

Guidance on the Strategic Report



The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, applying to financial years ending on or after 30 September 2013, were issued in August. While the new regulations represent a relatively modest change to the existing 'Business review' requirements, the FRC have issued for consultation *Guidance on the Strategic Report* with a view to providing a catalyst for companies to publish more concise and relevant narrative reports, thereby facilitating communication and engagement with investors.

It is intended that the final *Guidance on the Strategic Report* serves as a best practice statement and, as such, will have persuasive rather than mandatory force.

The draft guidance

The draft guidance sets out that the purpose of the Strategic Report is to provide shareholders of a company with the ability to assess how the directors have performed their duty to promote the success of the company for their collective benefit. It then goes on to address materiality, communication principles and content elements.

Materiality

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.

Information is material if its omission from or misrepresentation in the Strategic Report might reasonably be expected to influence the economic decisions shareholders make on the basis of the annual report as a whole.

Communication principles

The communication principles provide guidance on the qualitative characteristics of the disclosures and are intended to emphasise that the Strategic Report is a medium of communication between a company's directors and its shareholders. The principles are reproduced below (in blue) along with additional explanatory narrative:

The Strategic Report should be fair balanced and understandable. The Strategic Report should be neutral, addressing positive and negative aspects of the entity's development, performance, position and future prospects. The directors should ensure that shareholders are not misled as a result of the omission of, or emphasis given to, any information on any aspects of the entity's development, performance, position or future prospects.

The Strategic Report should be concise. The Strategic Report should contain only the strategic and other important information that is relevant to the assessment of how the directors have performed their duty to promote the success of the company for the benefit of its shareholders.

Where appropriate, information in the Strategic Report should have a forward looking orientation.

Information on how a fact or circumstance might affect the entity's future development, performance or position should be included. This information is not intended to be the same as a forecast of future results, rather it is a focus on aspects of the year under review that are relevant to an assessment of future prospects.

The Strategic Report should provide information that is entity-specific. 'Boilerplate' information is of only limited use to shareholders. However, information on how a particular fact or circumstance might affect, or has affected, the development, performance or position of the entity's business and how it is responding to the fact or circumstance provides more insightful information that can be used in the assessment of future prospects.

The Strategic Report should highlight relationships and interdependencies (linkages) between information presented in different parts of the annual report. While each part of the annual report is independently useful, more valuable insight can be provided if linkages between the information in different components and sections are highlighted.

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. When contemplating a change to the structure of the Strategic Report, directors should consider whether the change represents an improvement in the quality of information provided.

Content elements

The content elements for the Strategic Report set out in the [draft] guidance are derived from the Companies Act 2006, as amended by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 and are reproduced below (in blue) along with additional explanatory narrative:

The Strategic Report should include a description of the entity's principal objectives and its strategies for achieving those objectives. The Strategic Report should include a description of the entity's business model.

The description of the entity's business model should set out how it generates or preserves value, and how it captures that value. It should provide shareholders with an understanding of how the entity is structured, the market in which it operates, and how the entity engages with that market (e.g., what part of the value chain it operates in, its main products, services, customers and its distribution methods). It should also describe the nature of the relationships, resources and other inputs that are necessary for the successful continuation of the business.

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.

The development, performance and position of every entity is affected by its external environment. The Strategic Report should include a description of the entity's major markets and its competitive position within those markets together with any internal trends such as the development of new products and services or the benefits expected from capital investment. It should cover the significant features of the legal, regulatory, macro-economic and social environment in which the entity operates, and how that has influenced the business. It should also set out the directors' analysis of the potential effect on the future development, performance or position of the entity of the trends or factors identified.

The Strategic Report should include a description of the principal risks and uncertainties facing the entity, together with an explanation of how they are managed or mitigated.

The risks and uncertainties included in the Strategic Report should be limited to those considered by the entity's management to be the most important to the future development, performance or position of the entity; and should be sufficiently specific that a shareholder can understand why they are important to the entity. Significant changes in principal risks such as a change in likelihood or possible effect, or the inclusion of new risks, should be highlighted and explained. An explanation of how the principal risks and uncertainties are managed or mitigated should also be included.

The analysis in the Strategic Report should include the financial and non-financial key performance indicators (KPIs) utilised by the directors to measure progress towards achieving a particular objective or strategy.

The KPIs used in the analysis should be those that the directors judge are most effective in assessing progress against objectives or strategies. The entity should provide information that enables shareholders to understand each KPI used in the Strategic Report.

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.

The Strategic Report should set out the key strengths and tangible and intangible resources available to the entity, which will assist it in the pursuit of its objectives. Particular attention should be given to those items that are not reflected in the financial statements.

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. Where this information is material it should be placed in the Strategic Report. However, the Strategic Report should not be seen as a replacement for other forms of reporting addressed to other stakeholders

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 entity (other than persons falling within sub-paragraph (a)); and (c) the number of persons of each sex who were employees of the entity. To the extent that they are matters which are considered to be of strategic importance to the entity, the Strategic Report should also include information which would otherwise be disclosed in the directors' report.

What next

Although the guidance is still subject to consultation, and may change, quoted companies preparing Strategic Reports in line with the new Regulations may find it useful and persuasive. Furthermore, while the draft guidance has been written with quoted companies in mind, it may also be useful for other entities preparing Strategic Reports. Feedback on the draft guidance should be provided to the FRC by 15 November 2013. The draft guidance can be found at www.frc.org.uk/Home.aspx

Contact us

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