the annual report is independently useful, more valuable insight can be provided if the strategic report highlights and explains linkages between the information disclosed in them.

Linkage example

Providing independent information on an entity's business strategy and directors' remuneration arrangements in the strategic report and directors' remuneration report components will be informative. However, highlighting and explaining linkages between these two components of the annual report might provide a deeper insight into the entity's executive incentivisation policies.

6.19 The most appropriate method of dealing with these linked requirements will depend on factors such as the nature of the information and any regulatory requirements specific to the disclosures being made. The methods are closely linked to the guidance on the placement of information in the annual report set out in Section 3 and may involve the use of **cross-referencing** or **signposting** or combining related disclosures. Where cross-referencing or signposting is used, care should be taken that the nature of the relationship or interdependency is adequately explained, rather than just highlighting its existence.

6.20 It is probable that the information related to some disclosure requirements will be relevant to several different parts of the annual report. Where this is the case, directors will need to consider how the linkages between these discrete disclosure requirements can be highlighted and explained in the most efficient and understandable way.

6.21 The duplication of information should generally be avoided as it usually leads to unnecessary volumes of disclosure detracting from the understandability and usefulness of the annual report as a whole. In some cases, it may be necessary to repeat certain pieces of information, however this should be limited to circumstances when this would tell the company's story more effectively. This may also be achieved by using signposting or cross-referencing.

Example

The directors might consider some information on trends and factors to be relevant to an understanding of an entity's strategy, **principal risks** and current year performance. Directors might choose to highlight relevant linkages either through:

- combining relevant information on trends and factors with the strategy, principal risks and current year performance disclosures;
- highlighting linkages between relevant information on trends and factors and different parts of the strategic report dealing with strategy, principal risks and current year performance; or
- a combination of some or all of the above.

6.22 It would be impracticable to highlight and explain all relationships and interdependencies that exist within the annual report while also ensuring the strategic report is both concise and understandable. In consequence, priority should be given to the relationships and interdependencies that are most relevant to the assessment of development, performance, position or future prospects of the business.

6.23 **The structure and presentation of the strategic report should be reviewed annually to ensure that it continues to meet its objectives in an efficient and effective manner.**

6.24 Consistent structure, presentation and content will facilitate comparison from year to year but the benefits of continuity should not override innovation where this will improve the relevance and understandability of the information presented.

6.25 **The content of the strategic report should be reviewed annually to ensure that it continues to be relevant in the current period.**

6.26 Content that has been brought forward from previous years should be reviewed to ensure that it has continuing relevance. Any information that is no longer necessary in meeting the objectives of the strategic report should be removed.

Section 7
The strategic report: content elements

7.1 The content elements can be analysed into three broad categories – strategic management, business environment and business performance:

Strategic management	Business environment	Business performance
How the entity intends to generate and preserve value	The internal and external environment in which the entity operates	How the entity has developed and performed and its position at the year end
• Strategy and objectives • Business model	• Trends and factors • Principal risks and uncertainties • Environmental, employee, social, community and human rights matters	• Analysis of performance and position • Key Performance indicators (KPIs) • Employee gender diversity

7.2 Paragraph 7.1 notwithstanding, the various content elements required[25] to be included in the **strategic report** should not be addressed in isolation; there are numerous relationships and interdependencies between elements and other disclosures in the **annual report** which, as noted in paragraph 6.15, should be highlighted and explained in the strategic report. The relevance and strength of the relationships and interdependencies between the content elements will vary according to the facts and circumstances of the entity.

7.3 Where there has been a **material** change in the facts or circumstances relating to any of the content elements set out below, that fact should be highlighted and explained.

Strategic management

7.4 **Strategy**, **objectives**, and **business model** are inter-related concepts. Different businesses may use different terms for these concepts and/or may approach them in a different order. This guidance is not designed to impose a specific order or approach on an entity. Irrespective of the order or approach taken, the disclosure of an entity's strategy, objectives and business model should together explain what an entity does and how and why it does it.

7.5 **The strategic report should include a description of the entity's strategy[26] and the objectives it is intended to achieve.**

7.6 An entity will usually have a number of formal objectives that it intends to achieve in pursuit of its ultimate aim or mission. The entity will also have developed a strategy that describes the means by which it intends to achieve these objectives.

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[25] As noted in paragraph 2.1, this is best practice guidance. Certain content elements described in this section of the guidance are not mandatory for companies that do not meet the definition of a **quoted company**. Appendix III sets out which strategic report requirements apply to companies that are not quoted companies.

[26] Section 414C(8)(a) of **the Act** and **the Code**, Provision C.1.2.

7.7 A description of the strategy for achieving an entity's objectives provides insight into its development, performance, position and future prospects. The disclosure of the entity's objectives places the strategy in context and allows shareholders to make an assessment of its appropriateness.

Linkage example

Relating the development and performance of the entity during the year to the strategy that was in place at the time will allow shareholders to assess the directors' actions in pursuit of the entity's objectives and may be relevant in an assessment of the entity's future prospects.

7.8 The description of the entity's strategy and objectives should concentrate on the high-level priorities related to its development, performance, position and future prospects.

7.9 Objectives can be financial or non-financial in nature and may be expressed in quantitative or qualitative terms.

7.10 Where relevant, linkage to and discussion of **key performance indicators (KPIs)** should be included in any descriptions given in order to allow an assessment of the entity's progress against its strategy and objectives. Similarly, emphasising the relationship between an entity's **principal risks** and its ability to meet its objectives may provide relevant information.

7.11 **The strategic report should include a description of the entity's business model.**[27]

7.12 The description of the entity's business model should set out how it generates or preserves value over the longer term, and how it captures that value. It should describe what the entity does and why it does it. It should also make clear what makes it different from, or the basis on which it competes with, its peers.

7.13 The description of the business model should also provide shareholders with a high-level understanding of how the entity is structured, the markets in which it operates, and how the entity engages with those markets (e.g. what part of the value chain it operates in, its main products, services, customers and its distribution methods).

7.14 An entity will often create value through its activities at several different parts of its business process. The description of the business model should focus on the parts of the business processes that are most important to the generation, preservation or capture of value.

Example

An entity operating in the pharmaceuticals sector might have a ready market for an innovative drug; the key to the value creation process is in the development and approval of that drug. In this case, the business model description should give due emphasis to the critical drug development and approval processes.

[27] Section 414C(8)(b) of the Act and the Code, Provision C.1.2.

7.15 The description of the business model should provide shareholders with a broad understanding of the nature of the relationships, resources and other inputs that are necessary for the success of the business.

7.16 The description of the business model should provide context for the strategic report and the annual report more broadly.

> ***Linkage example***
>
> Identifying relationships between the business model and other content elements could provide linkage with other relevant information in the strategic report. For instance, it could highlight the principal risks that affect, or strategy that relates to, a specific part of the business model.

Business environment

7.17 **To the extent necessary for an understanding of the development, performance or position of the entity's business, the strategic report should include the main trends and factors likely to affect the future development, performance or position of the business.**[28]

7.18 Trends and factors affecting the business may arise either as a result of the external environment in which the entity operates or from internal sources. They may have affected the development, performance or position of the entity in the year under review or may give rise to opportunities or risks that may affect the entity's future prospects.

> ***Example***
>
> The environment within which an entity operates, particularly that related to consumer sentiment, can change quickly as a result of a specific incident or media interest. A recent incident or media coverage need not be directly related to the entity, and need not have affected the current year performance, to have the potential to give rise to new risks or opportunities that may have a material effect on its future prospects.

7.19 The strategic report should include a description of the entity's major markets and its competitive position within those markets. It should also cover other significant features of its external environment (e.g. the legal, regulatory, macro-economic and social environment) and how those influence the business. The strategic report should set out the directors' analysis of the potential effect of the trends or factors identified on the development, performance, position or future prospects of the entity.

7.20 The discussion of internal trends and factors will vary according to the nature of the business, but could, for example, include the development of new products and services or the benefits expected from capital investment.

7.21 Where practicable and relevant, the trend or factor should be quantified and the source of the evidence underpinning it identified.

[28] Section 414C(7)(a) of the Act.

Example

An entity may wish to state in its strategic report that the market in which it operates has grown substantially in the past five years. In this case, the strategic report should, where practicable, indicate by how much the market has grown and provide a link to the research or report from which the statistic has been taken.

7.22 Given the influence that trends and factors might have on many aspects of the entity's development, performance, position or future prospects, the linkage of this type of information to other areas of the strategic report and the annual report more broadly will be particularly important.

Linkage example

The strategic report might highlight the principal risks or opportunities that arise from, or the strategy that has been adopted as a result of, significant trends and factors identified. It might also highlight how certain trends or factors have affected the development, performance or position of the entity through reference to information in the financial statements.

7.23 **The strategic report should include a description of the principal risks and uncertainties facing the entity,[29] together with an explanation of how they are managed or mitigated.[30]**

7.24 The risks and uncertainties included in the strategic report should be limited to those considered by the entity's management to be material to the development, performance, position or future prospects of the entity. They will generally be matters that the directors regularly monitor and discuss because of their likelihood, the magnitude of their potential effect on the entity, or a combination of the two.

7.25 Directors should consider the full range of business risks, including both those that are financial in nature and those that are non-financial. Principal risks should be disclosed and described irrespective of how they are classified or whether they result from strategic decisions, operations, organisation or behaviour, or from external factors over which the board may have little or no direct control. The assessment should include consideration of threats to solvency and liquidity.

Linkage example

Principal risks may result from matters described in paragraph 7.29. In such cases, information on the policies adopted by the entity on those matters and the effectiveness of those policies (as set out in paragraph 7.34) will be important to the assessment of how the entity manages or mitigates these risks.

7.26 The descriptions of the principal risks and uncertainties facing the entity should be specific so that a shareholder can understand why they are material to the entity. This might include a description of the likelihood of the risk, an indication of the circumstances under which the risk might be most relevant to the entity and its

[29] Section 414C(2)(b) of the Act.

[30] It is considered best practice to explain how principal risks are managed or mitigated. The FRC's consultation 'Proposed Revisions to the UK Corporate Governance Code', Provision C.2.1 reflects this.

possible effects. An explanation of how the principal risks and uncertainties are managed or mitigated should also be included to enable shareholders to assess the impact on the future prospects of the entity.

Linkage example

The disclosure of risk management or mitigation might be enhanced with the discussion of the reporting and monitoring process, for example, through disclosures that explain the entity's appetite for risk, how often the risk is reviewed, and by whom. Risk management and mitigation could also be linked to an entity's overall approach to risk management and internal control which is often included in the corporate governance report.

7.27 Significant changes in principal risks such as a change in likelihood, probable timing or possible effect, or the inclusion of new risks, should be highlighted and explained.

Example

It could be useful to explain the change in risk profile since the previous year and how the entity has responded to this change in terms of its risk mitigation.

7.28 A risk or uncertainty may be unique to the entity, a matter that is relevant to the market in which it operates, or something that applies to the business environment more generally. Where the risk or uncertainty is more generic, the description should make clear how it might affect the entity specifically.

Linkage example

Where relevant, the description of the principal risks and uncertainties facing the entity should include linkage to and discussion of the entity's strategy and/or business model. Any linkage to accounting estimates and judgements disclosed in the notes to the financial statements, the going concern statement, trends or factors from the external environment described elsewhere in the strategic report, or any other linked disclosure in the annual report, could also be highlighted and, where relevant, discussed.

7.29 **To the extent necessary for an understanding of the development, performance or position of the entity's business, the strategic report should include information about:**

(a) environmental matters (including the impact of the business of the entity on the environment);

(b) the entity's employees; and

(c) social, community and human rights issues.

The information should include a description of any relevant policies in respect of those matters and the effectiveness of those policies.

Where information on any of the matters described above is not included in the strategic report because it is not considered necessary for an understanding of the development, performance or position of the company's business, the strategic report should state the matters that are not covered in the strategic report.[31]

[31] Section 414C(7)(b) of the Act.

7.30 There can be a strong relationship between the development, performance, position or future prospects of an entity and some or all of the matters described in paragraph 7.29, particularly over the longer term. This may be because a particular matter gives rise to a principal risk or uncertainty or because the entity has gained a competitive advantage from its policies and responses to such matters. The relative importance of the matters will depend on the sector in which the entity operates and its strategy and business model.

7.31 The strategic report should include information on a matter described in paragraph 7.29 when its influence, or potential influence, on the development, performance, position or future prospects of the entity's business is material to shareholders.

> ***Example***
>
> An entity that sources its products from overseas could face risks (e.g. reputational risks) relating to customer concerns over local labour practices. In this situation, the entity might have put in place a system to validate and monitor adherence to stated labour practice policies across its supply chain. Where the nature or magnitude of the potential effect of the risk on the business is such that it would be material to shareholders, it should be described and discussed in the strategic report.

7.32 The information should make clear how any matters identified under paragraph 7.29 might affect the development, performance, position or future prospects of the entity's business.

7.33 The influence, or potential influence, of the matters described in paragraph 7.29 on the development, performance, position or future prospects of the entity's business may sometimes be better described through the integration of the relevant information with other content elements, rather than through the use of a separate 'corporate social responsibility' section of the strategic report but, in any case, clear linkage should be provided.

> ***Linkage example***
>
> The way an entity conducts its business in relation to the issues in paragraph 7.29 may affect its licence to operate/trade in a particular location or market, or may potentially result in a major event that will directly or indirectly affect the entity (e.g. a material litigation, loss of revenue or reparation cost). The risk of such an event may constitute a principal risk or uncertainty to the entity and/or the actions taken in response to these matters may constitute a strategy that warrants disclosure. In such circumstances, the information about the issue might be most appropriately disclosed alongside a description of the related risk or strategy rather than in a separate part of the strategic report.

7.34 Where information on a specific matter described in paragraph 7.29 is considered necessary for an understanding of the development, performance, position or future prospects of the entity's business, a description of some or all of the following items could be included in the strategic report when they are considered relevant:

(a) the entity's policy in respect of the matter, together with a description of any measures taken to embed the commitment within the organisation;

(b) any process of due diligence through which the entity:

(i) assesses the actual or potential impacts arising from its own activities and through its business relationships;

(ii) integrates the findings from these assessments and takes action to prevent or mitigate adverse impacts;

(iii) tracks the effectiveness of its efforts; and

(iv) communicates its efforts externally, in particular to affected stakeholders; and

(c) the entity's participation in any processes intended to remediate any adverse effects that it has caused or to which it has contributed.

7.35 Where an entity uses KPIs to monitor its performance in respect of any of the matters described in paragraph 7.29, the most efficient way of communicating information on the effectiveness of its policies on those matters will often be through reference to those measures.

7.36 Directors may refer to a source of guidance (e.g. the UN *Guiding Principles on Human Rights*) or a voluntary framework that provides advice on how the entity should conduct its business, suggests ways of monitoring or tracking performance, or provides examples of disclosures that might be helpful in communicating information to the entity's stakeholders. In preparing the strategic report, the directors may choose to comply fully or partially with that guidance or voluntary framework, or take a more general regard of its content. Where such an approach is taken, directors should nevertheless ensure that only information that is necessary for an understanding of the development, performance, position or future prospects of the entity's business, or that is otherwise required by law, is included in the strategic report.

7.37 Information on any of the matters described in paragraph 7.29 that is not considered necessary for an understanding of the development, performance, position or future prospects of the entity's business should not be included in the strategic report. Where the directors wish to put this information in the public domain, it should be located outside of the strategic report, for example in a separate sustainability or corporate social responsibility report which could be located online.

Business performance

7.38 **The strategic report should provide an analysis of the development and performance of the business in the financial year and of its position at the end of that year.**[32]

7.39 The analysis should complement the financial statements, where relevant providing additional explanations of amounts recognised in the financial statements and the conditions and events that shaped the information contained in them.[33]

Example

The strategic report might, where relevant, include comments on:

- the existence and timing of commitments for capital expenditures;
- changes in revenue from year to year that result from organic growth, acquisitions, foreign exchange, etc. (a 'revenue bridge'); or
- financing arrangements (e.g. changes in net debt or approach to financing of long-term liabilities).

[32] Section 414C(2)(a) and (3) of the Act.
[33] Section 414C(12) of the Act.

7.40 The development and performance of the business should be analysed in the context of the strategy applied by the entity during the financial year. Segmentation of the analysis of development, performance or position should be consistent with the segments identified in the financial statements.

7.41 Where necessary for an understanding of the development, performance, position or future prospects of the entity, the analysis should make reference to cash flows during the year and factors that may affect future cash flows. Where appropriate, the strategic report should discuss the entity's current and prospective liquidity and its ability to fund its stated strategy.

7.42 The strategic report should include information on the entity's key strengths and tangible and intangible resources. This should include those items that are not reflected in the financial statements. Depending on the nature of the business, these may include: corporate reputation and brand strength; customer base; natural resources; employees; research and development; intellectual capital; licences, patents, copyrights and trademarks; and market position.

7.43 **The analysis in the strategic report should include financial and non-financial key performance indicators (KPIs).[34]**

7.44 The KPIs used in the analysis should be those that the directors judge to be most effective in assessing progress against objectives or strategy, monitoring principal risks, or are otherwise utilised to measure the development, performance or position of the entity.

7.45 Non-financial KPIs can be indicators of future financial prospects and progress in managing risks and opportunities. They may include, for example, measures related to product quality, customer complaints, or the matters identified in paragraph 7.29.

7.46 Where possible, KPIs should be generally accepted measures that are widely used, either within the entity's industry sector or more broadly. However, the comparability of the KPIs between industry peers should not override the effectiveness of the KPIs for assessing the performance or position of the entity's own business.

Linkage example

The use of KPIs that also form part of directors' current or future incentive plans in the analysis of principal risks, strategy and performance will provide a clearer indication of how these matters might affect or have affected executive remuneration.

7.47 Comparatives should be included and the reasons for any significant changes from year to year explained. Consistency in the presentation of KPIs is a desirable quality.

7.48 The entity should provide information that enables shareholders to understand each KPI used in the strategic report. For example, the following information should be identified and explained where relevant:

(a) its definition and calculation method;

(b) its purpose;

(c) the source of underlying data;

(d) any significant assumptions made; and

[34] Section 414C(4) of the Act.

(e) any changes in the calculation method used compared to previous financial years, including significant changes in the underlying accounting policies adopted in the financial statements which might affect the KPI.

7.49 Where a line-item from the financial statements, or a commonly used KPI, has been adjusted for inclusion in the strategic report, the term used for that adjusted measure should be clear and, where practicable, a reconciliation to an appropriate financial statement line-item and explanation of any material adjustments should be provided.

> ***Example***
>
> Where an entity uses earnings before interest, tax, depreciation, amortisation (EBITDA) and certain restructuring costs as a KPI, the measure could be referred to as 'EBITDA before restructuring costs' or similar. A reconciliation to an appropriate financial statement line-item and explanation of the adjustment should be provided.

7.50 Similar KPIs should be clearly distinguishable from each other.

> ***Example***
>
> An entity may use one adjusted earnings per share measure when discussing performance and another when discussing executive remuneration in the directors' remuneration report. The terms adopted to describe each KPI should be unique and used consistently and the differences between the two KPIs clearly identified.

7.51 **The strategic report should provide a breakdown showing, as at the end of the financial year:**

(a) the number of persons of each sex who were directors of the company;

(b) the number of persons of each sex who were senior managers of the company (other than persons falling within sub-paragraph (a)); and

(c) the number of persons of each sex who were employees of the company.[35]

7.52 A 'senior manager' is an employee who has responsibility for planning, directing or controlling the activities of the entity or a strategically significant part of it. In the strategic report of a consolidated group, directors of subsidiary companies that are included in the consolidated financial statements are also considered 'senior managers'.[36]

7.53 In referring to a 'strategically significant' part of an entity and by including directors of subsidiaries included in the consolidated financial statements, the definition of a 'senior manager' in paragraph 7.52 is wider than the definition of key management personnel in IAS 24 *Related Party Disclosures* and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

7.54 An entity might not consider that including all directors of all subsidiaries included in the consolidated financial statements in the statutory definition of 'senior managers' accurately reflects its executive pipeline. This may be the case, for instance, where a subsidiary is insignificant in the context of the group as a whole. In such cases, it may be appropriate to provide an enhanced analysis of the statutory 'senior manager' category.

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[35] Section 414C(8)(c) of the Act.
[36] Section 414C(9) & (10) of the Act.

For example:

	Male	Female
Directors of the company	x	x
Employees in other senior executive positions	x	x
Directors of subsidiary companies not included in above	x	x
Total senior managers other than directors of the company	x	x
Other employees of the group	x	x

7.55 Where the strategic report includes an enhanced analysis such as that suggested in paragraph 7.54, a description of how employees included in any non-statutory category have been identified should be provided. Information on other executive pipeline or general employee diversity matters should also be provided where it is necessary to put the diversity statistics into context. While percentages of male and female directors and employees can be informative, numbers must also be provided.

Other content elements

7.56 **To the extent that matters are considered to be of strategic importance to the entity, the strategic report should include information that would otherwise be disclosed in the directors' report.**[37]

7.57 There are a number of **directors' report** disclosure requirements that are closely related to matters that should be considered for inclusion in the strategic report. Where this information is also necessary for an understanding of the development, performance, position or future prospects of the entity, it should be included as part of the strategic report. However, where the information is not necessary for that purpose, these disclosures should be included in the directors' report. In such cases, a **signpost** enabling shareholders to drill-down to this information should be considered when it is related to matters covered in the strategic report. Appendix IV includes an analysis of directors' report disclosure requirements.

7.58 Where information that is required to be disclosed in the directors' report is included in the strategic report, it does not also need to be included in the directors' report. However, where this is the case, the directors' report should **cross-reference** information that has been included in the strategic report instead of the directors' report.[38]

Signature of the statutory reports and the statement of directors' responsibilities

Summary of legal requirements

The Act requires the board of directors to approve the strategic report, directors' report and directors' remuneration report, as well as the financial statements. The name of the director or secretary of the company who has signed each report on behalf of the board should be stated on every copy of that report in accordance with section 433 of the Act. The Act does not specify where in each report the name should be located.

[37] Section 414C(11) of the Act.

[38] SI 2008/410 'Large and Medium-sized Companies and Groups (Reports and Accounts) Regulations 2008': Schedule 7, Part 1(1A).

Section 8
The strategic report with supplementary material

Statutory option to provide strategic report with supplementary material

Summary of legal requirements

Section 426 of **the Act** allows a company, in certain circumstances, to send its members the **strategic report** with supplementary material instead of the full **annual report**. The supplementary material, which is specified in section 426A of the Act, includes information on the audit report issued on the annual accounts and, in the case of a **quoted company**, limited extracts from the directors' remuneration report. This option replaces the option to send summary financial statements to members instead of the full annual report.

8.1 Where this statutory option is taken, the Act requires a complete strategic report, as it appears in the annual report, to be sent to the company's shareholders. Compliance with the law would not be achieved if the shareholders were sent a summarised version of, or selected extracts from, the strategic report that is included in the company's annual report.

8.2 Similarly, disclosures that are included in the strategic report by **cross-reference** to another part of the annual report must also be sent to shareholders along with the main body of the strategic report in order to comply with the law.

Example

A quoted company has chosen to present the strategic report's quantitative employee gender diversity disclosures alongside the description of the board's policy on diversity, its objectives for implementing the policy and its progress on achieving those objectives, that **the Code** recommends is set out in a separate nomination committee report. It has included a cross-reference to these quantitative disclosures in the company's strategic report in order for it to meet the requirements of section 414C(8). If the company wishes to take the option to send its shareholders the strategic report and supplementary material instead of the full annual report, it must ensure that the quantitative employee gender diversity disclosures form part of the supplementary material that is sent with the main body of the strategic report.

8.3 The strategic report will often **signpost** or otherwise refer to **complementary information** presented elsewhere in the annual report; this signposting will often include a reference to a page number in the full annual report. The directors may wish to consider whether including a clarifying statement in the 'strategic report with supplementary material' is appropriate to draw attention to the fact that this information is not included as part of the document that has been issued.

8.4 While there is no requirement to include any supplementary information other than that specified under section 426A of the Act under this statutory option, a company may include additional extracts from, or summaries of, information contained in the full annual report, if the directors consider it appropriate. The nature and extent of these extracts will vary from company to company and will depend on the information needs of the company's shareholders and the nature and format of the information already included in the strategic report.

Non-statutory summarised business information

8.5 Business information that is tailored to the needs of a specific subset of the company's shareholders can be more easily produced when its form and content is not prescribed in law or regulation. In consequence, a non-statutory approach to sending summarised business information may be considered appropriate. This might particularly be the case where a company's shareholder base contains subsets of investors who have significantly different information needs.

> ***Example***
>
> A company's shareholder base may comprise substantial retail and institutional investor subgroups. The directors may find that the shareholders in the retail investor subgroup wish to receive business information that is less detailed than would be appropriate for inclusion in the strategic report within the full annual report. In these circumstances, the directors might consider it appropriate to send non-statutory summarised business information which focuses on the issues that they believe will be of the greatest relevance to the retail investors, rather than to send this subgroup of shareholders the strategic report with supplementary material as described in paragraphs 8.1 to 8.4.

> ***Summary of legal requirements***
>
> Section 435 of the Act sets out the requirements in connection with publication of non-statutory accounts. Where a company chooses to send its members non-statutory summarised business information that includes any financial statements, then it must ensure that it complies with the requirements in section 435.
>
> Where this non-statutory approach is taken, members must also be sent one of the statutory reports (i.e. either the strategic report with supplementary material, described in paragraphs 8.1 to 8.4 above, or the full annual report).

Electronic publication of statutory reports

8.6 In certain circumstances, the statutory report required to be sent to shareholders can be sent electronically (e.g. on a CD or DVD, by e-mail or through a link to the company's website) rather than in hard copy form.

> ***Summary of legal requirements***
>
> Sections 146 and 147 of the Act set out the requirements in respect of the communication of information by a company to its members. A company may choose to send its annual report to consenting members by electronic means. In order to take advantage of this option, the company must give its members the opportunity to choose to receive their annual report in a hard copy form. This is normally done when a member becomes a shareholder but can be done at any later date. If the consent letter is worded appropriately, the member can be assumed to have consented to electronic delivery if they do not respond. Publication of the annual report on the company's website can also be considered an acceptable form of delivery to consenting members as long as the company's articles permit it and the company has notified the member of its availability and where it can be found.

Appendix I: Glossary

the Act	The Companies Act 2006.
annual report	The annual accounts and reports that members of the company are entitled to receive under section 423 of **the Act**.
business model	How the entity generates or preserves value over the longer term.[39]
complementary information	Complementary information is information that is relevant to shareholders but is not necessary to effectively communicate the information that is required by law or regulation. Complementary information can be more detailed information or additional voluntary information (e.g. a five year summary or a glossary).
components	The distinct reports and other sections that are required to be included in the **annual report** by law or regulation (e.g. the **strategic report**, the **directors' report**, the corporate governance report, the directors' remuneration report and the financial statements).
cross-referencing	A means by which an item of information, which has been disclosed in one **component** of an annual report, can be included as an integral part of another component of the annual report. A cross-reference should specifically identify the nature and location of the information to which it relates in order for the disclosure requirements of a component to be met through the relocated information. A component is not complete without the information to which it cross-references. Cross-referenced information must be located within the annual report. Cross-referencing is different to **signposting**.
the Code	The 2012 UK Corporate Governance Code.
directors' report	The report that is required by section 415 of the Act which incorporates the disclosures specified by the Act and its associated regulations.
DTR	The Disclosure and Transparency Rules.
key performance indicators (KPIs)	Quantitative measures used by directors to assess progress against **objectives** or **strategy**, track **principal risks**, or otherwise monitor the development, performance or position of the business.
LR	The UK Listing Authority (UKLA) Listing Rules.

[39] **The Code**, Provision C.1.2.

material (in the context of the strategic report)	Information is material if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole. Only information that is material in the context of the strategic report should be included within it. Conversely, the inclusion of immaterial information can obscure key messages and impair understandability of information provided in the strategic report. In such circumstances, the immaterial information should be excluded from the strategic report.
objective	A specific aim that the entity wishes to achieve.
principal risk	A risk or combination of risks that can seriously affect the performance, future prospects or reputation of the entity. These should include those risks that would threaten its business model, future performance, solvency or liquidity.
quoted company	A company whose equity share capital has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000; or is officially listed in an EEA State; or is admitted to dealing on either the New York Stock Exchange or the exchange known as NASDAQ.[40]
signposting	A means by which a shareholder's attention can be drawn to **complementary information** that is related to a matter disclosed in a component of the annual report. A component must meet its legal and regulatory requirements without reference to signposted information. Signposts should make clear that the complementary information does not form part of the component from which it is signposted. Signposted information may be located either within or separately from the annual report. Signposting is different to **cross-referencing**.
strategic report	The report, required by section 414C of the Act, which provides shareholders of the company with the ability to assess how the directors have performed their duty under section 172 (duty to promote the success of the company).
strategy	A plan or approach which is intended to help the entity achieve an objective.

[40] Section 385 of the Act.

Appendix II: The Accounting Council's advice to the FRC to issue *Guidance on the Strategic Report*

Introduction

1. This report provides an overview of the main issues that have been considered by the Accounting Council in advising the FRC during the development of the *Guidance on the Strategic Report*.

2. In developing this guidance, the Accounting Council has obtained input from the Narrative Reporting Working Group (Working Group). This group comprised of investors, preparers, auditors, representatives from the Department for Business, Innovation and Skills (BIS) and the International Integrated Reporting Council (IIRC) as well as representatives from the FRC's Corporate Governance, Corporate Reporting Review and Financial Reporting Lab teams. The FRC is grateful to the members of the Working Group for their input during the development of this guidance.

Advice

3. The Accounting Council is advising the FRC to issue *Guidance on the Strategic Report.*

Background

4. BIS has asked the FRC to prepare non-mandatory guidance on the application of the **strategic report** requirements introduced into **the Act** by the *Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013* (the 'Regulations'). Separate guidance on the application of the mandatory greenhouse gas (GHG) emissions reporting required by the Regulations has been published by the Department for Environment Food and Rural Affairs (DEFRA).[41]

5. The *Guidance on the Strategic Report* will replace the Accounting Standards Board's *Reporting Statement: Operating and Financial Review* (RS).

6. When 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. The *Guidance on the Strategic Report* is also broadly consistent with the guidance in the International Accounting Standards Board's (IASB) IFRS Practice Statement *Management Commentary*.

7. The FRC is also monitoring developments relating to the EU Directive amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large companies and groups (the 'Directive') and the implementation of those requirements in the UK. The requirements will apply to large public-interest entities (as defined) with more than 500 employees. The majority of the disclosures in the Directive are already reflected in the strategic report requirements of the Act. The main change for UK companies will be the introduction of disclosures on anti-corruption and bribery issues. Once the requirements are implemented in the UK, we will consider updating the *Guidance on the Strategic Report* to reflect any changes to UK law.

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[41] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf

Objectives

8. The FRC is committed to improving the quality of financial reporting and would like to encourage annual reports to be more relevant to the needs of shareholders. The FRC's projects on the disclosure framework and cutting clutter are a step towards this goal and the *Guidance on the Strategic Report* will contribute to achieving this aim.

9. In developing the guidance, the Accounting Council has drawn on the feedback from the FRC's Discussion Paper *Thinking about Disclosures in a Broader Context*. That discussion paper has a broad scope which includes disclosures in narrative reports such as the strategic report. The discussion paper noted that providing disclosures should be a communication rather than a compliance exercise; it considered issues such as the application of **materiality** to disclosures and highlighted the challenges caused by different authoritative sources setting disclosure requirements. While it is not possible to address all of the problems with disclosures in a single piece of non-mandatory guidance, the Accounting Council believes that improving disclosures in the strategic report will be a step in the right direction.

10. The objectives that the Accounting Council have set for the *Guidance on the Strategic Report* are intended to ensure that the guidance helps entities to prepare strategic reports, and annual reports more generally, that: (a) are focused on the needs of shareholders; (b) tell a cohesive story of the business; and, (c) make full use of the flexibility that exists within the regulatory framework.

11. The Accounting Council believes that the *Guidance on the Strategic Report* should draw on, but not be bound by, the guidance in the RS that it replaces.

Scope

12. With the introduction of the strategic report, the Accounting Council believes there is an opportunity to make the annual report a more cohesive document. It believes that this can only be achieved by setting the strategic report in the context of the annual report as a whole. Therefore, the Accounting Council suggested that the scope of the guidance should go beyond the strategic report, emphasising linkages between the strategic report and other parts of the annual report.

13. A number of respondents who commented on the Exposure Draft *Guidance on the Strategic Report* expressed a concern that the guidance was principally aimed at **quoted companies**. They noted that the majority of companies preparing a strategic report will not be quoted companies and, as such, are not required by law to provide three of the eight content elements (drawn from section 414C of the Companies Act 2006). They also noted that relatively few companies preparing a strategic report would be within the scope of **the Code**, from which the term 'fair, balanced and understandable' has been drawn.

14. The *Guidance on the Strategic Report* is intended to illustrate and promote best practice reporting and that information should be disclosed when it is relevant to shareholders. The Accounting Council does not believe that it would be best practice for an unquoted company to prepare a strategic report which omitted, for example, information on a material human rights issue, simply because there was no explicit legal or regulatory requirement to address such matters. Similarly, the Accounting Council believes that best practice would not be achieved if an unquoted company prepared a strategic report which was not fair, balanced and understandable.

15. The Accounting Council also notes that Appendix III and IV of *Guidance on the Strategic Report* highlight the application of the strategic report and **directors' report** disclosure requirements to different types of entity. In addition, where the requirements are drawn from the Act, its regulations or the Code, the source of the content elements and communication principles are set out in the footnotes.

The annual report

16. The Accounting Council believes that, to set the guidance in context, it is necessary to understand the purpose of the annual report and its intended audience.

The purpose of the annual report

17. The Accounting Council believes that, in order to ensure that the annual report is a relevant, concise and understandable document, it is essential for there to be clarity around both its purpose and primary audience. The Accounting Council believes that, in line with the Act, the annual report should be a document for shareholders. This will ensure that annual reports provide information that is relevant to shareholders and, in turn, result in clear and concise reporting.

18. Section 414C(1) of the Act states that the legal addressees of the strategic report are the members of the company. In consequence, paragraph 3.2 acknowledges that the strategic report provides information to meet their needs (members are referred to in the guidance as the 'shareholders'). However, the Accounting Council believes that the needs of a wider investor group than simply current shareholders should be borne in mind when the annual report is being drafted; preparers should also consider the needs of other investors (including debt investors) and potential investors.

19. Paragraph 3.4 acknowledges the fact that information in the annual report may also be of interest to users other than investors. However, the Accounting Council does not believe that the annual report should seek to address the needs of these other stakeholders, unless that information is also material to shareholders. The guidance makes clear that the annual report should not be seen as a replacement for other forms of reporting addressed to other stakeholders but that, instead, information that is more specialised or detailed than is necessary to meet the requirements of law or regulation can be **signposted** from it.

Placement of information

20. The Accounting Council considers that Table 1 is useful in clarifying the objectives of each **component** of the annual report. By clarifying the objectives of each of these components, the Accounting Council believes that preparers will be better able to make judgements regarding where and how information should be presented.

21. In developing the objectives set out in Table 1, the Accounting Council intended to build on concepts that have already been developed by the FRC or the IASB. Therefore, the purpose of the annual report is as set out in the FRC's 2009 Discussion Paper *Louder than Words* and is consistent with the IASB's objective of financial reporting as set out in its *Conceptual Framework for Financial Reporting*.

22. The objectives for the directors' remuneration section were based on *Directors' Pay: Consultation on revised remuneration reporting regulations* (BIS, June 2012).

23. The Accounting Council acknowledges that a risk associated with a graphical representation of an annual report, or indeed any systematic description of the components and purpose of an annual report, is that it implies a desired or preferred structure for all annual reports. This is not the Accounting Council's intention. The Accounting Council believes that it is important that an annual report is drafted and structured in such a way that, as well as being compliant with all of the relevant laws and regulations, it is fair, balanced and understandable. It encourages companies to consider and challenge the 'traditional' structure of the annual report with an objective of organising information so as to improve its understandability and accessibility.

24. During the development of the guidance, respondents to the Exposure Draft noted that Table 1 did not include a chairman's statement when the Code specifically encourages a personal statement from the chairman. Similarly, it did not include the audit committee report or nomination committee report as separate components. Other respondents thought that the table should include the financial highlights, a chief executive officer's report, or a sustainability report, all of which are commonly found in annual reports in practice.

25. The Accounting Council notes that Table 1 is intended to show the minimum requirements for reports set out in law and regulation and that the inclusion of these other items might result in a greater risk that companies would see it as being more structurally prescriptive than is intended. The Accounting Council has, however, introduced a reference to the three sections of the corporate governance component specifically mentioned in the Code along with an acknowledgement that the corporate governance component is usually presented as a separate part of the annual report and included in the directors' report by **cross-reference**.

26. The Exposure Draft introduced the concepts of 'core' and 'supplementary', which were intended to ensure that the most important information is given prominence over other, more detailed information. Respondents to the consultation requested more clarity around the meaning of the terms 'core' and 'supplementary', the interaction of those terms with the guidance on materiality, and the consistency of the concepts with the shareholder focus adopted in the guidance.

27. The concept was intended to promote effective communication between the company's directors and its shareholders. The Accounting Council considers that it would be difficult to develop a precise definition of these terms as the types of information that would be 'core' or 'supplementary' would vary according to the specific facts and circumstances of an entity.

28. In view of the comments from respondents and the Accounting Council's original intentions, the terms 'core' and 'supplementary' have been removed from Section 3 and replaced with guidance that is intended to emphasise the need for effective communication.

29. For the avoidance of doubt, the Accounting Council is clear that when information is not material for shareholders, it should be excluded from the annual report, except where law or regulation requires disclosure regardless of materiality.

30. The Accounting Council would like to encourage a flexible approach for placement of information in the annual report and its components. The most appropriate structure for effective communication is a matter of judgment based on the company's facts and circumstances and the directors' assessment of the needs of its shareholders.

31. Directors may consider that there may be more detailed, complementary information that is not required to be disclosed in the strategic report by law or regulation but would be useful for other users. Where the directors judge that the level of detail would inhibit the effective communication of the most important matters that affect the company, they might conclude that the most appropriate way of communicating that information is outside of the annual report (e.g. online).

32. The Accounting Council notes that there may be instances when law or regulation requires disclosure regardless of materiality: where this is the case, this type of information could be positioned in a different location within the annual report, for example in the directors' report which could be located at the back of the annual report, so that it does not detract from the effective communication of the information that the directors consider to be most relevant to shareholders.

33. One challenge the recommendations in Section 3 pose is to ensure that there is clarity regarding the information that is and is not subject to audit. The Accounting Council acknowledges that preparers will need to be particularly careful in this respect if they elect to cross-reference or signpost to information that may be subject to different levels of assurance or no assurance at all.

The strategic report: purpose

34. During the course of the development of the *Guidance on the Strategic Report*, the Accounting Council became aware of a commonly held misconception that the strategic report would be an additional higher-level summary of information contained within the annual report; that it would contain only 'strategically important' information which may be of a different level of materiality or importance to the information formerly included in the business review. However, the purpose and required content of the strategic report, as it is described in the Act, does not differ significantly from that of the business review which it replaces.

35. The Accounting Council intends that the three content-related objectives of the strategic report set out in paragraph 4.6 ensure that the purpose of the strategic report, as defined by the Act, is met. In meeting these objectives, the Accounting Council believes that the strategic report will contribute to the overall objectives of the annual report which are to provide information that is useful for making resource allocation decisions and for assessing directors' stewardship.

36. The fourth objective, set out in paragraph 4.7, reflects the importance that the Accounting Council attaches to the view that one role of the strategic report is to be an aid to navigation around the myriad of corporate information that is available about an entity. The Accounting Council holds the view that signposting from the strategic report should facilitate 'drill-down' to further detail elsewhere in the annual report and beyond.

The strategic report: materiality

37. The Accounting Council believes that the application of the concept of materiality is a key issue for the strategic report. The inclusion in the strategic report of narrative information that is not material to shareholders, and is not otherwise required by law or regulation, is considered a key driver of 'clutter'. In addressing the issue of materiality in a separate section, as well as embedding references within other sections, the Accounting Council would like to reinforce the importance of the application of materiality in the context of the strategic report.

38. While the changes introduced into the Act represent only a relatively modest change to the pre-existing legal requirements, the Accounting Council hopes that they might act as a catalyst for companies to revisit their policies and practices with a view to preparing relevant and focused annual reports more generally. The section on materiality provides guidance on the level of detail that should be included in the strategic report; it may result in some companies eliminating some detail previously included in the business review section of their annual report.

39. Respondents who commented on the Exposure Draft were generally supportive of the approach taken to the application of materiality. Some respondents, however, suggested that the concept of materiality as set out in the Exposure Draft was a narrow definition. Section 172 of the Act sets out the director's duties in respect of business conduct. Some respondents are of the view that the role of the strategic report is to report on the matters outlined in section 172 and that the application of materiality should go beyond the needs of shareholders. BIS has written to the FRC to clarify a number of legal points relating to the Regulations and in that it has confirmed that the concept of materiality as set out in this guidance is consistent with the Act.

40. While directors are explicitly required to take the interests and issues set out in section 172 into account in the way the business is run, that section does not imply any specific duties to those other stakeholder groups or impose disclosure requirements above those set out in section 414C. The Accounting Council believe that, in meeting the disclosure requirements set out in section 414C (on which the content elements in Section 7 are based), the strategic report will fulfil its statutory purpose.

41. Several respondents requested additional guidance on the application of the concept of materiality in the strategic report, with some respondents suggesting the inclusion of material taken from UK GAAP, IFRSs and auditing standards.

42. While sympathetic to the call for greater guidance on the application of materiality in the context of the strategic report, the Accounting Council chose to limit the amendments to the guidance to the clarification of a relatively small number of specific application points raised by the respondents. The Accounting Council is mindful of work on the topic of materiality being undertaken by the IASB and does not want to prejudge the conclusions of that project by developing potentially inconsistent guidance.

The strategic report: communication principles

43. As the *Guidance on the Strategic Report* is focused on the strategic report, the Accounting Council has drafted the communication principles to provide guidance on qualitative characteristics that are specific to the strategic report. It acknowledges, however, that they will also be relevant in the drafting of the annual report as a whole. The qualities described in this part of the guidance are generally those which were highlighted as desirable by investors. In some cases, however, the qualities also have a legal or regulatory source.

44. The Code requires the annual report as a whole to be fair, balanced and understandable. While the Act requires the strategic report to be both fair and balanced, there is no similarly direct requirement for it also to be understandable. The Accounting Council considers that, given the annual report, when taken as a whole, must be fair balanced and understandable, the strategic report section must also have those same characteristics.

45. The Accounting Council has included the reference to ‘comprehensive’ in paragraph 6.7 because it is an explicit requirement of the Act. Its inclusion does not conflict with the recommendation that the strategic report should also be concise as the Accounting Council has interpreted comprehensive, in this respect, to be a function of breadth of information rather than depth of information. The depth of information on any particular subject should be a function of materiality, which is considered in Section 5 of the guidance.

46. The Accounting Council intends the reference to ‘short-, medium- and long-term’ to indicate that the strategic report should not concentrate solely on a single timeframe (e.g. it should not just consider the short-term). Information in the strategic report should not necessarily be categorised or organised in this way, although the timescale associated with a particular fact or circumstance may be relevant information to disclose.

47. Effective linkage enhances the usefulness of individual pieces of information in an annual report and increases their relevance to investors. The Accounting Council considers that ‘linkage’ is a key quality for investors.

48. During the development of the guidance, the Accounting Council considered the inclusion of a communication principle recommending that the structure and presentation of the strategic report should remain consistent from year to year unless a change represented an improvement of the communication of the information contained in the strategic report. Although consistency from year to year was a quality investors desired, the Accounting Council believes that an over emphasis on consistency might inhibit the more general communication improvements that are seen as a priority.

49. As a result of comments received on the Exposure Draft, the Accounting Council added a communication principle that recommends annual review of the content of disclosures in the strategic report. The Accounting Council considers that this annual review process will ensure that the information remains relevant for the current year.

The strategic report: content elements

50. BIS has requested the FRC to prepare non-mandatory guidance to support the new legal requirements for the strategic report. Therefore, the content elements in this guidance closely follow the legal requirements. Subject to some minor alterations to the wording where it is considered necessary to clarify the language used, the wording of the bold content elements set out in Section 7 is generally consistent with that used in the Act. These bold content elements are supplemented with supporting detail that describes the nature of information that the Accounting Council believes should be considered for disclosure in respect of each requirement.

51. There are a limited number of examples where the bold content elements differ more substantively from the requirements of the Act in order to provide emphasis to particular aspects of a requirement or to strongly encourage the disclosure of certain additional information. The principal substantive differences between the bold content elements and the requirements of the Act are as follows:

    - paragraph 7.5 – The description of the **objectives** that the **strategy** is intended to achieve is a not statutory requirement but is a bold content element;
    - paragraph 7.23 – The description of how **principal risks** are managed or mitigated is a not statutory requirement but is a bold content element;
    - paragraph 7.39 – Additional explanations of amounts included in the financial statements is a statutory requirement but not a bold content element; and
    - paragraph 7.58 – The disclosure of what directors' report information has been disclosed instead in the strategic report is a statutory requirement but not a bold content element.

52. The Accounting Council wishes to provide some guidance on how information might be presented in the strategic report without being seen to be too prescriptive regarding its structure or content. It has sought to achieve this by highlighting examples of the way in which the content elements might be combined or interact with each other; these examples are set out in the 'linkage example' boxes within the guidance.

Objectives, strategy and business model

53. Provision C.1.2 of the Code describes a **business model** as 'the basis on which the company generates or preserves value over the longer term'. The definition used in the guidance is consistent with the Code.

54. During the development of the guidance, preparers and investors indicated that it is important that the description of the business model explains how the entity differs from its competitors.

55. The Accounting Council believes that it is important for investors to understand how the value generated by the business activities is captured and converted into financial benefits. This quality of a business model description has been added into the content element guidance.

56. The Accounting Council acknowledges that different businesses use different terms for objectives, strategy and business model. In addition, distinguishing between these concepts is challenging and reaching a consensus on how they should be differentiated is difficult, as they are inextricably linked. However, despite some respondents suggesting

that these concepts be approached as a single requirement, the Accounting Council advised to continue with the approach taken in the Exposure Draft and to define and describe concepts separately. In reaching its decision to do this the Accounting Council noted that many preparers and the Working Group indicated that this is an area that is difficult to apply and on which guidance would be helpful and also that the Act treats strategy and business model as separate concepts.

57. Although the Act, and this guidance, deals first with strategy and then with the business model, the Accounting Council believes that entities could apply a different order to these concepts when presenting this information in their annual report. The Accounting Council also does not intend to imply that other definitions or terminology cannot be used in the strategic report.

Principal risks and uncertainties

58. The definition of a principal risk, and the language used in the guidance paragraphs under the principal risks content element has been developed taking into account the FRC's review of its guidance on risks and going concern arising from the Sharman Inquiry.

59. Taking decisions on how a company should approach the principal risks it faces is a fundamental part of the duties of a director. Information on how the principal risks are managed is therefore important to shareholders when making resource allocation decisions and assessing management's stewardship. In consequence, the Accounting Council believes that such information should be included in the strategic report. Where a company has a non-UK listing (e.g. on the New York Stock Exchange or NASDAQ), directors will need to consider the regulatory requirements in those jurisdictions before including this information in their overseas filings.

60. At the time of publication of the guidance, the FRC's consultation 'Proposed Revisions to the UK Corporate Governance Code' is underway. This consultation proposes amendments relating to risks and going concern. In consequence, the wording in the *Guidance on the Strategic Report* may not be fully aligned with the output of that consultation. The Accounting Council will consider whether any amendments are needed in respect of this as part of any future updates to the guidance.

Environmental, employees, social, community and human rights matters

61. A number of the respondents noted that there was relatively little guidance in the Exposure Draft on how to address the new requirement to include, to the extent necessary for an understanding of the development, performance or position of the entity's business, information on human rights issues. Several respondents also advocated the inclusion of explicit references to third-party guidance that deals with some or all of the matters listed in paragraph 7.29.

62. The Accounting Council has chosen not to suggest disclosures that are specific to the new human rights disclosure requirement. Instead, it suggests possible disclosures based on recommendations in the UN *Guiding Principles on Human Rights* that can be applied equally to any of the matters listed in paragraph 7.29. The Accounting Council has taken this approach because:

- it does not consider it appropriate to deal exclusively with only one of the five matters listed in paragraph 7.29 in the guidance; and
- it believes that providing similarly detailed guidance on all of the matters listed in paragraph 7.29 would be unnecessary and place an inappropriate emphasis on this single disclosure requirement.

63. While the Accounting Council acknowledge that directors may wish to refer to other third-party guidance when developing and monitoring the entity's policies in respect of the

matters listed in paragraph 7.29 or when drafting disclosures for inclusion in the annual report, it does not believe it to be practicable or desirable to identify specific sources of third-party guidance in *Guidance on the Strategic Report*. Instead, the Accounting Council has taken the approach of providing more general guidance on when reference to these third-party sources might be appropriate.

Employee gender diversity

64. The main issues identified by respondents in respect of the employee gender diversity disclosures arose from the practical consequences of the definition of a ‘senior manager’ used in the Act. In particular, they highlighted the potentially onerous task of undertaking a gender analysis of subsidiary directors in very large groups and the lack of differentiation between directors of strategically significant and less important subsidiaries.

65. As the definition of ‘senior manager’ is defined in law, the Accounting Council has in the guidance clarified the statutory meaning of the term in order to prevent its misinterpretation. Some respondents expressed concern that applying the statutory definition could lead to a misleading disclosure. To address this, the guidance includes an example of an additional voluntary analysis that might be used to further illustrate the gender mix of the entity’s senior executive pipeline.

Strategic report with supplementary material

66. A large number of the respondents who commented on the Exposure Draft noted that the Exposure Draft did not include guidance on the replacement of the summary financial statements with the strategic report (along with some specified supplementary material). Respondents highlighted some practical questions such as: whether sending a summarised strategic report instead of the full strategic report contained in the annual report was appropriate; how the guidance on the placement of information in the annual report interacted with the new requirements; and, what is the appropriate level of formal financial information that should be included (voluntarily) in the supplementary information? The Accounting Council advised that a new section be included in the guidance to address these questions.

Appendix III
The Companies Act 2006 strategic report disclosure requirements

The following table summarises the disclosure requirements of **the Act** in respect of the strategic report.

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
s414C(1)	The purpose of the strategic report is to inform members of the company and help them to assess how the directors have performed their duty under s172 (duty to promote the success of the company).	✓	✓	✓ (Except those that would be small if not in an ineligible group – s414B)	×
s414C(2)(a)	The strategic report must contain a fair review of the company's business.	✓	✓		×
s414C(2)(b)	The strategic report must contain a description of the principal risks and uncertainties facing the company.	✓	✓		×
s414C(3)	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.	✓	✓		×

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
	The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:				
s414C(4)(a)	(i) analysis using financial key performance indicators; and	✓	✓	✓ (Except those that would be small if not in an ineligible group – s414B)	×
s414C(4)(b)	(ii) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.	✓	✓	✓ (Large companies only – s414C(6))	×
s414C(7)(a)	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 future development, performance and position.	✓	×	×	×

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
s414C(7)(b)	The strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about: (i) environmental matters (including the impact of the company's business on the environment); (ii) the company's employees; and (iii) 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 information of each kind mentioned in s414C(7)(b)(i), (ii) or (iii), it must state which of those kinds of information it does not contain.	✓	×	×	×
s414C(8)(a)	The strategic report must include a description of the company's strategy.	✓	×	×	×
s414C(8)(b)	The strategic report must include a description of the company's business model.	✓	×	×	×

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
s414C(8)(c), (9) & (10)	The strategic report must include a breakdown showing at the end of the financial year: (i) the number of persons of each sex who were directors of the [parent][42] company; (ii) the number of persons of each sex who were senior managers of the company (other than persons falling within sub-paragraph (i)) [or who were directors of undertakings included in the consolidation];[43] and (iii) the number of persons of each sex who were employees of the company. A senior manager is an employee of the company who has responsibility for planning, directing or controlling the activities of the company, or a strategically significant part of the company.	✓	×	×	×

42 In the case of group accounts, this category comprises directors of the parent company only (s414C(10)(a)).
43 In the case of group accounts, this category includes directors of subsidiary undertakings who otherwise would not meet the definition of a senior manager (s414C(10)(b)).

Reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
s414C(11)	The strategic report may also contain such matters otherwise required by regulations made under s416(4) to be disclosed in the directors' report that the directors consider are of strategic importance to the company.	✓	✓	✓ (Except those that would be small if not in an ineligible group – s414B)	×
s414C(12)	The report must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.	✓	✓		×
s414A(4) & s414C(13)	A group strategic report may, where appropriate, give greater emphasis to the matters that are significant to the undertakings included in the consolidation, when taken as a whole. With the exception of the disclosures required by s414C(8), in relation to a group strategic report s414C has effect as if the references to the company were references to the undertakings included in the consolidation.	✓	✓		×
s414C(14)	Nothing in s414C requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.	✓	✓	✓ (Except those that would be small if not in an ineligible group – s414B)	×
s414D(1)	The strategic report must be approved by the board and signed on behalf of the board by a director or the secretary of the company.	✓	✓		×

Appendix IV
The Companies Act 2006 directors' report disclosure requirements

The following tables summarise the disclosure requirements of **the Act** and its associated regulations in respect of the directors' report.

Companies Act 2006 reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
s236	Statement of the existence, at any time during the financial year to which a directors' report relates or when the directors' report is approved, of qualifying indemnity provisions (whether made by the company or otherwise) for the benefit of one or more directors of the company or directors of an associated company.	✓	✓	✓	✓
s416(1)	The names of the persons who, at any time during the financial year, were directors of the company.	✓	✓	✓	✓
s416(3)	The amount (if any) that the directors recommend should be paid by way of a dividend.	✓	✓	✓ (Except those that would be small if not in an ineligible group – s415A)	×
s418(2)	A statement to the effect that, in the case of each of the persons who are directors at the time the report is approved, (a) so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware, and (b) he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information.	✓	✓	✓	✓ (If audited)

Companies Act 2006 reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
s419(1)	Approval by the board of directors and signature on behalf of the board by a director or the secretary of the company.	✓	✓	✓	✓
s419(2)	If in preparing the report advantage is taken of the small companies' exemption, the directors' report must contain a statement to that effect in a prominent position above the signature.	×	×	× (Except those that would be small if not in an ineligible group – s415A)	✓

Regulations[44] reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
Sch 7.1A	Identification of the information for which the company has chosen, in accordance with s414C(11) of the Companies Act, to set out in the company's strategic report which would otherwise be required by Schedule 7 of the 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008' to be contained in the directors' report.	✓	✓	✓	×

[44] In the case of a medium-sized or large company, Schedule 7 of the 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008'. In the case of small companies, Schedule 5 of the 'Small Companies and Groups (Accounts and Directors' Reports) Regulations 2008'.

Regulations reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
Sch 7.3(2) & 4(1) Sch 5.2(2-3) & 3(1)	Information on political donations made or political expenditure incurred by the company or its subsidiaries, if in excess of £2,000 in aggregate.	✓ (Other than wholly owned subsidiaries of UK-incorporated companies)	✓ (Other than wholly owned subsidiaries of UK-incorporated companies)	✓ (Other than wholly owned subsidiaries of UK-incorporated companies)	✓ (Other than wholly owned subsidiaries of UK-incorporated companies)
Sch 7.6(1)(a)	Unless the information is not material for an assessment of the assets, liabilities, financial position and profit or loss of the company (and any subsidiaries included in its consolidation), an indication of financial risk management objectives and policies, including the policy for hedging each major type of forecasted transaction for which hedge accounting is used.	✓	✓	✓	×
Sch 7.6(1)(b)	Unless the information is not material for an assessment of the assets, liabilities, financial position and profit or loss of the company (and any subsidiaries included in its consolidation), an indication of exposure to price risk, credit risk, liquidity risk and cash flow risk.	✓	✓	✓	×
Sch 7.7(1)(a)	Details of any important events affecting the company (and any subsidiaries included in its consolidation) since the end of the financial year.	✓	✓	✓	×
Sch 7.7(1)(b)	An indication of likely future developments in the business of the company (and any subsidiaries included in its consolidation).	✓	✓	✓	×
Sch 7.7(1)(c)	An indication of activities (if any) of the company (and any subsidiaries included in its consolidation) in the field of research and development.	✓	✓	✓	×

Regulations reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
Sch 7.7(1)(d)	Unless the company is an unlimited company, an indication of the existence of branches (as defined in s1046(3) of the Companies Act 2006) of the company outside of the United Kingdom.	✓	✓	✓	×
Sch 7.8-9	Information on the acquisition of own shares.	✓	✓	×	×
Sch 7.10(3) Sch 5.5(3)	A statement describing the company's policy regarding the hiring, continuing employment and training, career development and promotion of disabled persons.	✓ (Where the weekly average number of employees exceeds 250)	✓ (Where the weekly average number of employees exceeds 250)	✓ (Where the weekly average number of employees exceeds 250)	✓ (Where the weekly average number of employees exceeds 250)
Sch 7.11(3)	For employees working wholly or mainly in the UK, a description of the action that has been taken during the financial year to introduce, maintain or develop arrangements aimed at: (a) providing employees systematically with information on matters of concern to them as employees; (b) consulting employees or their representatives on a regular basis so that the views of employees can be taken into account in making decisions which are likely to affect their interests; (c) encouraging the involvement of employees in the company's performance through an employees' share scheme or by some other means; (d) achieving a common awareness on the part of all employees of the financial and economic factors affecting the performance of the company.	✓ (Where the weekly average number of UK-based employees exceeds 250)	✓ (Where the weekly average number of UK-based employees exceeds 250)	✓ (Where the weekly average number of UK-based employees exceeds 250)	×

Regulations reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
Sch 7.13(2) & 14	Detailed information, including any necessary explanatory material with regard to that information, on matters including: (a) the structure of the company's capital (including securities not admitted to trading on a regulated market); (b) any restrictions on the transfer of securities in the company; (c) persons with a significant direct or indirect holding of securities in the company; (d) persons who hold securities carrying special rights with regard to control of the company; (e) voting rights of shares in employee share schemes; (f) restrictions on voting rights; (g) agreements between holders of securities that are known to the company and may result in restrictions on the transfer of securities or on voting rights; (h) any rules that the company has about the appointment and replacement of directors, or the amendment of the company's articles of association; (i) the powers of the company's directors, including in particular any powers in relation to the issuing or buying back by the company of its shares; (j) significant agreements to which the company is a party that take effect after or terminate upon, a change of control of the company following a takeover bid, and the effects of any such agreements;	✓ (Company quoted on an EU-regulated market only)	×	×	×

Regulations reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
	(k) any agreements between the company and its directors or employees providing for compensation for loss of office or employment (whether through resignation, purported redundancy or otherwise) that occurs because of a takeover bid, unless disclosure of the agreement would be seriously prejudicial to the company and the company is not under any other obligation to disclose it.	✓ (Company quoted on an EU-regulated market only)	×	×	×
Sch 7.15(2), (3) & (18)	To the extent it is practicable for the company to obtain the information, the quantity of emissions in tonnes of carbon dioxide equivalent from activities for which that company is responsible including:[45] (a) the combustion of fuel; and (b) the operation of any facility. To the extent practicable for the company to obtain the information, the report must state the annual amount of emissions in tonnes of carbon dioxide equivalent resulting from the purchase of electricity, heat, steam or cooling by the company for its own use. Comparatives must be given after the first year of the application of this requirement.[46]	✓	×	×	×
Sch 7.15(4)	A statement of what information in Sch 7.15(2) & (3) is not disclosed and why, if it is not practicable for the company to obtain some or all of that information.	✓	×	×	×

[45] Separate guidance on the application of the greenhouse gas (GHG) emissions disclosure requirements has been published by the Department for Environment Food & Rural Affairs (DEFRA): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf

[46] The GHG emissions disclosure requirements are effective for the first time in periods ending on or after 30 September 2013.

Regulations reference	Requirement	Quoted public company	Other public company including AIM	Large and medium-sized private company	Small private company
Sch 7.16	The methodologies used to calculate the information disclosed under Sch 7.15(2) & (3).	✓	×	×	×
Sch 7.17 & 18	At least one ratio which expresses the quoted company's annual emissions in relation to a quantifiable factor associated with the company's activities. Comparatives must be given after the first year of the application of this requirement.	✓	×	×	×
Sch 7.19	The period for which the company is reporting if the period for which it is reporting the information required by Sch 7.15(2) & (3) is different to the period in respect of which the directors' report is prepared.	✓	×	×	×

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