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FRC Financial Reporting Council

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Guidance on the 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".

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.