Deloitte.

September 2011

Governance in Brief

Your summary of the latest corporate governance developments

Headlines

- Next steps on Effective Company Stewardship.
- FRC sets out insights on current approaches to risk management.
- Towards integrated reporting – IIRC says the world has changed and reporting must too.

Next steps on Effective Company Stewardship

In Brief: If annual reports are to enable investors and stakeholders to determine whether a company can create and sustain value over the short, medium and/or long term then there is a need for greater transparency about the judgements made by management and auditors in the course of preparing and auditing the financial statements. This is the point at the heart of the FRC's paper issued on 1 September 2011. This FRC paper sets out the steps it now proposes to take, under the umbrella of "Effective Company Stewardship", on which the FRC consulted earlier in 2011.

These steps could impact, to varying degrees, the responsibilities of boards, audit committees and auditors and could result in amendments to the UK Corporate Governance Code, the Turnbull Guidance on internal control, the Guidance on Audit Committees and International Standards on Auditing (UK and Ireland). The development of narrative reporting standards is still under consideration. This FRC paper is a signposting for future changes and further consultations and pronouncements should be expected later in the year.

Potential impact on audit committees

- An extension of the remit of an audit committee to include consideration of the whole annual report, including the narrative report.
- The audit committee may be required to provide a report to the whole board setting out the approach that it has taken to the discharge of its responsibilities. This report, if approved by the board, would then be published in full in the annual report.

Potential impact on narrative reporting

- More focus on strategic risk including the strategy for implementing the business model and the risks inherent in that model.
- The FRC will consider the need for narrative reporting standards.
- The FRC will consider the impact of its enquiry into lessons learned on going concern and liquidity risks and the Government's proposals on narrative reporting due to be published in the autumn.

Potential impact on the UK Corporate Governance Code

- Changes to reflect the outcome of the FRC's work on going concern and liquidity risk and risk management.
- Amendments to reflect any extension in the remit of the audit committee.
- Amendments to require companies to put their audits out to tender at least once in every 10 years, or explain why they have not done so.

Potential impact on the Code's supporting Guidance

- The FRC intends to update the Turnbull guidance on internal control (Internal Control: Revised guidance for directors) to reflect the lessons from its work on risk (see below).

- The Guidance on audit committees would be updated to reflect any changes made in respect of the remit of the audit committee (see above).

Potential impact on auditors and ISAs (UK and Ireland)

Auditors to provide increased insight to audit committees on the audit process to reassure users of financial statements that all material matters have been properly disclosed and to ensure that the audit committee understands how the auditors have reached their audit opinion. At a minimum, this may include the auditors views on:

- the effectiveness of the company's system of control;

- judgements about what is of material significance and the implications of those judgements;

- the appropriateness of the accounting policies (individually and in aggregate); and

- overall conclusions on the valuations of the company's assets.

In addition the FRC would like to see auditors providing an expanded audit report that includes:

- a new section addressing the completeness and reasonableness of the audit committee's report; and

- identification of any matters in the annual report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit.

Date: 1 September 2011

Source: Financial Reporting Council

Further info: http://www.frc.org.uk/images/uploaded/documents/ECS%20Feedback%20Paper%20Final1.pdf

FRC sets out insights on current approaches to risk management

In Brief: The majority of investors who participated in meetings with the FRC felt that there was scope for considerable improvement in reporting on risk and internal control. A key improvement would be for companies to integrate commentary on risk throughout the report, rather than treating it is a stand-alone section. In particular this would include linking reporting on risk to discussion of strategy and the business model. There would also be an explanation of the changes in the company's risk exposure over the previous twelve months and an indication if the exposure might change in the future. There would be disclosure of how key risks are being mitigated.

Other insights gained by the FRC during its meetings to learn more about how boards are approaching their responsibilities for risk management include the following:

- Different board committee structures may be appropriate to different industries. So the decision should be left to individual boards rather than imposing a requirement for a risk committee on all companies.

- The board should be expected to agree its appetite or tolerance for key individual risks as opposed to determining an overall risk appetite for the company which was deemed to be problematic given the rapidly changing nature of the economic environment.

- The Board needs to focus especially on those risks capable of undermining the strategy or long-term viability of the company or damaging its reputation.

- Reputational risk has grown in importance and requires greater attention but not necessarily as a separate category, but a consequence of failure to manage other risks successfully.

- A focus only on "net risk" could be dangerous. It is essential that boards have a view on the company's potential exposure to risk.

- Managing the flow of information to the Board was considered one of the most difficult challenges by many participants. It is important for the Board and committees to indicate to management what information they need to do their job effectively.

As noted above, the FRC intends to update the Turnbull guidance on internal control to reflect the lessons from its work on risk and to reflect the role of the board as articulated in the new version of the Code. The FRC intends to carry out a limited review during 2012.

Date: 1 September 2011

Source: Financial Reporting Council

Further info: http://www.frc.org.uk/images/uploaded/documents/Boards%20and%20Risk%20final1.pdf

Towards integrated reporting – IIRC says the world has changed and reporting must too

In Brief: The International Integrated Reporting Committee (IIRC) Discussion Paper "Towards Integrated Reporting – Communicating Value in the 21st Century" considers the rationale for Integrated Reporting, offering initial proposals for the development of an International Integrated Reporting Framework and outlining the next steps towards its creation and adoption. Its purpose is to prompt input from all those with a stake in improved reporting, including producers and users of reports.

The IIRC states that changes in the way business is conducted are interdependent and reflect trends such as:

- globalisation;
- growing policy activity around the world in response to financial, governance and other crises;
- heightened expectations of corporate transparency and accountability;
- actual and prospective resource scarcity;
- population growth; and
- environmental concerns.

The IIRC believes that against this background, the type of information that is needed to assess the past and current performance of organisations and their future resilience is much wider than is provided for by the existing business reporting model. While there has been an increase in the information provided, key disclosure gaps remain.

Five Guiding Principles underpin the preparation of an Integrated Report.

- Strategic focus.
- Connectivity of information.
- Future orientation.
- Responsiveness and stakeholder inclusiveness.
- Conciseness, reliability and materiality.

To take this initiative forward the IIRC will:

- undertake a Pilot Programme to encourage experimentation and innovation among companies and investors;
- develop an International Integrated Reporting Framework Exposure Draft, reflecting responses received to this Discussion Paper and the experience gained from the first year of the Pilot Programme;
- work with others to support the development of emerging measurement and reporting practices relevant to Integrated Reporting;
- raise awareness among investors and other stakeholders and encourage organisations to adopt and contribute to the evolution of Integrated Reporting;
- explore opportunities for harmonising reporting requirements within and across jurisdictions; and
- develop institutional arrangements for the ongoing governance of Integrated Reporting.

Date: 12 September 2011

Source: The International Integrated Reporting Committee

Deadline for comment: 14 December 2011

Further info: http://www.theiirc.org/the-integrated-reporting-discussion-paper/

Time to take action

- Challenge existing risk management processes and determine if there is sufficient focus on strategic risk.
- Discuss at board level your company's response to the challenge from investors, noted by the FRC, to improve disclosures on risk and internal control by linking them to discussion of strategy and the business model.

On the horizon

- A Government paper setting out its plans on narrative reporting.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. 13784A

Member of Deloitte Touche Tohmatsu Limited