



# SORP information sheet 5

## The Strategic Report and company charities

### 1. Background

1.1 The Charity Commission and the Office of the Scottish Charity Regulator are the joint SORP-making body for charities and as such are required by the Financial Reporting Council's (FRC) code of practice (SORPs: Policy and Code of Practice) to keep the Statement of Recommended Practice (SORP) under review.

1.2 As part of its work, the joint SORP-making body may issue 'Information Sheets' which seek to clarify the application of the SORP or particular recommendations contained within the SORP. Information sheets are released to assist preparers and auditors of accounts apply the SORP's recommendations. Information Sheets are not approved by the Financial Reporting Council before their release nor do they amend the SORP (issued in March 2005). Information Sheets are advisory in nature and do not carry the authority of the SORP.

1.3 In August 2013 the UK Parliament approved 'The Companies Act 2006 (Strategic Report and Director's Report) Regulations 2013'. These Regulations introduce into the Companies Act 2006 a requirement for all large and medium-sized companies to prepare a separate Strategic Report. The regulations also remove the requirement to include a Business Review in the directors' report. The new requirements apply to financial periods ending on or after 30 September 2013.

1.4 The Strategic Report of a charity that is a company should meet three main objectives:

- to provide context for the related financial statements;
- to provide an analysis of the charity's past performance; and
- to provide insight into the charity's main objectives and strategies, and the principal risks it faces and how they might affect future prospects.

1.5 The SORP Committee have considered the requirement to prepare a Strategic Report and how this interacts with the current Trustees' Annual Report required under SORP 2005. The SORP Committee concluded that there are no fundamental issues of principle arising as a result of the new requirement which will require revision to the current SORP at this stage. In particular, the purpose and required content of the Strategic Report does not differ significantly from that of the Business Review which it replaces. However, it was felt that some additional guidance on the component elements of the Strategic Report and how they will fit with the requirements of the Trustees' Annual Report would be helpful to users of the SORP.

## 2. Index of topics

- Who is affected?
- The legislative requirements
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### Who is affected?

3.1 Only charitable companies that are either medium-sized or large as defined under the Companies Act 2006 are required to prepare a strategic report. For these companies, the Strategic Report will replace the Business Review for accounting periods ending on or after 30 September 2013.

3.2 As with the Business Review prior to these changes, small companies are exempt from the requirements to prepare a Strategic Report. Small companies are defined by section 381 and section 382 of the Companies Act 2006. A parent company only qualifies as small if the group headed by it qualifies as small (see Section 383 of the Companies Act 2006).

3.3 A company qualifies as small in relation to its first financial year if two or more of the following qualifying conditions are met in that year:

- (i) Annual turnover\* not more than £6,500,000
- (ii) Balance sheet total not more than £3,260,000
- (iii) Average number of employees not more than 50

\* Charities applying the Charities SORP should also consider their gross income and note that thresholds are subject to amendment.

3.4 A group qualifies as small in relation to its first financial year if two or more of the following qualifying conditions are met in that year:

- (i) Aggregate annual turnover\* not more than £6,500,000 (or £7.8 million gross - before consolidation adjustments)
- (ii) Aggregate balance sheet total not more than £3,260,000 (or £3.9 million gross - before consolidation adjustments)
- (iii) Average aggregate number of employees not more than 50

\* Charities applying the Charities SORP should also consider their gross income and note that thresholds are subject to amendment.

3.5 A company or group qualifies as small in relation to a subsequent financial year -

- (a) if the qualifying conditions are met in that year and the preceding financial year;
- (b) if the qualifying conditions are met in that year and the company qualified as small in relation to the preceding financial year;
- (c) if the qualifying conditions were met in the preceding financial year and the company qualified as small in relation to that year.

## 4. The legislative requirements

4.1 The regulations amend the Companies Act 2006 to insert new sections which set out the duty to prepare and the content of a Strategic Report and delete the sections that dealt with the Business Review. The regulations also amend the Companies Act 2006 to substitute the option to send summary financial statements to the members with an option to send the Strategic Report and supplementary material. In addition, the regulations amend the requirements for the contents of the directors' report set out in Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) and in Schedule 5 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (S.I. 2008/409).

4.2 The principal change is the introduction of new sections into the Companies Act 2006 (s414A-414D) that require all companies that are not small to prepare a Strategic Report which must contain:

- a fair review of the company's business; and
- a description of the principal risks and uncertainties facing the company.
- The review should be balanced and comprehensive and consistent with the size and complexity of the business. It must cover:
  - the development and performance of the company's business during the financial year; and
  - the position of the company at the end of the year.

4.3 The Strategic Report is a distinct report in its own right and requires separate approval by the company's directors (who are also the charity's trustees). However, as most of the information required by the Strategic Report is already required under SORP 2005, to remove unnecessary duplication, the Strategic Report should be included within the Trustees' Annual Report as a separate clearly delineated section headed Strategic Report. Where information is provided in a 'Strategic Report' section of the Trustees' Annual Report, it will form also part of Trustees' Annual Report and so will not need to be repeated in other sections of the Trustees' Annual Report in order to comply with the SORP's requirements.

4.4 In approving the Trustees' Annual Report, the trustees must include a clear statement that they are also approving the Strategic Report in their capacity as company directors.

## 5. Information required and the structure of the Trustees Annual Report

5.1 For charitable companies the Strategic Report will contain the information which was previously within the Business Review with the key difference being that the information must now be presented as a clearly delineated section within the Trustees' Annual Report.

5.2 The Strategic Report is required to contain a balanced and comprehensive review of the charity's development and performance in the financial year. The information on 'achievements and performance' currently contained in Trustees' Annual Report will provide much of the information required for this part of the Strategic Report. The SORP states that the Trustees' Annual Report should contain information that enables the reader to understand and assess the achievements of the charity and its subsidiary undertakings in the year. The SORP also requires a review of the charity's performance against objectives that have been set and for the report to provide both qualitative and quantitative information that helps explain achievement and performance.

5.3 Strategic Report's requirements for a balanced and comprehensive review of the financial position at the end of the year is similarly likely to be met by the type of information previously provided in a charity's 'financial review' section of its Trustees' Annual Report.

5.4 The Strategic Report also requires a description of the principal risks and uncertainties facing the charity. Previously, under the SORP, this information would have been presented within the 'Structure, Governance, and Management' section of the Trustees' Annual Report. The Strategic Report should focus on principal risks and uncertainties that can seriously affect the performance, future prospects or reputation of the charity, including its viability.

5.5 The SORP also requires the Trustees' Annual Report to contain information about the charity's future plans. Where the information provided is relevant to understanding the charity's development, this information should also be provided within the Strategic Report of the charity.

5.6 The joint SORP-making body recommends company charities that must prepare a Strategic Report restructure their Trustees' Annual Report to allow the information required in a Strategic Report to be presented as a separate section of the Trustees' Annual Report. For example, the Trustees' Annual Report may be structured\* as follows:-

- Reference and Administrative Details of the Charity, its Trustees and Advisors
- Structure, Governance and Management
- Objectives and Activities
- Strategic Report which includes:
  - Achievements and Performance
  - Financial Review
  - Plans for Future Periods
  - Principal Risks and Uncertainties
- Funds held as Custodian Trustees on Behalf of Others

\* Note: the SORP does not require the information contained in Trustees' Annual Report to be presented in a specified order.

## 6. Further Information

6.1 The Financial Reporting Council has issued an Exposure Draft of its proposed Guidance on Strategic Report which provides further non-mandatory guidance supporting the introduction of the Strategic Report.