

# CONSULTATIONS

## FINANCIAL REPORTING COUNCIL

## EXPOSURE DRAFT: GUIDANCE ON THE STRATEGIC REPORT

### INTRODUCTION

These comments are submitted by the Association of International Accountants (AIA), with input from a Technical Committee and members of the Association.

### ABOUT AIA

The Association of International Accountants (AIA) was founded in the UK in 1928 as a professional accountancy body and from conception has promoted the concept of 'international accounting' to create a global network of accountants in over 85 countries worldwide.

AIA is recognised by the UK government as a recognised qualifying body for statutory auditors under the companies act 2006, across the European Union under the mutual recognition of professional qualifications directive and as a prescribed body under the companies (auditing and accounting) act 2003 in the Republic of Ireland. AIA also has supervisory status for its members in the UK under the money laundering regulations 2007.

AIA promotes and supports the advancement of the accountancy profession both in the UK and internationally. The AIA exams are based on international financial reporting and international auditing standards and are complimented by a range of variant papers applicable to local tax and company law in key jurisdictions together with an optional paper in Islamic accounting.

AIA members are fully professionally qualified to undertake accountancy employment in the public and private sectors.

## AIA RESPONSE

### SECTION 3 THE ANNUAL REPORT

Section 3 of this draft guidance includes an illustration (Illustration 1) which is intended to clarify the purpose of each part of the annual report and help those that prepare annual reports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

#### QUESTION 1

DO YOU THINK THAT ILLUSTRATION 1 IS HELPFUL IN ACHIEVING THIS OBJECTIVE?

We consider that the illustration acts as an informative 'summary' to preparers of annual reports (to complement the overall guidance provided). The 'section objective/component objectives' elements act well to communicate key messages from the guidance.

However, we would also like to comment that use of the word 'shareholder' appears to have been adopted throughout the guidance document (and within the illustration). Within the introduction to the guidance the need to 'improve corporate accountability and transparency', and improve the quality of narrative reporting more generally, are stated. Given these aims of the guidance, would the use of the words 'users of the financial statements' or 'stakeholders' be more applicable and aligned to the goals of the guidance document, rather than the restricted implications of using the word 'shareholders'. All users of financial statements will benefit for improvements suggested in the guidance document. (We acknowledge that this is discussed on P. 31, point 22/23 in the Accounting Council's comments – however, the restrictive use of word shareholder does not seem in alignment with the overall aim of the guidance).

#### QUESTION 2

DO YOU AGREE WITH THE OBJECTIVES OF EACH COMPONENT AND SECTION OF THE ANNUAL REPORT WHICH ARE INCLUDED IN ILLUSTRATION 1?

Under section objectives of strategic report the statement 'to provide context for the related financial statements', raises questions immediately to the reader. Therefore to complement this statement, we would suggest that a reference to the paragraph where the objective is discussed in more depth (later in the document under section 6) is inserted, following each of the statements under Strategic report/section objectives.

i.e. Following statement 'To provide context for the related financial statements', a reference to 'Paragraph 6.X'. However on reading through section 6 I still have concerns in my mind how to interpret the statement (and where it is addressed specifically in section 6, although the statement is seen to be repeated under section 6.2).

The addition of paragraph references within the illustration, to further expand on the strategic report objectives would be considered beneficial to the reader. Other than the first objective discussed above, all of the other objectives appear clear and unambiguous.

**QUESTION 3**

DO YOU THINK THE GUIDANCE ON THE PLACEMENT OF INFORMATION IN THE ANNUAL REPORT IN PARAGRAPHS 3.10 TO 3.14 WILL HAVE A POSITIVE INFLUENCE IN MAKING THE ANNUAL REPORT MORE UNDERSTANDABLE AND RELEVANT TO SHAREHOLDERS?

In principle, the guidance provided on placement should have a positive impact on the majority of 'knowledgeable' users of financial statements, who are aware of changes to reporting. However, there is potential for less experienced users of financial statements to be disadvantaged through a 'non-standard' format discussed under section 3.11. Due to non-standard formats, less experienced users may have difficulty in comparability of annual reports for investment or other purposes.

Point 3.1 whilst being very valid and essential for improvements to communication of key information to users of financial statements, may be open to interpretation in terms of 'the most appropriate /ordering or the most appropriate locations' wording used in the examples under this section.

We suggest that paragraph 3.13 and 3.14 should be the first statement under this section, followed by section 3.11 and 3.12 and examples.

**SECTION 5 STRATEGIC REPORTS AND MATERIALITY**

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

**QUESTION 4**

DO YOU AGREE WITH THIS APPROACH? IS THE LEVEL OF GUIDANCE PROVIDED ON THE SUBJECT OF MATERIALITY APPROPRIATE?

We believe that the guidance adequately defines materiality and its relation to the strategic report.

However, we would suggest that paragraphs 5.2 and 5.5 should be combined in some way, as they are communicating the same message regarding relevance of content.

**SECTION 6 THE STRATEGIC REPORT****QUESTION 5**

DO YOU AGREE WITH THE PROPOSED 'COMMUNICATION PRINCIPLES', SET OUT IN PARAGRAPHS 6.5 TO 6.27 OF THE DRAFT GUIDANCE, WHICH DESCRIBE THE DESIRED QUALITATIVE CHARACTERISTICS OF INFORMATION PRESENTED IN THE STRATEGIC REPORT? DO YOU THINK THAT ANY OTHER PRINCIPLES SHOULD BE INCLUDED?

The concept of impression management should be discussed within this section (particularly in relation to point 6.7 to ensure that 'shareholders are not misled') and related to the governance mechanisms elsewhere in the annual report (i.e. highlighting control mechanisms over impression management of the strategic report). Misleading representation in graphical form inevitably impacts investment decisions, so this point should be stressed more firmly in this section.

### QUESTION 6

IN THIS DRAFT GUIDANCE, WE HAVE AIMED TO STRIKE A BALANCE BETWEEN THE NEED TO ENSURE THAT THE STRUCTURE AND PRESENTATION OF THE STRATEGIC REPORT IS SUFFICIENTLY TAILORED TO THE ENTITY'S CURRENT CIRCUMSTANCES AND THE NEED TO FACILITATE COMPARISON OF THE STRATEGIC REPORT FROM YEAR TO YEAR. DO YOU THINK THE GUIDANCE IN PARAGRAPHS 6.26 AND 6.27 ACHIEVES THE CORRECT BALANCE?

We agree these paragraphs are sufficient at present. However to enhance paragraph 6.27 the concept of comparability could be added, e.g. in the form of 'When change is considered necessary, the directors should ensure that the strategic report allows adequate mapping for comparability with prior year presentation'.

### QUESTION 7

THE 'CONTENT ELEMENTS' IN BOLD TYPE DESCRIBED IN PARAGRAPHS 6.28 TO 6.73 DO NOT GO BEYOND THE REQUIREMENTS SET OUT IN THE ACT, ALTHOUGH THE PRECISE WORDING MAY HAVE BEEN EXPANDED TO MAKE THEM MORE UNDERSTANDABLE. DO YOU THINK THIS IS APPROPRIATE? IF NOT, WHAT OTHER 'CONTENT ELEMENTS' SHOULD BE INCLUDED IN THIS DRAFT GUIDANCE?

We agree that the expansion of wording for 'understandability' is essential within the guidance. However, it is appropriate that the guidance only contains the requirements set out in the Act. The guideline document has been clear throughout of the importance of 'clear and concise' communication of key content, therefore it would not be appropriate to expand on content elements beyond the legislation at this point in the guidance.

### QUESTION 8

APPENDIX I 'GLOSSARY' USES THE SAME DEFINITION OF A BUSINESS MODEL AS THE CODE ('HOW THE ENTITY GENERATES OR PRESERVES VALUE'). IS THE LEVEL OF GUIDANCE PROVIDED ON THE BUSINESS MODEL DESCRIPTION IN PARAGRAPHS 6.38 TO 6.41 SUFFICIENT?

We believe that the level of guidance is appropriate. Point 6.39 is particularly helpful, however it is thought that point 6.40 should be incorporated in point 6.38 (or follow on directly from point 6.38, as this expansion/example specifically related to the 'codes definition', whereas point 6.39 is a more generalised point).

### QUESTION 9

DO YOU THINK THAT THIS DRAFT GUIDANCE DIFFERENTIATES SUFFICIENTLY BETWEEN THE CONCEPTS OF BUSINESS MODEL, OBJECTIVES AND STRATEGIES? IF NOT, WHY NOT AND HOW MIGHT THE GUIDANCE BE IMPROVED?

We consider that section 6.29 shows the differences between objectives/strategy/business model well in illustrated form. However, it may be more appropriate to reorder the content elements into business model (what business does), then follow on by objectives and strategies (as this seems a more logical order to discuss, as the business model is already in existence and objective and strategy are current/future related). The selected order, however may have been organised to reflect the way in which the items appeared in sections of the Act.

Section on business model (6.37-6.41) provides a clear definition of what business does, how and where it generates value, and linkage to risk. However when reading the example 6.40 there seems to be some crossover to objective/strategy (which is inevitable as the concepts are inter related). The section on objectives/strategies (6.31-6.35) is not as strong however and could be expanded further (especially point 6.35 which is particularly vague in how directors can achieve appropriate communication).

#### QUESTION 10

THIS DRAFT GUIDANCE INCLUDES ILLUSTRATIVE GUIDANCE (THE 'LINKAGE EXAMPLES') ON HOW THE CONTENT ELEMENTS MIGHT BE APPROACHED IN ORDER TO HIGHLIGHT RELATIONSHIPS AND INTERDEPENDENCIES IN THE INFORMATION PRESENTED. ARE THESE LINKAGE EXAMPLES USEFUL? IF NOT, WHAT ALTERNATIVE EXAMPLES OR APPROACH SHOULD BE USED?

From a personal viewpoint, the reviewer found the linkage examples a distraction when reading through the guidance documents. These sorts of examples are more useful when read as an appendices of illustrations. Then in the illustrations, specific reference to the guidance paragraphs referred to can be made (and the process of referring back to the sections, embeds the guidance in the 'preparers' of annual report more effectively).

#### FURTHER INFORMATION

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

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