The strategic report: Bringing your story to life.

GATHER

Reporting intelligence white paper
03/ Making sense of governance and reporting regulations

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Mei Ashelford, FCA BBA
Editor and Director of reporting intelligence at Gather

mei@gather.london
020 3176 0343
www.gather.london

My role is to advise clients on the ever-evolving regulatory landscape and best practice in corporate governance and reporting.

I am a chartered accountant with close to 20 years' technical reporting experience, six of which I spent as a Governance and Reporting policymaker at the Financial Reporting Council.

About this white paper

This is the third paper in our series of white papers that explore the challenging landscape of corporate governance and reporting, focusing on the implications to those preparing annual reports for listed companies.

This paper builds on the second of our papers, Changes in Corporate Governance: Do then say, which outlined the key corporate governance and reporting regulations that became effective in 2019. In this paper, we will explore the 'say' of 'Do then say'; specifically the structure and content of the strategic report. We will explain what the regulatory requirements are, how to put together a strategic report that brings your story to life, and answer some frequently asked questions.

Who is this paper for?

This paper is intended for those involved in the development, production and publication of the annual report, particularly those who have responsibility for the strategic report and corporate governance report, and those involved in investor relations and corporate communications.

The papers

The regulations around corporate governance and reporting are complex; keeping abreast of these ever-changing requirements is challenging. Our series of white papers help to break these down into bite-sized, manageable chunks:

2019
September
01/ Making sense of governance and reporting requirements
December
02/ Changes in corporate governance and reporting: Do then say.

2020
January
03/ The strategic report: Bringing your story to life
February
04/ Digital reporting: Implications of ESEF and XBRL reporting
March
05/ The future of audit, monitoring and enforcement: What does this mean for companies?

Contents:

Quick read

The purpose of the strategic report
In short, the strategic report is from the directors to the shareholders and should provide them with information that allows them to assess how the directors have performed under their section 172 duties. However, it should include information that may be relevant to other stakeholders if it is also material to the shareholders, i.e. it would have a significant impact on a company's business model and strategy.

The building blocks of content
Regardless of whether a company is a PIE or not, the basic building blocks of content for the strategic report are in essence the same:
- Strategy
- Business model
- Market trends
- Principal risks and uncertainties
- Environmental matters
- Employee matters
- Community matters
- Social matters
- Human rights matters
- Anti-corruption and anti-bribery matters
- Analysis of performance and position
- Key performance indicators
- Employee gender diversity

There is a lot of crossover between the existing disclosure requirements and those introduced by the Miscellaneous Reporting Regulations which include s172 and stakeholder engagement reporting. There are no regulations around what order the content elements should be in and companies should endeavour to structure their strategic reports to provide a logical, flowing narrative.

The Corporate Governance Code and the Guidance both state that there must be clear links between purpose, strategy, business model, values and culture. The important thing to note is that these linkages should exist in the way the business is governed and run. If they do not, trying to retrofit linkages for reporting purposes will be difficult – and that applies across all elements of the strategic report

The content elements that are typically weak are the business model, market trends and principal risks.

Business models often end up missing the basics and making it too lofty and complicated. They should be written like a five-minute elevator pitch explaining what you do, how you do it, where you do it, what you need to do it (critical success factors), what are your differentiators, how you make money. There is also too much focus on making it into a graphic on only one spread. Keep it simple. Describe it in words, and if you can incorporate graphics to improve comprehensibility then do so.

Market analyses typically miss the wider, mega trends affecting society more generally – for example climate change, people living for longer, technology, changes in the way people work and what competitors are up to.

With principal risks, companies often disclose too many risks that are not prioritised and not specific. Shareholders want to know what is keeping the Board up at night and what are the greatest risks faced by the business that might put their investment at risk. If you draft the content of this section through that lens, you will produce a much more decision-useful piece of analysis.

Approach to s172 statements
The Guidance states the preferred approach is to complete the compliance statements by providing cross references into other parts of the strategic report. Clearly with so much crossover in terms of content elements for the strategic report, and the desire to avoid duplication, the best approach to producing a strategic report is to write a single, logical and flowing narrative that encompasses all the content elements as discussed in the previous section whilst building in content specifically required for the non-financial information statement and s172 statement. This will result in the statements themselves being very bland – a table with cross references – but the informative and useful content will be woven seamlessly into the rest of the strategic report.

Communication principles
To be fair, balanced and understandable the report should include both positive and negative aspects of performance, position and future prospects. Marketing spin should be avoided.

To improve clarity, industry specific jargon should be avoided, and always endeavour to use simple language. Content authors should always assume the reader knows nothing about the business or industry. Utilise graphics and tables if it will make information easier to understand.

Companies are understandably reluctant to provide forward-looking information, however providing insights into the future and how events (past or future) may affect your strategy or business model going forward will always aid understanding. There are many examples of when it would be appropriate. For example, noting what the impact of a new regulation coming into effect next year might be and what steps have been taken in preparation would be useful information.

Often there are several authors contributing content into the strategic report. The best way to avoid duplication and maximise efficiency is to spend time up front planning the structure and content. Work out what the narrative should be, what you want to say and where, and how the elements link together. Get all content owners involved in this process. It may take several iterations to get this right, but it will be worth it.

Once content has been generated, there needs to be a single copyeditor that reads the whole strategic report, and arguably the whole annual report, from cover to cover to ensure the content is coherent, consistent, concise and clear and that it brings your story to life.

Regulatory monitoring and assurance over the strategic report
The FRC does monitor compliance on the strategic report as well as the financial statements.

The auditor's report is required to state whether, based on the work undertaken in the course of the audit, the information in the strategic report, directors' report and corporate governance statement:
- is consistent with the financial statements;
- has been prepared in accordance with applicable legal requirements; and
- contains any material misstatements.[1]

In short, auditors are not currently required to provide any assurance over the accuracy of the information contained within the strategic report. However, this may change in the future following the Brydon Review[2] which recommended that alternative performance measures (APMs) and key performance indicators.

Making sense of governance and reporting regulations

Key:

- A Corporate Governance Reform Package
- B Kingman Review
- C CMA Audit Market Review
- D Brydon Review
- E EU Non-Financial Reporting (NFR) Directive
- F IFRSs
- G Energy and Carbon Report Regulation
- H RTS on European Single Electronic Format (ESEF)

2014

- E **April** NFR Directive agreed in EU
- F **May** IFRS 15 Revenue from Contracts with Customers issued
- F **July** IFRS 9 Financial Instruments issued

2016

- E **January** IFRS 16 Leases issued
- F **November** Government issues its green paper on corporate governance
- F **December** NFR Directive brought into UK law

2017

- E **1 January** NFR Regulation becomes effective
- F **May** IFRS 17 Insurance Contracts issued
- A **August** Government issues its Corporate Governance Reform Package
- A **September** ICSA: The Governance Institute and The Investment Association issue joint guidance The Stakeholder Voice in Board Decision Making
- H **December** Final draft RTS on ESEF published by ESMA

2018

- F **1 January**
  - IFRS 9 becomes effective
  - IFRS 15 becomes effective
- B **April** Government launches Kingman Review of the FRC
- A **July**
  - The Companies (Miscellaneous Reporting) Regulations are made
  - The FRC issues a revised UK Corporate Governance Code
  - The FRC issues a revised Guidance on the Strategic Report
- A **October** GC100 issue Guidance on directors' duties: Section 172 and stakeholder considerations
- C **October** CMA launches audit market study
- G **November** The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 made
- B **December** Recommendations from Kingman Review published
- C **December** CMA issues update paper, inviting comments
- D **December** Government launches Brydon Review into audit quality and effectiveness
- H **December** RTS on ESEF approved by the European Commission

2019

- A **1 January** Governance and reporting regulations become effective
- F **1 January** IFRS 16 becomes effective
- B **March** Government announces that FRC will be replaced with ARGA with initial consultation
- B **March** CMA publishes final report and recommendations
- G **1 April** Energy and carbon report regulation becomes effective
- H **June** RTS on ESEF approved by the EU
- D **By end of 2019** Expect final recommendations of the Brydon Review

2020

- H **1 January** RTS on ESEF becomes effective

2021

- F **1 January** IFRS 17 becomes effective

Fool me once, shame on you...

Poor corporate governance +

- Lack of boardroom accountability
- Unethical/questionable behaviour
- Short-termism
- Poor risk management and internal controls
- Unjustified executive pay packages

Poor corporate reporting +

- Not decision-useful
- Boilerplate
- Cluttered with immaterial information
- Not fair, balanced and understandable
- Not transparent
- Inaccurate
- Incomplete
- Inconsistent
- Incoherent

Poor quality audit +

- Poor quality assurance work
- Expectation gap between what stakeholders believe an audit should do versus what an audit actually does
- Information gap between what information stakeholders believe they need versus what information (whether audited or otherwise) is available

Limited monitoring and enforcement =

- Limited monitoring work
- Limited scope of enforcement work
- Limited sanctions for non-compliance

Loss of public trust in business

This paper builds on the second of our papers, Changes in Corporate Governance: Do then say, which outlined the key corporate governance and reporting regulations that became effective in 2019. In this paper, we will explore the 'say' of 'Do then say'; specifically the structure and content of the strategic report. We will explain what the regulatory requirements are, how to put together a strategic report that brings your story to life and answer some frequently asked questions.

The purpose of a strategic report

Who is the strategic report for?

In short, the strategic report is from the directors to the shareholders and should provide them with information that allows them to assess how the directors have performed under their section 172 duties. However, it should include information that may be relevant to other stakeholders if it is also material to the shareholders, i.e. it would have a significant impact on a company's business model and strategy.

The Guidance defines a strategic report as '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)'.[3]

The Guidance goes on to explain that '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'.[4] Importantly the Guidance also states that '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… they are material to the shareholders. The annual report should not, however, be seen as a replacement for other forms of reporting addressed to other stakeholders.'[5]

This begs the question of what is considered 'material' to shareholders? The Guidance includes a detailed section on materiality (Section 5). In essence it says that materiality is entity-specific and requires directors to apply judgement based on their assessment of the relative importance of the matter. When making that assessment directors should consider the significance of the matter relative to the entity's business model and strategy.

So the short answer to the question is that the strategic report is from the directors to the shareholders, but it should include content that may be relevant to other stakeholders if it is also material to shareholders. The acid test of whether something is material to shareholders is whether the matter would have a significant impact on a company's business model and strategy.

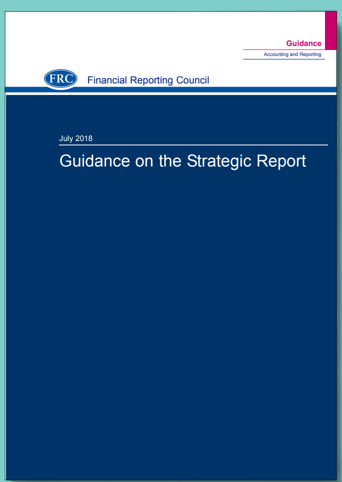
A brief history

The requirement to prepare a strategic report came into being in 2013 through The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

It has since been amended twice:

- The first amendment was to implement EU Directive 2014/95/EU on non-financial reporting through The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016. These regulations introduced the requirement for certain companies that meet the definition of a public interest entity (PIE) to include a non-financial information statement within their strategic report.
- The second amendment (The Companies (Miscellaneous Reporting) Regulations 2018) introduced, amongst other things, the requirement to provide a s172 statement and new directors' report disclosures around employee, supplier and customer engagement.

The Financial Reporting Council (FRC) updated their Guidance on the Strategic Report (the Guidance) in July 2018 to reflect those subsequent amendments.



[3] Glossary to the Guidance on the Strategic Report (FRC, July 2018)
[4] Paragraph 3.2 of the Guidance on the Strategic Report (FRC, July 2018)
[5] Paragraph 3.4 of the Guidance on the Strategic Report (FRC, July 2018)

The legal requirements

The regulations around the disclosure requirements of the strategic report are complex and confusing.

Companies meeting different criteria have to report different things. For example:

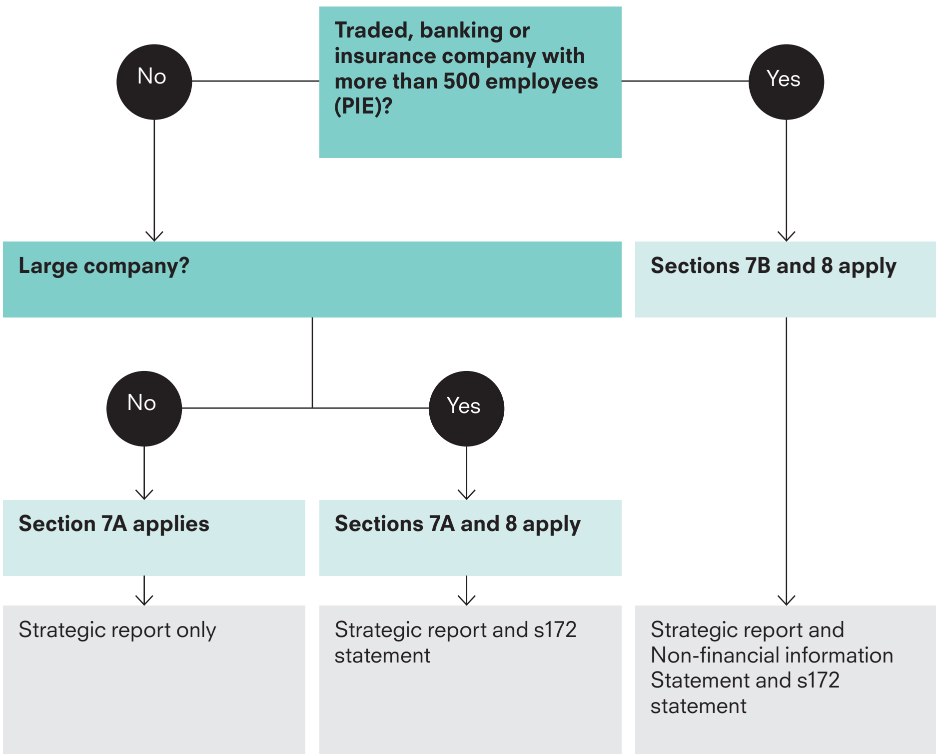
- Public interest entities (PIEs) are required to provide a non-financial information statement and report on their policies in relation to, amongst other things, anti-bribery and anti-corruption that non-PIEs do not.
- Quoted companies (which may or may not be PIEs) have to provide more information, for example a description of their strategy and business model, that non-quoted companies do not.
- Large companies (regardless of whether they are a PIE or not, or quoted or not) are also required to provide a section 172 (s172) statement.

If you add to the mix the new requirements introduced into the directors' report by the Miscellaneous Reporting Regulations 2018 around engagement with employees and other stakeholders, which if strategically important should be elevated up into the strategic report, you end up with a very messy set of regulations.

Is there an easy way to work out what the relevant content requirements are?
Yes, the Guidance is split into three content sections:

- Section 7A contains guidance on the content elements for companies that are not PIEs
- Section 7B contains guidance on the content elements for companies that are PIEs
- Section 8 contains guidance on the content elements for s172 reporting

The Guidance also includes a handy flow chart to help preparers work out what they should be reporting:



Section 8 will be mandatory for all quoted companies by virtue of their size (i.e. they will meet the large company thresholds). The key decision for quoted companies is whether they should be following Section 7A (which provides guidance for companies that are not PIEs) or Section 7B (which provides guidance for companies that are PIEs and are required to produce a non-financial information statement).

What is a public interest entity (PIE)?
A PIE is defined as 'a traded, banking or insurance company with more than 500 employees'.

What is a traded company?
A traded company is one with 'transferable securities admitted to trading on a regulated market (section 474(1) of the Act)'.

What is a quoted company?
'Quoted' is defined in the Companies Act 2006 as UK incorporated companies that are quoted on the UK Official List, the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area. It does not include companies listed on the Alternative Investment Market.

What's the difference between traded and quoted companies?
In simple terms, quoted companies are a subset of traded companies, i.e. traded companies include companies that only have listed debt, companies that only have listed equity shares (quoted companies) and companies that have both.

What is a large company?
Any company that meets the large company thresholds as set out in the Companies Act 2006, being two out of the following: having a turnover of more than £36m, balance sheet total of more than £18m and more than 250 employees.

All quoted companies by virtue of their size will inevitably meet the large company thresholds.

Read the second in our series of white papers **Changes in Corporate Governance: Do then say** to find out more about the new regulations that came into effect in 2019.

The building blocks of content: Bringing your story to life

The rest of this white paper focuses on the requirements that would apply to quoted companies, which may or may not be PIEs. Quoted companies will, by default, meet the large company thresholds therefore it is assumed that the Miscellaneous Reporting Regulations are mandatory. Further it is assumed that the directors' report requirements around stakeholder engagement are strategically important and therefore are reported in the strategic report.

Regardless of whether the company is a PIE or not, the basic pieces of content are in essence the same. The following table summarises these building blocks into three categories alongside the new requirements introduced by the Miscellaneous Reporting Regulations. As you can see there is a lot of cross over between the different regulatory requirements, for example employee matters crosses over all the regulations.

	Existing requirements		**New requirements introduced by the Miscellaneous Reporting Regulations effective from 1 Jan 2019**	
	Non-PIEs (Section 7A)	PIE inc non-financial information statement (Section 7B)	s172 statement (Section 8)	Directors' report requirements
Strategic management				
Likely consequences of any decision in the long term.			✓	
Strategy	✓	✓		
Business model	✓	✓		
Business environment				
Market trends and factors	✓	✓		
Principal risks and uncertainties	✓	✓		
Environmental matters	✓	✓	✓	
Employee matters	✓	✓	✓	✓
Social matters	✓	✓		
Community matters	✓	✓	✓	
Human rights matters	✓	✓		
Anti-corruption and anti-bribery matters		✓		
Need to foster business relationships with suppliers, customers and others			✓	✓
Desirability of the company maintaining a reputation for high standards of business conduct.			✓	
Need to act fairly between members (i.e. investor relations)			✓	
Business performance and position				
Analysis of performance and position	✓	✓		
Key performance indicators	✓	✓		
Employee gender diversity	✓	✓		

The content elements of the existing requirements

Strategy

What the Guidance says

The Guidance states that a company's purpose, strategy, objectives and business model should together explain what it does and how and why it does it, and that its purpose, strategy and values should be aligned with its culture.

Hints and tips

The Corporate Governance Code and the Guidance both state that there must be clear links between purpose, strategy, business model, values and culture. The important thing to note is that these linkages should exist in the way the business is governed and run. If they don't, trying to retrofit linkages for reporting purposes will be difficult – and that applies across all elements of the strategic report.

Business model

What the Guidance says

The description of a company's business model should explain how it generates and preserves value over the longer term. The business model should be consistent with a company's purpose. A critical part of understanding an entity's business model is understanding its sources of value, being the key resources and relationships that support the generation and preservation of value.

Hints and tips

The business model is typically the weakest part of reporting in the annual report. Companies often focus too much on explaining 'value creation' and 'resources and relationships' and end up missing the basics and making it too lofty and complicated.

The business model should be written like a five-minute elevator pitch. A simple barometer of whether you are including the right information is to imagine what you would say if you were pitching to a potential investor; imagine the questions they are likely to ask. For example what do you do, how do you do it, where do you do it, what do you need to do it (critical success factors), what are your differentiators, how do you make money?

There is also too much focus on making it into a graphic on only one spread. Keep it simple. Describe it in words, and if you can incorporate graphics to improve comprehensibility then do so. You should try to keep your basic headline business model to one spread, but further information should be provided in subsequent spreads to support it. For example, most companies will highlight the importance of their employees to their operations, therefore there should be more information explaining how the business engages with them and what is done to attract and retain them.

Market trends and factors

What the Guidance says

Trends and factors affecting the business may arise as a result of the external environment in which the entity operates or from internal sources. In considering the external trends, it is important that entities consider both the trends in the market in which the entity operates and the trends and factors relating to society more generally. This could include trends in the regulatory, macro-economic environment and changes in societal expectations.

The strategic report should set out the directors' analysis of the potential effect of the trends or factors identified on the future development, performance or position or future prospects of the entity. Where practicable and relevant, the trend or factor should be quantified and the source of the evidence underpinning it identified.

Hints and tips

The thing that is typically missing is the wider, mega trends affecting society more generally – for example climate change, people living for longer, technology, changes in the way people work and what competitors are up to.

Trends should be limited to those that are relevant to the business (i.e. that influence strategy or business model).

Principal risks and uncertainties

What the Guidance says

Risks and uncertainties should be limited to those considered to be material. They will generally be matters that the board regularly monitor and discuss because of their likelihood, the magnitude of their potential effect on the entity, or a combination of the two.

The board should consider the full range of business risks, including both those that are financial in nature and those that are non-financial.

In determining which risks are the principal risks, entities should consider the potential impact and probability of the related events or circumstances arising and the timescale over which they may occur.

The descriptions of the principal risks and uncertainties 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 and its 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.

Hints and tips

Companies often disclose too many risks, that are not prioritised and not specific to the company. Shareholders want to know what is keeping the Board up at night and what are the greatest risks faced by the business that might put their investment at risk. If you draft the content of this section through that lens, you will produce a much more decision-useful piece of analysis.

The Corporate Governance Code 2018 also has introduced a requirement to disclose emerging risks.

Environmental, employees, social, community, human rights and anti-corruption and anti-bribery matters

What the Guidance says

Information on environmental, employee, social, community, human rights and anti-corruption and anti-bribery matters should not be considered in isolation but should be integrated throughout the report where appropriate and, in particular, considered when disclosing the entity's strategy and business model, principal risks and uncertainties and KPIs.

When determining the appropriate level of information to disclose in the strategic report, entities should consider the following (non-exhaustive) list of factors:

1. the extent to which the matter has an effect on a company's business model, strategy, objectives, purpose, or culture;
2. the extent to which the matter has an effect on an entity's tangible assets, intangible assets or other sources of value, such as key stakeholder relationships (including any reputational risks) or other factors that may contribute to long-term success;
3. the extent to which the matter could have an effect on an entity's market share or position in the market;
4. the extent to which the matter constitutes a major issue facing the sector in which the entity operates; and
5. the potential severity or frequency of impacts on the environment.

Hints and tips

Integration is the key. If any of the matters are material to the business it should form part of the strategy, business model, KPIs and principal risks. Again, retrofitting linkages for reporting purposes will be difficult. This integration has to happen at a strategic and operational level.

The Guidance includes a series of questions for Boards to consider on these matters to help determine the appropriate level of information that should be reported which will help identify what information may be relevant. When generating content consideration should be given to specific reporting requirements of the non-financial information statement (if relevant) and the new requirements introduced by the Miscellaneous Reporting Regulations (including the s172 statement and the stakeholder engagement disclosures) and this should be built into the content. Those statements and stakeholder engagement requirements are covered in more detail in the next section.

Analysis of performance and position

What the Guidance says

The strategic report must provide a fair, balanced and comprehensive 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 include a narrative of the development, performance and position of the business in the financial year which is consistent with the information contained in the financial statements.

The strategic report should explain performance during the year in the context of how the company has performed relative to prior periods. It could explain performance relative to stated targets and relative to the external environment in which it is operating, in order that shareholders can make an assessment of the future development, performance or position of the business.

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.

Hints and tips

It is often the financial team that is responsible for drafting this content which may not have had sight of other elements of the strategic report. A good financial and operational review uses information from other parts of the strategic report, such as strategy, business model, market trends and risks, to bring the financials to life. A good analysis should never leave a reader asking why or so what.

Key Performance Indicators (KPIs)

What the Guidance says
The analysis in the strategic report must include financial and, where appropriate, non-financial key performance indicators (KPIs), including information relating to environmental and employee matters.

The KPIs used in the analysis should be those that are most effective in assessing progress against objectives or strategy, monitoring principal risks, or otherwise utilised to measure the development, performance or position of the entity. There should be alignment between the KPIs presented in the strategic report and the key sources of value and risks identified in the business model.

Non-financial KPIs provide insight into future financial prospects and progress in managing risks and opportunities. They may include, for example, measures related to product quality, customer complaints, environmental matters or employee metrics.

Where possible, KPIs should reflect the way that the board manages the entity's business. Comparatives should be included and the reasons for any significant changes from year to year explained.

The entity should provide information that enables shareholders to understand each KPI used in the strategic report. For example, its definition and calculation method, its purpose, the source of underlying data, any significant assumptions made and 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.

Hints and tips
Ideally KPIs should be those used to run the business and should include financial and non-financial KPIs that clearly link to the strategy and business model. Again, retrofitting linkages for reporting purposes will be difficult. This integration has to happen at a strategic and operational level.

Trend data for each KPI must be supported with commentary explaining how it's calculated, why it's important and why it's changed. The inclusion of targets or thresholds provides even better decision-useful information.

Employee gender diversity

What the Guidance says
The strategic report should provide a breakdown showing, as at the end of the financial year:

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

While percentages of male and female directors and employees can be informative, numbers must also 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.

Hints and tips
Gender diversity crosses over with employee matters, and also Board diversity in the Governance Report. Some thought should be given as to where this information is positioned and appropriate cross referencing included.

There is no regulatory requirement to disclose gender pay gap information within the annual report, however, if it is material and strategically important to shareholders, some information should be included with a cross reference to your more detailed gender pay gap report.

Other frequently asked questions

Do the content elements have to go in a certain order?
No, there is not any prescribed order. Companies are encouraged to order the elements of their strategic report to tell a logical, integrated narrative. The order and flow will vary from company to company, and may even vary from year to year. We work closely with our clients to carefully plan the structure and content of a report ahead of any content generation to ensure the story flows.

Do the content elements need to link to each other?
Yes, the Guidance encourages companies to think about how pieces of information link to each other to create a logical, integrated narrative. For example, if the business model states that a company is reliant on a highly trained and engaged workforce, a principal risk to the business might be the loss of access and retention of talent, and the report should set out how the business invests in its people to ensure this risk is minimised. In creating these linkages, the focus should be on creating a truly integrated narrative with substance, not on just filling the report with icons and cross-references.

Can we use alternative titles for the content elements e.g. rather than 'business model' use 'How we work'?
Yes, but from a comms perspective, you should use a title that logically links to the underlying content so that a reader can navigate the report and find relevant information quickly and easily.

Does the report have to contain a chairman's statement and CEO's statement?
No, there is no legal requirement to include statements from the chairman and CEO.

We have a lot to say about a certain topic, how much information should we put in?
Remember that the strategic report is from the directors to the shareholders, but it should include content that may be relevant to other stakeholders if it is also material to shareholders. The acid test of whether something is material to shareholders is whether the matter would have a significant impact on a company's business model and strategy.

For example, allowing employees charitable giving days would only have a significant impact on a company's business model or strategy if having a highly skilled and engaged workforce was critical to the success of the business, and that it is necessary to provide a socially conscious benefits package (of which charitable giving days is one element) to attract and retain the right kind of talent. If you have a lot to say we would recommend that information is communicated through a different medium, for example your website, a separate sustainability report, your talent acquisition portal or other marketing material. The strategic report should only contain information that is material to the shareholders.

The non-financial information statement, s172 statement and stakeholder engagement disclosures

The non-financial information statement

What the Guidance says

As noted above, a company is only required to provide a non-financial information statement if it meets the definition of a PIE.
The non-financial information statement should contain the following information or include cross-references to where such information can be found in the main body of the strategic report:

- A company's business model.
- Information, to the extent necessary for an understanding of the entity's development, performance and position and impact of its activity, relating to:
  - environmental matters;
  - employees;
  - social matters;
  - respect for human rights; and
  - anti-corruption and anti-bribery matters.
- A description of the policies pursued in relation to the matters above and any due diligence process implemented in pursuance of those policies along with a description of the outcome of those policies.
- If the entity does not pursue policies in relation to one or more of the matters, a clear and reasoned explanation for the entity's not doing so.
- A description of the principal risks arising in relation to the matters arising in connection with the entity's operations, and where relevant and proportionate – a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk, and a description of how it manages the principal risks.
- A description of the non-financial key performance indicators relevant to the entity's business.
- Where appropriate, references to, and additional explanations of, amounts included in the entity's annual accounts.

Entities are encouraged to meet the requirements of the non-financial information statement through a title and a series of cross-references, so as to maintain the coherence of the strategic report. Entities are discouraged from replicating information located elsewhere in the strategic report in the non-financial information statement.

Hints and tips

Something that is often overlooked is that the regulations specifically ask for a description and the outcome of policies pursued in relation to environmental matters, employees, social matters, human rights and anti-corruption and anti-bribery matters, and an explanation if policies are not pursued. It is not enough to have broad brush contents on those matters.

The s172 statement

What the Guidance says

The information contained in a s172 statement will depend on the individual circumstances of each company, but companies will probably want to include information on some or all of the following:

- the issues, factors and stakeholders the directors consider relevant in complying with section 172(1) (a) to (f) and how they have formed that opinion;
- the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and
- information on the effect of that regard on the company's decisions and strategies during the financial year.

Section 172 requires directors to promote the success of the company by having due regard to the following matters:

a. the likely consequences of any decision in the long term;
b. the interests of 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 between members of the company.

There will be linkages and overlaps between information contained in the strategic report and that required to be included in the s172 statement. Companies are encouraged to avoid repetition, maintain the cohesion of the narrative contained within the strategic report and incorporate information into the s172(1) statement by cross-reference where appropriate.

Hints and tips

s172 is not just about stakeholder engagement and it is important that all six matters are addressed in the strategic report. The likely consequences of any decision in the long term, a company's impact on the community and environment, the need for high standards of business conduct and to act fairly between members is equally important.

Demonstrating that directors have considered the likely consequences of any decision in the long term could be achieved through a case study and can be brought out through the way content is framed throughout the strategic report.

The need for high standards of business conduct could be demonstrated through explanations of the desired culture and values and how the Board monitor them, and codes of conduct, internal controls and policies (eg. anti-bribery, human rights and whistleblower) designed to ensure integrity and transparency in business.

Stakeholder engagement disclosures

As noted above, the Miscellaneous Reporting Regulations introduced new stakeholder engagement disclosure requirements into the directors' report. Assuming those matters are of strategic importance, the disclosures should be reported in the strategic report.

The regulatory requirements

Employee engagement

The directors' report for a financial year must contain a statement:

a. describing the action that has been taken during the financial year to introduce, maintain or develop arrangements aimed at:
   - providing employees systematically with information on matters of concern to them as employees;
   - 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;
   - encouraging the involvement of employees in the company's performance through an employees' share scheme or by some other means;
   - achieving a common awareness on the part of all employees of the financial and economic factors affecting the performance of the company.
b. summarising:
   - how the directors have engaged with employees; and
   - how the directors have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year.

Other stakeholder engagement

The directors' report for the financial year must contain a statement summarising how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the financial year.

Hints and tips

There is heavy overlap between these disclosure requirements and the revised requirements in the UK Corporate Governance Code around engagement. To avoid duplication this content needs to be carefully planned so that the strategic report and governance report need to dovetail.

So what's the best approach to ensure compliance?

The Guidance states the preferred approach is to complete the compliance statements by providing cross references into other parts of the strategic report. Clearly with so much crossover in terms of content elements for the strategic report, and the desire to avoid duplication, the best approach to producing a strategic report is to write a single, logical and flowing narrative that encompasses all the content elements as discussed in the previous section whilst building in content specifically required for the non-financial information statement and s172 statement. This will result in the statements themselves being very bland – a table with cross references – but the informative and useful content will be woven seamlessly into the rest of the strategic report.

This begs the question of whether standalone statements are necessary if all the necessary disclosures are included somewhere in the strategic report. Unfortunately it is a regulatory requirement to provide separately identifiable statements within the strategic report with the titles 'Non-financial information statemen' and 'Section 172 statement'. The statements must form part of the strategic report, and therefore cannot appear elsewhere such as the governance report or directors' report. The regulations do not stipulate where in the strategic report these statements need to go. One approach might to be to group them together in one section alongside the viability and going concern statements.

Communication principles

What the Guidance says

The strategic report should be fair, balanced and understandable, and clear yet comprehensive.

Information contained in the report should be company-specific and have a forward-looking orientation where appropriate.

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

The structure, presentation and content of the strategic report should be reviewed annually to ensure that it continues to meet its purpose and only contains information that is relevant.

Hints and tips

Always review your report from the prior year with an objective eye. Consider what can be improved and don't be afraid to change the structure, content or the way information is presented to improve the quality of the report year on year.

In order to be fair, balanced and understandable the report should include both positive and negative aspects of performance, position and future prospects. Marketing spin should be avoided.

To improve clarity, industry specific jargon should be avoided, and always endeavour to use simple language. Content authors should always assume the reader knows nothing about the business or industry. Utilise graphics and tables if it will make information easier to understand.

Companies are understandably reluctant to provide forward-looking information, however providing insights into the future and how events (past or future) may affect your strategy or business model going forward will always aid understanding. There are many examples of when it would be appropriate. For example, noting what the impact of a new regulation coming into effect next year might be and what steps have been taken in preparation would be useful information.

Often there are several authors contributing content into the strategic report. The best way to avoid duplication and maximise efficiency is to spend time up front planning the structure and content. Work out what the narrative should be, what you want to say and where, and how the elements link together. Get all content owners involved in this process. It may take several iterations to get this right, but it will be worth it.

Once content has been generated, there needs to be a single copyeditor that reads the whole strategic report and arguably the whole annual report, from cover to cover, to ensure the content is coherent, consistent, concise and clear and brings your story to life.

Regulatory monitoring and assurance over the strategic report

Does the FRC (and in due course its successor, ARGA) monitor compliance on the strategic report?

Yes, the FRC does monitor compliance on the strategic report as well as the financial statements.

What are our auditors' responsibilities in respect of the strategic report?

The auditor's report is required to state whether, based on the work undertaken in the course of the audit, the information in the strategic report, directors' report and corporate governance statement:

- is consistent with the financial statements;
- has been prepared in accordance with applicable legal requirements; and
- contains any material misstatements[6].

In short, auditors are not currently required to provide any assurance over the accuracy of the information contained within the strategic report. However, this may change in the future following the Brydon Review[7] which recommended that alternative performance measures (APMs) and key performance measures (KPIs), which are both contained in the strategic report, should be subject to audit.

Read our fifth paper **The future of audit, monitoring and enforcement: What does this mean for companies?** (to be published in March 2020) to find out more about the potential changes in the audit market, the future of the FRC's monitoring and enforcement activities, and the possible implications for companies.

[6] Paragraph 3.7 of the Guidance on the Strategic Report (FRC, July 2018).
[7] A Government commissioned independent review of the quality and effectiveness of audit, chaired by Sir Donald Brydon, published in December 2019.

Glossary and abbreviations:

Brydon Review
The independent review commissioned by the Government in December 2018 into the quality and effectiveness of audit.

FRC
Financial Reporting Council.

The Guidance
The Guidance on the Strategic Report issued by the FRC in July 2018.

GATHER

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Employees, customers, shareholders and society are demanding a more balanced contract, based on purpose, values and relationships.

That puts all of us under constant scrutiny. What organisations say and do must join up from the boardroom to the very end of the supply chain if they are to retain their licenses to operate.

And, with trust in short supply, easy words have to be supported by hard evidence.

If you would like to explore how we can help you with your corporate reporting please contact us here:

+44 (0)20 7610 6140
info@gather.london

Floor 3
8-14 Vine Hill
London
EC1R 5DX

www.gather.london