Deloitte.

Annual report insights 2019

Surveying FTSE reporting

Contents

Overview

Change and uncertainty are the new norm in business. Uncertainty in political and economic environments, the impact and uncertainty of climate change and changes in societal expectations of business present a broad set of risks, demanding focus on long-term value creation, business resilience and license to operate. Changes in investors' and society's expectations have translated into the government's governance reform agenda and a growing demand for better corporate reporting that responds to the need to understand broader risks and business impacts.

Our yearly survey scours the annual reports of 100 listed UK companies, spread across the FTSE, both in terms of size and industry. To help companies face the challenges these changes present we examine the entire annual report, providing insight and inspiration ahead of the next reporting season.

Section 172 and creating value for broader stakeholders

One of the biggest changes to reporting requirements in the forthcoming reporting season is the introduction of the 'section 172 statement' in the strategic report. For periods beginning on or after 1 January 2019, all large UK companies must set out how directors have, as required by section 172 of the Companies Act 2006, promoted the long-term success of the company whilst having regard to the impact on a broad group of stakeholders such as employees, customers, suppliers, the environment and community. Section 172 itself is not new, so for some companies the new reporting requirement will not require a significant operational change.

Although no company surveyed had yet provided a section 172 statement, 31 companies were already referring to 'section 172', typically in their corporate governance disclosures. It also seems as though many companies are already conscious of the broader impact that they have on society, with 97 companies (2018: 94) identifying stakeholders other than investors, such as employees and customers, in their annual reports. 98 companies (2018: 92) acknowledged resources and relationships which, whilst not recognised in the financial statements, they depend on and impact.

Encouragingly, 85 companies (2018: 76) also discussed value created for at least one stakeholder other than investors, although the majority did not quantify this value, in financial terms or otherwise. Where quantification was provided it was not always for all the stakeholders that had been identified. Quantification often tended to be in relation to employees, such as the number of promotions or training hours received. Only five companies attempted to give some idea of how total value generated was allocated between stakeholders.

Purpose and culture

46 companies (2018: 32) set out a company purpose beyond making profits for shareholders. A company's purpose explains why it exists, going beyond financial drivers to incorporate a broader set of shared values and behavioural expectations. These values and behaviours in turn define a company's culture – one of the areas of focus in the new 2018 UK Corporate Governance Code, which also becomes effective in 2019.

Against a backdrop of scrutiny by an ever-increasing range of stakeholders, it was no surprise that 34 companies included a detailed discussion of corporate culture in their strategic report and 15 did so in their governance disclosures. 31 companies included some detail on the tools and techniques the board uses to monitor culture (2018: 23) and ten indicated that the board obtains some type of assurance regarding corporate culture – a substantial increase compared to four in 2018.

Risks and Brexit

On average companies disclosed ten principal risks (2018: ten). Consistent with our findings last year, companies continue to struggle with linking these risks to a company's strategy – only 48 companies made this link clear in the current year (2018: 47).

Turning to the specific risks, it came as no surprise that 86 companies surveyed (2018: 71) discussed Brexit within their risk reporting. 25 companies identified Brexit as a 'stand-alone' principal risk, with a further 36 including it as part of a broader principal risk. A further 25 companies went on to discuss Brexit but explained that they had concluded it was not a 'principal' risk.

The most common concern noted by those companies discussing Brexit in their risk reporting was the broader macroeconomic impact of the UK leaving the EU (mentioned by 62% of those companies). 52 companies made reference to Brexit within their corporate governance disclosures, typically setting out Board actions as the situation evolved, and 34 companies mentioned it in their financial statements.

Cybersecurity also continues to be high up companies' risk registers, with 71% (2018: 73%) identifying concerns over cybercrime as a principal risk.

Viability statements

Disappointingly it seemed that little progress had been made by companies in their longer term viability statements. Still only 16% of companies clearly differentiated their discussion of future prospects within the viability statement, up slightly from 13% last year. The lack of improvement and the retreat into boilerplate is an issue both for the FRC and for companies who might see additional or tougher requirements in this area following criticism of effectiveness of viability statements by Sir John Kingman in his report issued at the end of last year.

One suggestion from the report was for companies to include more details on specific stress testing. This year 28 companies set out clear scenarios they had used to test the model for their viability statement and 15 presented a conclusion covering each scenario (2018: 26 and 13).

Board evaluation

31 companies surveyed undertook an external board evaluation during the year (2018: 29). Of these, 84% described the nature and extent of the external evaluator's contact with the board and individual directors. Some of these disclosures made it clear that the evaluator had no contact beyond setting a questionnaire in collaboration with the chair and / or the company secretary, whilst others had attended board and committee meetings and met individually with each director and a selection of senior management. Given this range of approaches, insightful disclosure is critical for readers to understand the nature of the board evaluation process undertaken.

Board diversity and inclusion

In a slight improvement from last year, 30 companies indicated they had diversity targets for the board, up from 22 in 2018. Eleven included disclosure on the level of ethnic diversity on their board, up from six last year - we expect this to increase again next year as companies approach the 2021 target date mentioned in the Parker Review.

39 companies disclosed the gender diversity in the executive committee and their direct reports, in line with the Hampton-Alexander review's expectations (2018: 15%), with 50% of FTSE 350 companies meeting the requirement. Next year we expect to see a substantially higher figure as this becomes a disclosure requirement in the 2018 UK Corporate Governance Code.

2018 UK Corporate Governance Code

Around four fifths of companies in our survey sample were already subject to the 2018 UK Corporate Governance Code at the date of publication of this year's annual report and will need to report under that Code this coming year. In that context, it is surprising that only 40% of companies provided specific detail of changes they have made or planned to make in order to comply with the new Code. Almost the same number of companies made only a generic statement about the need to comply or that they would report on compliance in the next annual report.

More encouragingly, companies have clearly been working on meeting the independence requirements of the new Code. At least half of the board, excluding the chair, was made up of independent non-executive directors for 91% of companies this year, a jump from 69% of companies in 2018. This rises to 98% of the FTSE 350 companies surveyed and 100% of the FTSE 100.

Disclosures on the assurance the board receives included deep dives on culture, investigations in response to specific issues, and in several cases, an external evaluation or "health-check" of culture or values in the business. Twelve companies disclosed action taken by the board to address issues during the year around culture – for example, introducing new training on values, formal studies on the nature of culture in different parts of the business, revisiting of values and behaviours, and action to address findings regarding culture arising from an employee engagement survey.

Stakeholder engagement

New information on engagement with employees, suppliers and customers will also be required in large companies' directors' reports for 2019 calendar year-ends. This past year 90 companies described their engagement with employees and 64 described how they had engaged with customers. However, companies should make sure that they focus on the issues identified through such engagement that are material to investors and provide insightful information on how the company is responding.

Of the companies providing specific detail on implementing the new 2018 UK Corporate Governance Code, 43% reported on a particular workforce engagement mechanism (as per Code provision 5). A designated non-executive director was the most common engagement mechanism (22%), followed by an alternative mechanism not described in the Code (10%), a works council (7%), a combination of mechanisms (3%) and an employee director (1%).

Environmental, social and governance (ESG) factors

Obtaining stakeholder feedback enables a greater understanding of the ESG factors on which a company depends and which it impacts. This past year saw a slight improvement in companies reporting how broader ESG factors are being taken into account within the overall company strategy. 11% (2018: 10%) fully integrated ESG issues into their business strategy and a further 52% (2018: 38%) were bringing in some ESG components. However, over a third of companies continue to discuss such matters in a separate section of the annual report with little or no link back to strategy.

The requirements of the Non-Financial Reporting Directive, which have been in force for around two years, should provide a framework to enable companies to discuss these matters, particularly in terms of linking ESG information back to company policy and processes. However, these disclosures continue to be challenging, with policies not always clearly being described and little insight given into any due diligence undertaken over the application of those policies in practice. Disappointingly, only 56 of the 87 companies in scope provided a separate non-financial information statement.

Climate change

Climate change is likely to have an unprecedented impact on society, business and financial markets. Failure by business to respond to the risks posed by climate change has significant implications, such as disruption to supply chains, loss of asset values and market dislocation. The Financial Reporting Council (FRC) issued a joint statement with other financial regulators in July 2019, stating:

"The Boards of UK companies have a responsibility to consider their impact on the environment and the likely consequences of any business decisions in the long-term. They should therefore address, and where relevant report on, the effects of climate change (both direct and indirect)..."

More than half of the reports surveyed (57 companies) explicitly referred to "climate change". Four companies voluntarily provided fulsome disclosure in line with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). A further 16 companies referred to the TCFD recommendations in some other way, such as compliance through a separate sustainability report or a table cross-referring to various publications they make available.

From a risk perspective, the World Economic Forum's 2019 annual risk survey identifies the climate crisis as the number one threat to the global economy. It is therefore perhaps surprising that only seven companies (2018: one) included climate change within their principal risks, either as a stand-alone risk or as part of a broader principal risk. A further six companies identified climate change as a potential risk within their risk management disclosures but concluded it was not a principal risk.

Measuring performance

The use of alternative performance measures (APMs, sometimes referred to as 'non-GAAP measures') remains popular, with 93 companies including such measures in an up-front highlights page in their annual report and 88 including an adjusted measure of profitability. Compliance with the European Securities and Markets Authority (ESMA) Guidelines on APMs remains somewhat mixed – relatively common areas for improvement included provision of more company-specific reasons for including such measures and being sure to include IFRS equivalent measures in chairmen's and chief executives' statements.

In terms of the metrics that directors regard as 'key performance indicators' (KPIs), on average six financial measures and four non-financial measures were given in reports. Of those presenting non-financial KPIs, 57% included employee related metrics and 54% included health and safety measures.

Distributable profits

70 companies disclosed their dividend policy, with 48 making clear what it meant in practice and reflecting recommendations of the FRC's Financial Reporting Lab. Many investors are keen to have insight into the level of distributable profits a company has. 26 companies (2018: 32) explicitly disclosed a 'single figure', with a further 14 (2018: four) instead describing which of their equity reserves were distributable.

Financial statements

The biggest change for most of the financial statements we surveyed was the adoption of IFRS 9 Financial Instruments (80 companies) and IFRS 15 Revenue from Contracts with Customers (83 companies). No companies elected to restate comparatives on initial application of IFRS 9 and only 16 companies did so for IFRS 15, applying it with full retrospective effect.

Only 16 companies quantified the change to their loss allowances on transition to IFRS 9's expected loss model for impairments, with many others stating the effect was immaterial. 13 companies identified critical judgements or key sources of estimation uncertainty as part of their IAS 1 disclosures relating to IFRS 9 – often in relation to measuring loss allowances. 12 companies identified such items under IAS 1 relating to IFRS 15.

Companies continue to improve in distinguishing between judgements and estimates, something which is important given IAS 1 has different disclosure requirements for each – 78 companies (2018: 66) clearly split these items apart, on average giving 3 estimates and 2 judgements. Disappointingly, 23% of the descriptions given were so generic that they could have applied to any company – so there remains room for improvement in this regard.

Another area that the FRC has called for more insight on is in relation to supplier financing arrangements. Only 7 companies included disclosure indicating they had such arrangements, with the best disclosures including company specifics and explaining presentation of associated amounts in the balance sheet and the cash flow statement.

Looking ahead, IFRS 16 will be effective for the first time for most of the companies surveyed in the reporting season ahead. Only three companies had early adopted the standard last year, although 67 companies (2018: eight) quantified the expected impact ahead of its application. The FRC's thematic review of IFRS 16 disclosures in 2019 interim financial statements, when published, should provide useful pointers on expected disclosures.

Final thoughts

With annual reports now longer than ever, having reached an average of 172 pages (2018: 164), new financial standards, corporate governance and reporting requirements there is a lot for preparers to think about. This publication can help inform your planning, provide insight and inspire through examples of good practice in corporate reporting.

Veronica Poole
Global IFRS Leader and UK Head of Corporate Reporting
Deloitte

Introduction

In this publication we aim to provide insight into practices in annual reporting, focusing on areas where requirements have changed, where regulators are focusing or where innovative practices are emerging.

The publication presents the findings of a survey of 100 annual reports of UK companies with a premium listing of their equity on the London Stock Exchange. 93 of the 100 companies are the same as those used in the previous survey. The population comprises 19 FTSE 100 companies (2018: 19), 37 FTSE 250 companies (2018: 38) and 44 companies outside the FTSE 350 (2018: 43). Investment trusts, other than real estate investment trusts, are excluded from the sample due to their specialised nature. The reports analysed are for financial years ended between 29 September 2018 and 31 March 2019.

Each section addresses a different aspect of a typical UK listed company's annual report, generally distinguishing between:

- areas where compliance has been relatively good or improved;
- areas where companies have struggled to comply with requirements; and
- areas where companies have gone beyond mere compliance and are innovating or voluntarily providing information.

The topic of integrated reporting impacts multiple parts of companies' annual reports and is discussed in multiple sections of our publication. To help identify this recurring topic we have used the following colour-coding:

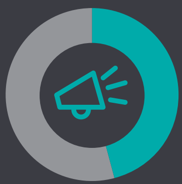
Integrated reporting – commentary highlighted blue

Although our survey data uses only companies from our sample, when selecting examples of good practice we have used material from companies that, in our view, best illustrate a particular requirement or innovation, regardless of whether they are in our sample.

Many more example disclosures can be found in an appendix accompanying the electronic version of this publication, available at www.deloitte.co.uk/annualreportinsights. A more detailed discussion of the regulatory requirements UK companies with a premium listing are subject to is also provided as an appendix in the electronic version.

Each section also includes a short list of items to watch out for in the reporting season ahead, reflecting areas of changing requirements or practice and areas of regulatory focus.

1. Purpose and culture



46%
Gave a clear, prominent description of their **purpose beyond making profits for shareholders**

34
Companies included a detailed discussion of **corporate culture** within the strategic report

A company's purpose explains why it exists, going beyond financial drivers to incorporate a broader set of shared values and behavioural expectations. These values and behaviours in turn define the company's culture. As discussed further in section 6, businesses are increasingly scrutinised by an ever-wider range of stakeholders. Purpose and culture therefore represent core pillars in the strategic decision-making process and establish the company's commitment to doing business profitably yet in an ethical, reputable and responsible manner.

In his 2019 letter to CEOs[1], Larry Fink, CEO BlackRock, said: *'Profits are in no way inconsistent with purpose – in fact, profits and purpose are inextricably linked. Profits are essential if a company is to effectively serve all of its stakeholders over time – not only shareholders, but also employees, customers, and communities. Similarly, when a company truly understands and expresses its purpose, it functions with the focus and strategic discipline that drive long-term profitability. Purpose unifies management, employees, and communities. It drives ethical behaviour and creates an essential check on actions that go against the best interests of stakeholders. Purpose guides culture, provides a framework for consistent decision-making, and, ultimately, helps sustain long-term financial returns for the shareholders of your company.'*

A clear company purpose should underpin the company story told through the annual report; the strategy should explain how the company intends to deliver on its purpose, while the business model should combine both purpose and strategy to explain what the company does and how it does it. Purpose should also be reflected in how a company discusses broader environmental, societal and governance (ESG) factors and its impact on society. The forthcoming requirement to present a section 172 (s172) statement creates a further expectation on directors to communicate how, through discharging their duty under s172, they have promoted the success of the company for the benefit of investors while having regard to other stakeholders (see section 6). Having a prominent purpose which sets out the company's broader aims sets the context for this.

46 companies (2018: 32) included a prominent and clear description of the company's purpose in the strategic report. 31 companies commented on corporate purpose in their governance reporting with four including case studies, which helped to bring the company's culture to life.

66 companies discussed culture or values to some degree in the strategic report, but only 34 companies did so in detail. 45 companies discussed culture within the corporate governance statement, with 15 doing so in some detail. Discussion of purpose and culture was more common among FTSE 100 companies, with all of these addressing culture in their strategic report and almost all referring to it in the corporate governance section as well. 68% of FTSE 100 companies set out a clear purpose in the strategic report, in contrast to 51% of FTSE 250 companies and only 32% of non-FTSE 350 companies.

The length and prominence of purpose statements continues to show some variation, although many companies place their statements upfront in the report, often on the inside front cover or highlights pages. Often this was a concise and high-level sentence, but some companies extended this to two or three sentences, giving more specific information, and some explicitly linked their purpose statement with the strategy and business model. A handful of companies presented a brief purpose upfront and went on to expand on this later in the report, incorporating discussion of corporate culture and setting out their values.

Good examples of purpose statements link to wider stakeholders whilst also providing clarity on the specific activities of the company. For example, Anglo American plc wrote *'Anglo American is re-imagining mining to improve people's lives. Using more precise extraction technologies, less energy and less water, we are reducing our physical footprint for every ounce, carat and kilogram of precious metal or mineral. We are combining smart innovation with the utmost consideration for our people, their families, local communities, our customers, and the world at large – to better connect the resources in the ground to the people who need and value them.'*

As investors focus increasingly on the longer term and broader value creation in making their investment decisions, it is essential that companies make their purpose clear, explain how their values support that purpose and demonstrate how it is delivered through maintaining a strong and consistent corporate culture.

What to watch out for

- [ ] Set out your company's purpose in a clear and prominent manner and consider how clearly it is linked to the strategy and business model, as suggested in the FRC's Guidance on the Strategic Report.

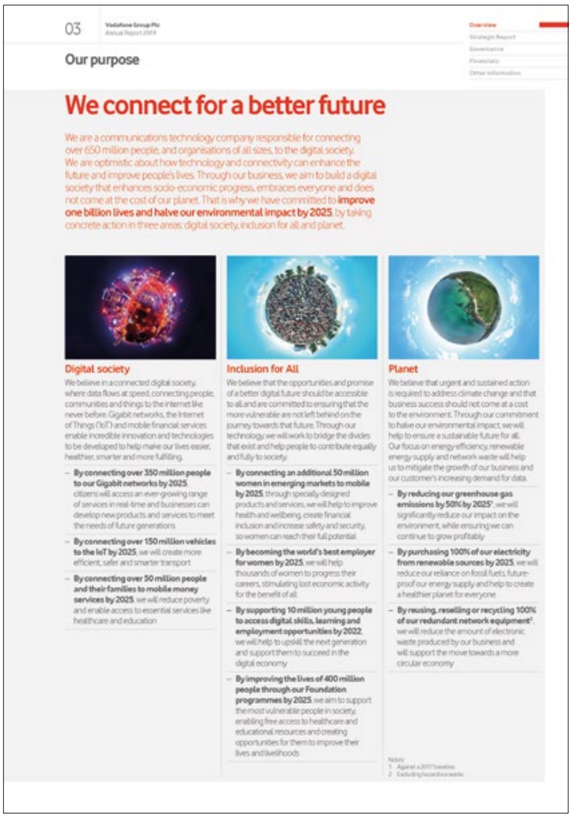
- [ ] Explain how your company's purpose is reflected in the corporate culture and the involvement of the Board in this area, including both how the company goes about setting culture and then how it is adhered to. A useful starting point is the FRC's report on 'Corporate Culture and the Role of Boards'[2] published in July 2016.

Examples of disclosure

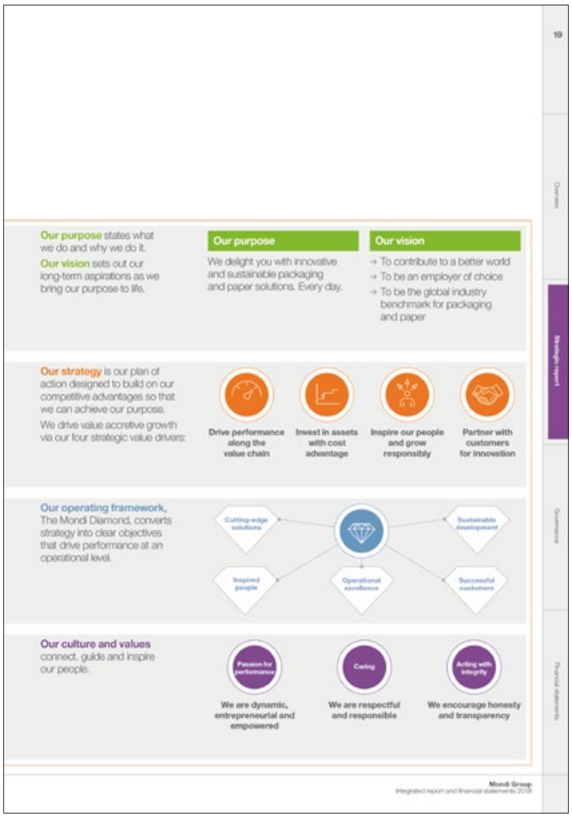
Vodafone plc's purpose goes beyond making a profit for shareholders and clearly sets out the three strategic decisions that flow from it.

Mondi Group plc sets out its purpose and frames it within the context of its strategy, business model and culture.

Vodafone plc



Mondi Group plc



See more examples of disclosure in the electronic version of this publication.

2. Climate change

More than half explicitly referred to "**climate change**" in their annual report

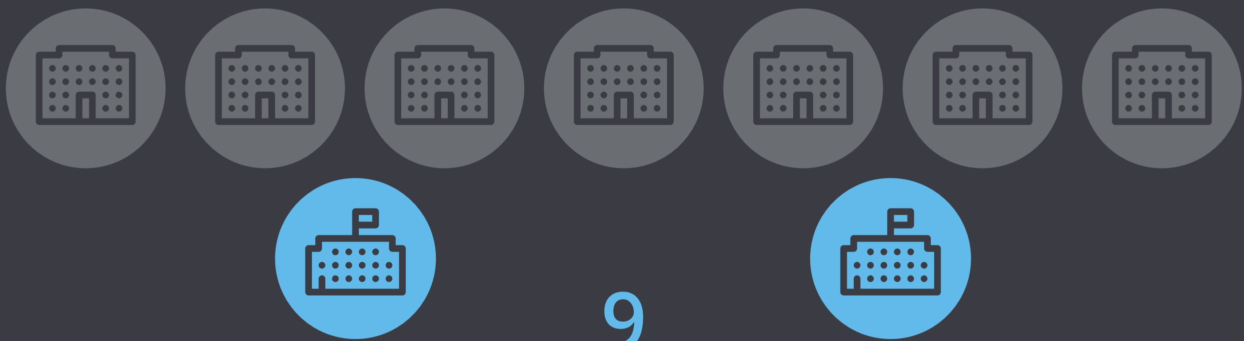
7

Companies referenced climate change within their **principal risks**

1 in 5 companies mentioned **TCFD** in their annual report

4

Companies provided fulsome **TCFD disclosures** within their annual report



9

Companies included climate change within discussion of their strategy, although only **2 companies** explained how their strategy is resilient to climate change

Climate change is likely to drive the most profound change to financial markets in our lifetimes, leading to significant market corrections and changes in the coming years. In October 2018, the Intergovernmental Panel on Climate Change published a report[3] concluding that time is running out. Climate change will have a marked impact on human health, food security, water supply, human security, and economic growth. Failure by business to respond to these risks has significant implications, such as disruption to supply chains, loss of asset values and market dislocation. Investors are already factoring climate change into their investment decisions and some are considering divestment, but as a last step if active engagement fails.

Disclosure around climate change in annual reports has historically been limited, with only one company in our survey last year including climate change as a principal risk. Following the Government's announcements of its new target to bring all greenhouse gas emissions to net zero by 2050 and of its Green Finance Strategy (which recognises the role of the financial sector in delivering global and domestic climate and environmental objectives), the Financial Reporting Council (FRC) issued a joint statement with other financial regulators in July 2019, making its expectations of UK boards very clear, stating:

The Boards of UK companies have a responsibility to consider their impact on the environment and the likely consequences of any business decisions in the long-term. They should therefore address, and where relevant report on, the effects of climate change (both direct and indirect). Reporting should set out how the company has taken into account the resilience of the company's business model and its risks, uncertainties and viability in both the immediate and longer-term in light of climate change. Companies should also reflect the current or future impacts of climate change on their financial position, for example in the valuation of their assets, assumptions used in impairment testing, depreciation rates, decommissioning, restoration and other similar liabilities and financial risk disclosures.

TCFD Recommendations

Recommendations published in 2017 by the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures ('TCFD recommendations')[4] provide comprehensive guidance on how climate change should be addressed through companies' governance, strategy, risk management, and metrics and targets. 825 organisations globally have become signatories to TCFD to express support[5]; despite this rather large number, many are still in the early stages of adoption, which is reflected in the findings of our survey.

Four companies surveyed – three banks and a utilities provider – voluntarily provided the full TCFD disclosures in their annual report, albeit noting that in some areas (such as scenario testing) there was still further work to be done. Three of these mentioned climate change within their discussion of principal risks and the fourth (a bank) clearly incorporated climate change within a more detailed discussion of credit risk under a separate risk section of the annual report.

A further 16 companies referred to the TCFD recommendations in their annual report in some other way, such as compliance through a separate sustainability report or else a table cross referring to a number of different available publications. Some referred to the TCFD recommendations as "informing" their work and using it to improve their own environmental disclosures, while others openly committed to complying with the recommendations in future. These companies were spread across a number of industries, and included companies in insurance, real estate, oil and gas, industrial technology, retail, mining, packaging and paper, construction, food and beverage, media and telecoms. Such variety reflects the pervasiveness of climate change and the impact it will have on different businesses.

Although reference to the TCFD recommendations was not extensive, 57 companies referred to "climate change" somewhere within their annual report, in all cases as part of their narrative reporting. Below, we examine disclosures made in the four areas covered by the TCFD recommendations, acknowledging that few companies were going so far as to report in accordance with the recommendations themselves.

In June 2019, the European Commission published its Guidelines on non-financial reporting: Supplement on reporting climate-related information[6] which integrates the TCFD recommendations into its original guidelines around fulfilling the disclosure requirement under the NFR Directive (see section 6). These guidelines concluded that, given the systemic and pervasive impacts of climate change, most companies under the scope of the NFR Directive are likely to conclude that climate is a material issue and as such should be disclosing relevant information for investors within the NFR Directive disclosures. In the UK these are incorporated into section 414CB of the Companies Act 2006 and section 7 of the FRC's Guidance on the Strategic Report.

Governance

The TCFD recommendations highlight the importance of understanding the governance and risk management context in which financial results are achieved. Seven companies referred to climate change in their corporate governance statement; another company referred to governance around climate change within its directors' report alongside its GHG emissions disclosure. These references varied in nature from a brief mention on the list of matters considered by the Board to more detailed considerations within Committee reports. One Board Reputation Committee described climate change as a 'recurring topic' in their discussions, referencing the Paris Accord and summarising key actions taken within the group during the year. One Risk Committee referenced correspondence with the FRC (itself seemingly initiated by external stakeholder pressure) regarding climate change within the company's environmental disclosures and how the current year's report now addresses all concerns raised. Another Audit Committee confirmed its role in concluding that climate change is now a principal risk for the company.

One of the key governance disclosures recommended by the TCFD is a description of the Board's oversight of climate-related risks and opportunities. There were disappointingly few companies which described this (only seven companies did so in their strategic report; and three others in the governance statement) and of those that did, the level of detail also varied. One company noted that both their Group Executive and Board teams had participated in Carbon Economy risk and opportunity workshops during the year as part of their annual strategic planning process.

Of those companies that described Board oversight, the thinking at Board level was most often led by a sub-committee of the Board. At other companies the Chairman and CEO led together, or else the CEO alone; for one company, oversight was retained by the whole Board. A handful of companies referred to the audit committee or finance's involvement in the company's approach to climate change. Some companies disclosed that assigned board level oversight would be confirmed in the coming year.

Strategy

Investors need to understand how climate-related issues may affect a company's business, strategy, and financial planning over the short, medium, and long term, as this informs expectations about future performance. 40 companies discussed climate change within their strategic report in a meaningful way beyond merely a fleeting reference. Most of these discussions were within the sustainability or CSR sections of their annual report although some, such as Croda International Plc and The Weir Group PLC, included climate change prominently in the first few pages of their report. Unusually, three companies referred to climate change only within the context of their principal risks (see below) without further meaningful discussion or linkage to strategy or impact on the business model elsewhere in the report (albeit one company was confirming that it was not, in fact, a principal risk).

In general, discussions around climate change varied in length and breadth of detail, some acknowledging the impact of climate change and focusing their intentions primarily on reducing their own carbon footprint, others looking at the broader opportunities that climate change presents.

The TCFD recommendations encourage companies to describe the resilience of their strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario. While nine companies included climate change within the broader discussion of their strategy, only two companies referred to how their strategy is resilient to climate change, and even then this was at a high level. One company described how they had "future-proofed" their business through their strategic direction, while the other made a fleeting reference to measures they had put in place to ensure operational resilience.

A handful of companies referred to scenario testing, although most of these indicated that this has not been performed to date but is being developed internally for future disclosure. One company noted that scenario testing had been performed as a pilot exercise for both physical and transition risks and noted the timeframes applied to the scenarios.

Despite the lack of explicit reference to how company strategy is resilient to climate change, eleven companies gave an example of how the business had changed or was changing specifically in response to climate change. For providers of financial capital this tended to relate to opportunities for 'green' financing or, as a minimum, considering ESG factors when making investments; for others this was often changes to reduce their own carbon footprint. Anglo American plc included a summary of their climate change policy within their discussion of one of their strategic objectives. National Grid plc explained how their response to climate risk now impacts capital allocation through the use of carbon pricing.

Risk management

The TCFD recommendations refer to climate-related risks as being either transitions risks (those relating to the transition to a lower carbon economy) and physical risks (those relating to the physical impacts of climate change).

Environment-related risks again dominated the World Economic Forum (WEF)'s 2019 annual risk survey, accounting for three of the top five risks by likelihood and top four by impact[7]. The WEF specifically calls out the climate crisis as the number one threat to the global economy. It is therefore perhaps surprising that only seven companies included climate change within their principal risks (2018: one), either as a standalone principal risk or else as part of a broader principal risk. A further six companies identified climate change as a potential risk within the risk management disclosures, but concluded it was not a principal risk. These 13 companies were from a range of industries, notably banking and insurance, mining, oil and gas, utilities, construction, media, packaging and paper, industrial services and a beverage manufacturer. Eight of these companies clearly disclosed relevant mitigating activities within their principal risk disclosures. Premier Oil plc explained in their corporate responsibility section how they integrated carbon and climate-related risks into their overall enterprise risk management framework.

Although only a few companies discussed climate change risk within the context of principal risks, 17 discussed more broadly within other sections of their strategic report steps they had taken to reduce or eliminate the risk. For one company this was divesting capital intensive and environmentally challenging businesses, particularly those with a higher dependence on fossil fuels. For one house builder their actions included incorporating sustainable drainage systems within new developments to address the increased risk of flooding due to climate change, while another referred to designing 'resilient and intelligent buildings' that could adapt to climate change. For other companies, the risk was reduced by implementing strategies to lower their own carbon footprint.

17 companies discussed investment made or planned in response to climate risk. Such investments ranged from new technologies and products to employee training specifically on the matter.

Metrics and targets

Disclosure of key metrics and targets enable investors to understand how companies are measuring and monitoring climate-related risks and opportunities. 25 companies included a metric relating to greenhouse gas (GHG) emissions or carbon footprint within their KPIs. Surprisingly, not all of these companies were discussing "climate change" specifically within their annual report, which could leave them open to challenge of whether this metric is really 'key', even more so when the KPI has not clearly been linked back to an element of strategy.

Six companies with a GHG or carbon KPI identified a target or goal that they are aiming for, which provided useful insight as to how successful they had been to date. Kingfisher plc's target to reduce carbon emissions is specifically aligned with the Paris Climate Agreement.

The most useful disclosures in this area were where companies explained the link between this metric and their strategy and identified the relevant risk as well, although surprisingly few companies achieved this with regard to this specific metric. An example of a company which linked these three elements is Croda International Plc.

Financial statements

As referred to in the FRC's statement, above, climate risk is not limited to disclosure and good governance. Climate change can and already does impact the numbers in the financial statements. Companies affected by extreme weather events like hurricanes, floods, droughts and wild fires are already reporting actual costs and losses associated with dealing with these events. The impact of more gradual changes such as changes in precipitation patterns, rising temperatures and rising sea levels and the impact of changing policy and technologies, as we shift to a low-carbon economy may also affect cash flow forecasts, cost of capital and availability of insurance and therefore may lead to impairments today. This may also impact expected asset useful lives and their residual values, valuations, provisions, contingencies and onerous contracts and pension obligations.

Disappointingly, no company within our sample referred to climate change explicitly within their financial statements, perhaps because of the difficulty in quantifying the effects. However, seven companies referred to the broader natural environment within the financial statements, all in the context of provisions (or contingent liabilities). These mainly related to environmental provisions to restore mines or other environmental claims to be settled.

One company explicitly referred to financial implications within their discussion of climate change in the strategic report, noting the cost savings already obtained following efforts to improve energy efficiency and reduce emissions. Another talked of progress in quantifying the financial implications of the potential risks and opportunities and included the possible monetary value of receiving fewer carbon trading scheme allowances. Hilton Food Group plc outlined how the identified risks and opportunities associated with climate change have been factored into their financial planning process.

What to watch out for

- [ ] Is climate change on your Board's agenda? Both the TCFD recommendations and the WEF Climate Governance Principles[8] can act as a useful tool to assist Boards in getting started.
- [ ] When disclosing your response to climate change, the TCFD recommendations act as a good framework to base disclosures around.
- [ ] Are your risk management processes capturing climate change related risks and opportunities?
- [ ] How are you monitoring climate change risks and opportunities? Where you have disclosed a relevant KPI, is this clearly linked back to disclosure around risk and your overall strategy?
- [ ] What assumptions, judgements or estimates relating to climate risk have you incorporated into the preparation of your financial statements? For example, where you have performed scenario analysis, has this been reflected in cash flow forecasts supporting impairment reviews and other asset valuations?

Examples of disclosure

Hilton Food Group plc outline how the identified risks and opportunities associated with climate change have been factored into their financial planning process.

Hilton Food Group plc

How the identified risks and opportunities have factored into our financial planning process

Revenues	Impacted in line with operating costs	Through our cost plus agreements with our customers changes in operating costs feed into revenues. We are dedicating more resources to CSR which has the potential to positively affect revenue.
Operating costs	Impacted	Certain examples of reduced energy costs due to efficiencies and technology such as LED lighting, the latest machinery and carbon management software. Increased costs may come, for example, from higher compliance costs or insurance premiums in the future.
Capital expenditures/ capital allocation	Impacted	Specification of equipment that Hilton purchases and the design of any new factories will have regard to the latest climate related risks and opportunities where Hilton strives to be efficient with as low an impact on the planet as possible.
Acquisitions and divestments	Not yet impacted	Climate related issues yet to be attributed to acquisitions and divestments. Seachill, acquired in 2017, has a strong track record for driving sustainability through the fish supply chain.
Access to capital	Impacted for some suppliers, facilities, or product lines	Increased internal funding for climate related innovation is available subject to normal commercial justifications.
Assets	Impacted for some suppliers, facilities, or product lines	Future proofing our assets in terms of climate related issues is factored into the building process for new and upgraded buildings.
Liabilities	Not yet impacted	Yet to calculate the financial planning process to liabilities with regards to the impact of climate related influences.

Anglo American plc summarise their climate change policy within their discussion of one strategic objective.

Anglo American plc

Anglo American's climate change policy articulates our commitment to five principles:

- Building internal agility and ensuring resilience to climate change
- Driving energy and carbon savings throughout our business
- Understanding and responding to the carbon life-cycle risks and opportunities of our products
- Developing and implementing collaborative solutions with our stakeholders
- Contributing our skills and knowledge to the development of responsible public policy.

National Grid plc explains how their response to climate risk impacts capital allocation through the use of carbon pricing.

National Grid plc

In our UK electricity business, carbon pricing now forms part of the information used to assess options and sanction our capex, and we will continue to roll out this approach across our business in 2019/20.

Premier Oil plc explained in their corporate responsibility section how they integrated carbon and climate-related risks into their overall enterprise risk management framework.

Premier Oil plc

We integrate carbon- and climate change-related risks into our overall enterprise risk management framework, where relevant. We recognise the potential physical risks that climate change poses to our operations.

These might include heightened storm risks and long-term sea level rises.

As part of our management of these risks, we undertake detailed meteorological and oceanographic impact assessments for all new projects during the design phase. These incorporate projections of rising sea levels and more frequent unpredictable weather events.

We also monitor the multiple corporate-level risks that climate change poses to the Company. Most notably, this includes the evolving fiscal and legislative response to climate change in our host countries. The 2015 Paris Agreement reflects the commitment of the international community in this respect. Premier will continue to monitor the developing policy environment and to adapt our future carbon emissions strategy accordingly.

See more examples of disclosure in the electronic version of this publication.

3. Brexit

86%

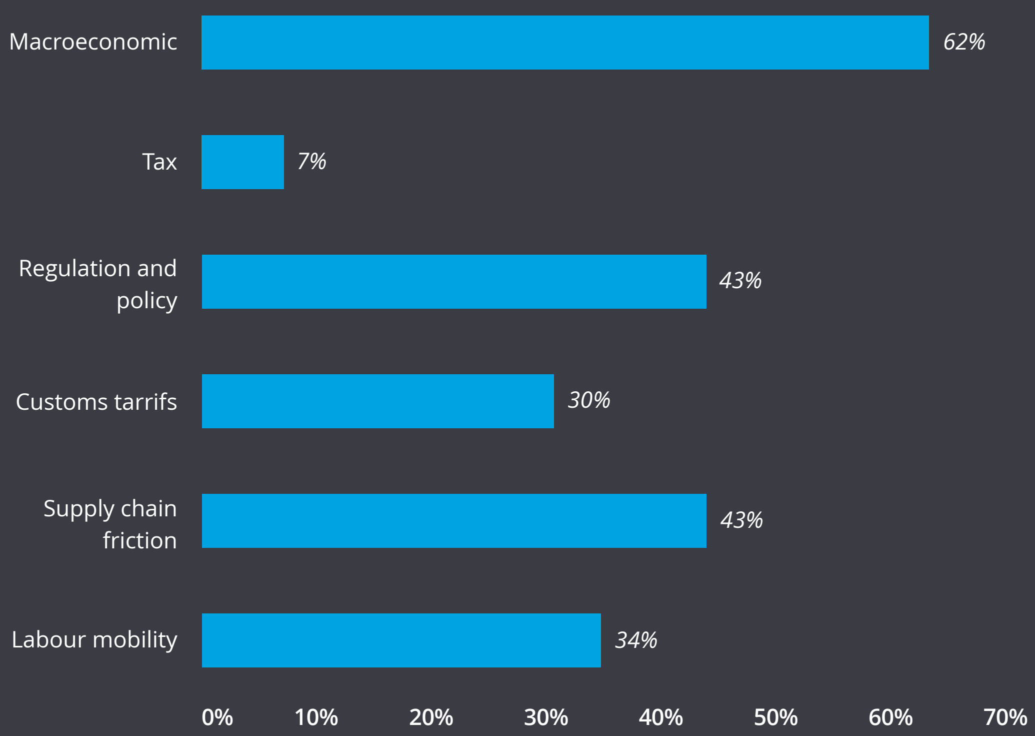
of companies discussed **Brexit** in their risk reporting...

25  25

...with **25 companies** identifying it as a principal risk in its own right...

...and **25 companies** stating that it was not a 'principal' risk

Factors noted within Brexit risk discussions



3

companies had already implemented **changes to their business model...**

5

others indicated that they **expect to make a change**

The United Kingdom's exit from the European Union ('Brexit') continues to be an important issue for a large number of companies listed in the United Kingdom. Since the referendum result on 23 June 2016 to leave the European Union, investors have sought insight on the effects leaving the Union will have on companies. Below we discuss companies' disclosures around Brexit.

For some companies, the effects of Brexit may change their operating model, for others the effects may be limited to the more general macroeconomic impacts. For the majority of companies surveyed, per their annual report disclosures, it seemed Brexit was not expected to bring about a change in their business model. That said, almost a third indicated that they are monitoring proceedings but have not yet concluded on whether or not there will be a change. Three companies had however, already implemented changes to their business model and five others indicated that they expect to make a change. These changes tended to involve the relocation of facilities into or out of the UK to ensure business continuity.

Perhaps disappointingly, disclosure of these changes was typically only found in the principal risks or viability sections of the annual report, rather than being incorporated into the main discussion of the strategy or business model. Presenting the information in this way may make it more difficult for users to understand how such changes would affect the strategy of a company in future.

It appears that the vast majority of companies are actively contemplating how Brexit will affect future operations, with 86% (2018: 71%) of companies discussing Brexit to some extent within the risk section. There was a great deal of variation in the detail and specificity of risks discussed. 25 companies specifically identified Brexit as a principal risk, although four of these entities' risks were generic in nature. A further 36 companies addressed Brexit as part of one of more principal risks, as opposed to presenting a singular risk of Brexit in its own right. Interestingly a further 25 companies discussed Brexit risk, in some cases in extensive detail, but went on to conclude that the risks posed by Brexit were not 'principal' risks affecting the future operations of the business.

Where Brexit was discussed within the risks section of the annual report, some common areas were as shown on the graph opposite. The most common factor noted, by 62% of those discussing Brexit in the risk section of their narrative reporting, was the broader macroeconomic impact of the UK leaving the EU.

52 companies also made reference to Brexit as part of their corporate governance disclosures, typically setting out what the Board or committees had been doing as the situation continued to unfold. Specifically looking at the longer-term viability statement, only 16 companies specified Brexit-related assumptions as part of their future forecasting.

As expected, references to Brexit were not entirely limited to the front-half, however only a relatively small number of companies (34) mentioned Brexit in the financial statements. Ten companies made reference within their going concern disclosures and seven companies did so within their IAS 1 judgements and estimates disclosure. 13 companies included reference to Brexit within their impairment disclosures and eight mentioned it elsewhere in their financial statements. Such numbers perhaps appear low when compared to the 61 companies who included Brexit as either a principal risk or part of a principal risk, especially when coupled with the uncertainty of Brexit.

With an exit from the European Union on 31 October 2019 the current default at the time of writing, by December 2019 companies may well need to capture and quantify the immediate effects of Brexit on asset values, as well as the anticipated effects through the forward looking statements of Going Concern and Viability. Depending on how the situation evolves, companies should also monitor legal developments relating to corporate reporting, particularly in the case of a 'No Deal' Brexit. In such a scenario, although many changes might only take effect for periods commencing after the point of the UK's exit from the European Union, others could need considering relatively soon after the point of exit.

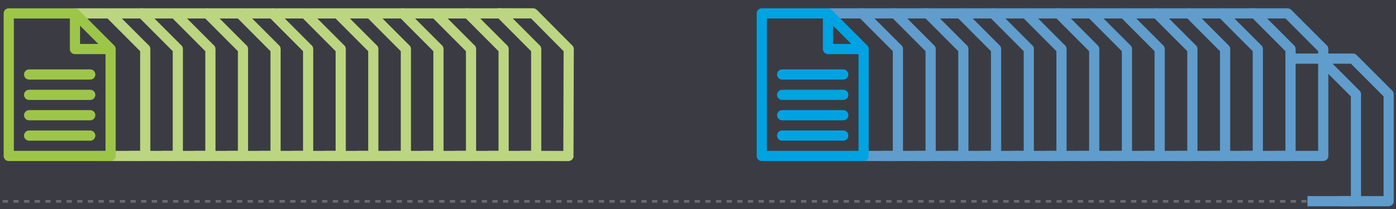
4. Report structure and preliminary announcements

Results were announced and reports approved on average **64 days** after year-end

84%

Issued a results announcement based on audited financial statements

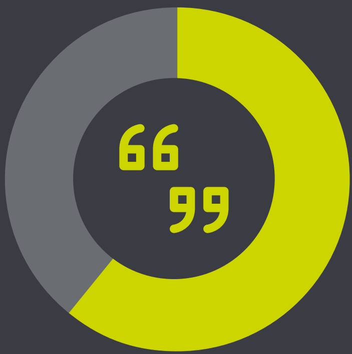
Average **report length** grew again from 164 to 172 pages



Reports comprised an average of

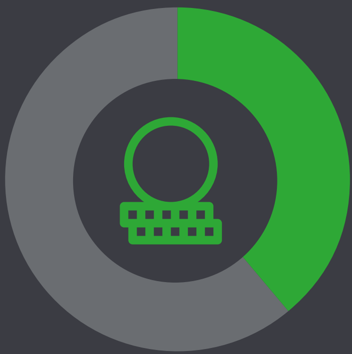
61%

narrative



39%

financial statements



14 companies mentioned how they had **regard to materiality** in their narrative reporting

Results announcements

Ahead of publishing their 'glossy' annual reports, companies took an average of 64 days (2018: 66 days) following their year-end to announce their results to the market. 84% (2018: 88%) clearly made announcements based on financial statements where the audit had been completed, while only 11% had clearly not had their audit completed.

Unsurprisingly, on average the FTSE 350 companies in our survey were faster at reporting to the market, taking 59 days (2018: 59 days), compared to those outside the FTSE 350 taking 70 days (2018: 74 days). The fastest company to report took just 31 days.

Report length and composition

Annual reports continued to grow in length over the past year, with the average length rising from 164 pages to 172 pages. Despite a lack of new requirements coming into force for most of the reports we looked at, narrative reporting still increased in length by five pages to reach an average of 106 pages.

Financial statements also increased by three pages to reach an average of 66 pages – factors that likely contributed to this increase included the adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*, plus increased information on the impending transition to IFRS 16 *Leases*. Further information on these new IFRSs is available in section 15. The average length of the audit report on companies' consolidated financial statements (excluding any separate audit report on parent companies' separate financial statements) rose from seven to eight pages.

Overall, the proportion of the report dedicated to narrative reporting, as opposed to the financial statements, remained constant compared to last year at 61%.

Materiality

Materiality is a concept relevant to narrative reporting as well as the preparation of financial statements. Although a company will typically have a diverse group of different stakeholders with varying interests, the FRC's Guidance on the Strategic Report (the FRC's Guidance) clarifies that the strategic report should contain information that is material to shareholders. Of course, which information is judged to be material will ultimately depend on a company's particular set of circumstances.

14 companies (2018: 13) made reference to materiality in their narrative reporting, most commonly in connection with their corporate social responsibility information – in some cases making reference to the Global Reporting Initiative concept of materiality, which considers impacts on and decisions taken by stakeholders other than shareholders.

As discussed in sections 5 and 8, approximately a third of companies present a separate section of their strategic report dedicated to corporate social responsibility matters, with a similar number referring to separate sustainability reporting outside of the annual report. It is important to note that the annual report must ultimately 'stand alone' and that other information outside of it cannot be incorporated by cross-reference in order to meet the requirements for the annual report itself, where such information is material. Sustainability information that is material to shareholders should be incorporated into the relevant sections of an annual report, whether that be disclosure of the business model, strategy, risks or other information.

More generally, companies are subject to a wide variety of reporting requirements nowadays, not just in respect of their annual reports. Some companies included information in their annual reports that is required under other reporting obligations. It was unclear in some cases whether they were doing so because they felt it fulfilled a requirement to be included in their annual report as it was viewed as material to shareholders.

For example, 19 companies included some or all of the information required under the Modern Slavery Act in their annual report, with a further 56 including a cross-reference to other reporting in this regard. Such cross-references were typically provided as part of a company's required annual report disclosures on human rights. Again, it is worth remembering that the annual report must ultimately 'stand alone' and contain all material required information.

Although it is not required to be included, 27 companies provided some information on their gender pay gap in their annual report. Another 30 companies provided a cross-reference to where further information on their gender pay gap could be found. Four companies, three of which were banks, went further still and provided some form of information on their ethnicity pay gap.

Directors' remuneration

One area that often attracts interest from users of annual reports is information on executive pay. Companies are required to provide considerable amounts of information on directors' remuneration in their annual reports, with remuneration reports this year averaging 18 pages in length, consistent with the previous year. The shortest remuneration report was only three pages long (by a company outside the FTSE 350), whilst the longest was 34 pages long (by a company within the FTSE 100).

One of the three components of a remuneration report is the policy report, although companies are only required to include it in their annual report in the years when the remuneration policy is subject to shareholder approval (at least every three years). However, the majority (96 companies) either provided a summary or the full version of their policy regardless of whether changes were being proposed.

For periods commencing on or after 1 January 2019, quoted companies will need to provide the ratio of CEO pay to the average pay of their UK workforce. It was encouraging to see 22 companies disclosing at least some of the required information in this area ahead of the mandatory implementation date.

What to watch out for

- [ ] Apply the new reporting requirements for periods commencing on or after 1 January 2019 relating to CEO pay ratios and outcomes of long-term incentive plans.

- [ ] Remember that the strategic report is only required to contain information material to shareholders and that the annual report should stand alone, i.e. include all the required material information.

- [ ] Consider the communication principles set out in the FRC's Guidance on the Strategic Report and the <IR> Framework's Guiding Principles, illustrated below.

<IR> Framework Guiding Principles

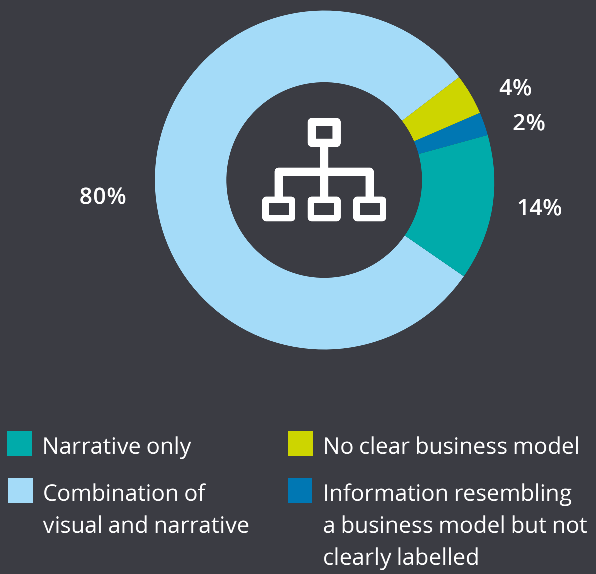
- **Conciseness**
- **Connectivity of information**
- **Stakeholder relationship**
- **Materiality**
- **Strategic focus and future orientation**
- **Consistency and comparability**

FRC's Communication Principles

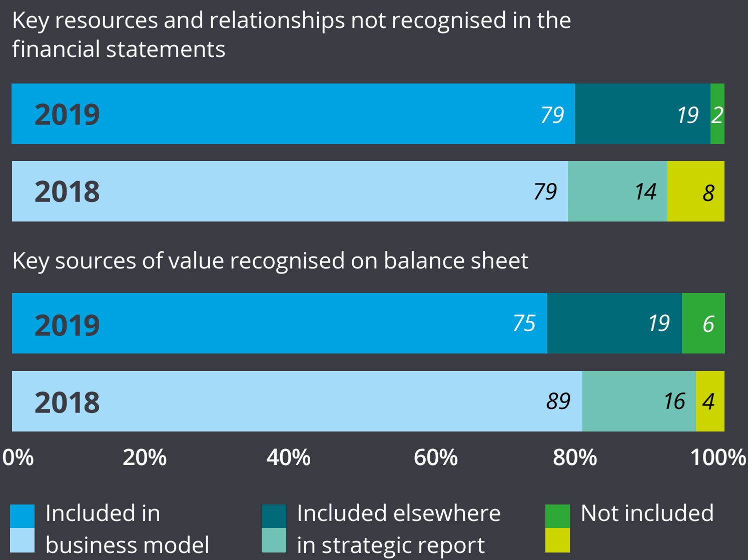
- The strategic report should be fair, balanced and understandable.
- The strategic report should be clear and concise yet comprehensive.
- Where appropriate, information in the strategic report should have a forward-looking orientation.
- The strategic report should provide information that is entity-specific.
- 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.

5. Strategy and business model

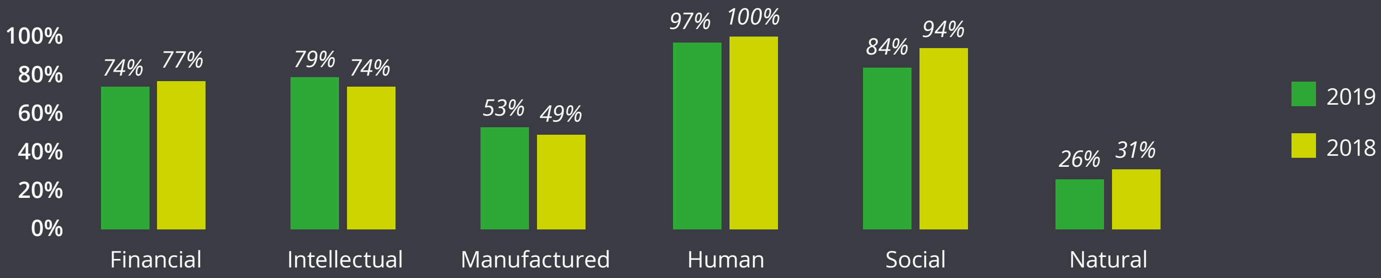
How is the business model presented?



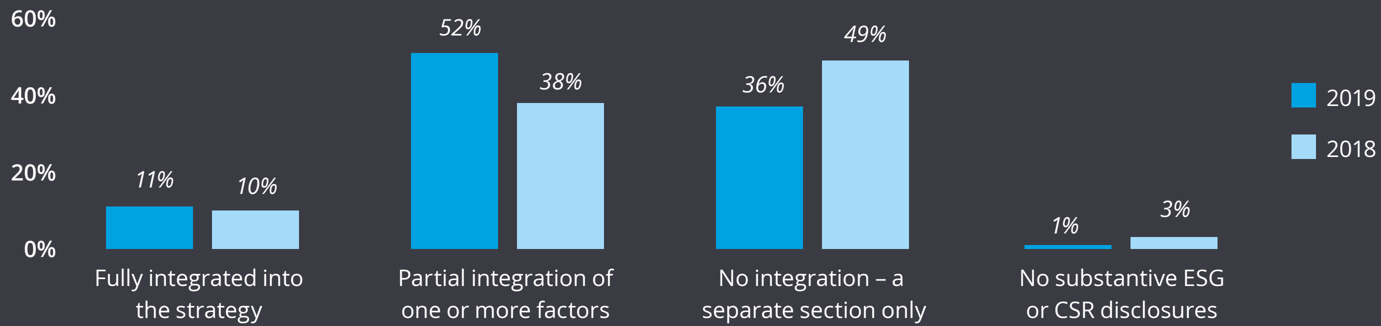
Which sources of value are presented in the business model?



Of those identifying <IR> capitals, which are referred to?



To what extent are broader ESG factors incorporated into the broader group strategy?



Compliance - positive trends

The strategy of a company is intrinsically linked to its purpose and business model. The purpose sets out a company's vision and the strategy explains how the company intends to achieve it. The business model reflects both vision and strategy together with the company's resources and activities, demonstrating how the directors create long term, sustainable value both for the organisation's shareholders and for its wider stakeholders. Effective linkage of these components of the annual report is therefore essential to a clear understanding of how a business operates.

As one of the first sections of the annual report that investors will look at, the business model needs to articulate what the company does and the financial and non-financial resources and relationships it relies upon. 96 companies included a business model within the strategic report (2018: 94), although two of these companies did not label it as such. The remaining four companies made some reference to a 'business model' at various places in the annual report but did not present anything which could be clearly identified as such. 82 companies included within the business model a clear description of what the company does, an increase on 71 in 2018, with a further 17 explaining this elsewhere in the report (2018: 29), typically upfront in the summary pages.

The business model needs to be clear, concise and readily understandable. One way of achieving this is to present the information in a visual manner, making use of graphics to highlight key pieces of information. The most popular manner of presentation continues to be to use a combination of words and graphics, with 80 companies adopting this approach. In the majority of cases, where graphics were used, they clearly aided in understanding the business model.

As shown in the graph opposite, the majority of companies continue to describe as part of their business model key resources and relationships that support value generation, both those recognised on balance sheet and those not reflected in the financial statements. The FRC's Guidance on the Strategic Report (the FRC's Guidance) considers an understanding of sources of value to be of critical importance.

Of those companies identifying relationships and resources not recognised in their financial statements (such as employees, brand, customer relationships and natural resources) all but six set out how their key relationships and resources were maintained. Such an understanding was specifically identified by the FRC's Financial Reporting Lab as useful information for investors. For example, companies identifying their employees as key resources tended to talk about how they incentivise and motivate employees to perform and how they invest in training and development.

This type of discussion is particularly informative where companies disclose metrics used to measure success in maintaining or enhancing their key resources or relationships. In the case of employees, companies frequently refer to employee engagement surveys and other similar feedback mechanisms, or disclose the number of employees who have received training which will enable them to perform better. It is also helpful to demonstrate how the maintenance and enhancement of resources and relationships link into the strategy and impact value creation.

For example, Hollywood Bowl plc identified its employees as a key resource and a stakeholder. It implemented an internal management training programme and disclosed the number of employees to have completed that programme in the year. They also explained how employees were benefitting from training, the positive impacts this has on customers and how this fed into their strategy.

Over a third of companies discussed resources and relationships consistent with the <IR> notion of 'capitals'; the number of companies doing so has shown a small but steady increase over the last three years, up from 32 in 2017 and 35 in 2018 to 38 in 2019. As last year, these companies continue to be spread fairly evenly across the FTSE. The use of <IR> capitals helps to demonstrate how key resources are used to generate value, facilitates a better understanding of the interdependencies between resources and enables businesses to ensure they consider all types of resource utilised by them. The use of <IR> capitals can also be helpful in explaining how value is created for various stakeholders.

Although it is good to see companies making use of the <IR> notion of capitals to describe resources in the business model, there is potential for companies to make greater use of the <IR> Framework and its concepts. Only six companies stated that they have considered the Framework more generally in preparing their annual report.

Compliance – problem areas

Given the clear reliance on broader ESG factors in their business models, companies should ensure that these wider factors are taken into account, particularly at board level, when setting the company's strategy. As shown in the graph opposite, although there has been some improvement in the number of companies including such elements in their description of strategy compared to last year, over a third continue to present a corporate social responsibility (CSR) section in their strategic report which is entirely separate from the strategy or business model. This brings into question whether broader ESG factors are taken into account when setting a company's strategy. Although 79 companies incorporate off balance sheet resources in their business model, only 63 companies incorporate ESG into their strategy to some extent, suggesting there is still much to do to incorporate specific thinking around ESG into strategic-level planning and implementation. This might commonly include a strategic objective relating to the environment or employee matters.

A company's strategy also depends on the market in which it operates; companies therefore need to explain their exposure to market trends, including the risks posed by and opportunities arising from doing business in those markets. 86% of companies (2018: 75%) clearly identified in their strategic report both risks and opportunities arising in the marketplace and discussed how they were applicable to the company. A further 7% (2018: 10%) clearly identified only the risks and 4% (2018: 12%) identified only the opportunities. Although 79 companies presented a separate market overview, these overviews did not always explain how market trends would result in risks and opportunities for the company itself. Instead many companies identifying risks and opportunities made this link to impact on the company within the broader strategic discussion.

Looking forward

With the new s172 statement and deeper consideration of engagement with wider stakeholders coming into play for 2019, companies now need to be considering how the directors' decisions translate into value for investors and other stakeholders. The introduction of the separate s172 statement represents an excellent opportunity for businesses to revisit their business model and strategy disclosures. These disclosures can be used as a means of driving the discussion around how directors have performed their duties to promote the success of the company, considering all relevant stakeholders.

This broader approach to good business should be reflected in a company's purpose, which needs to address the company's reason for existence not only in terms of financial objectives but in respect of all stakeholders. As discussed further in section 1, 46 companies included a purpose statement along these lines, but this still leaves significant room for improvement. A good example is Anglo American plc, where the company's purpose is set out as the driver for the company's strategy, both of which incorporate financial and non-financial considerations. Meanwhile, the more insightful business models go beyond shareholder value creation by identifying who their other stakeholders are and setting out how value is created for each (see also section 7). St Modwen Properties plc offers a good example of how this information might be presented.

Beyond the UK focus on s172, regulators and policy-makers around the world are focusing more heavily on the need to consider broader ESG factors, in particular climate change.

As discussed further in section 2, climate change is likely to drive some of the most significant changes to businesses in our lifetimes. Despite this, just nine companies included consideration of climate change in their strategy, and no companies brought it directly into the business model. Typically, discussion of climate change, together with other ESG factors, continues to be relegated to a separate sustainability or CSR section of the strategic report, if it is even mentioned at all. Weir Group plc identified the potential impact climate change could have on its strategy and explained how it is responding to the challenges. With increasing regulator focus on the effects of climate change and other ESG factors on businesses, these challenges – and, in some cases, opportunities - need to be assessed at board level and reflected upfront in a company's strategy and business model.

What to watch out for

- ☐ Consider whether it is clear how your company's strategy and business model support its purpose.
- ☐ Challenge whether your business model clearly describes what the company does, how it does it and the value it generates for its stakeholders.
- ☐ Set out how key resources, relationships and other off-balance sheet sources of value creation identified in the business model are maintained and enhanced. In particular, explain how these are measured and benchmarked.
- ☐ Ensure that the discussion of market trends is balanced, including risks and challenges as well as opportunities.
- ☐ Challenge whether non-financial considerations, including ESG factors and, in particular, climate change, have been considered and are fully integrated into the company strategy and business model.

Examples of disclosure

Anglo American plc demonstrates clearly how their strategy supports the company's purpose, incorporating financial and non-financial objectives.

Anglo American plc


THE PURPOSE TO REWARD JOURNEY

OUR STRATEGY

Portfolio

Innovation

People

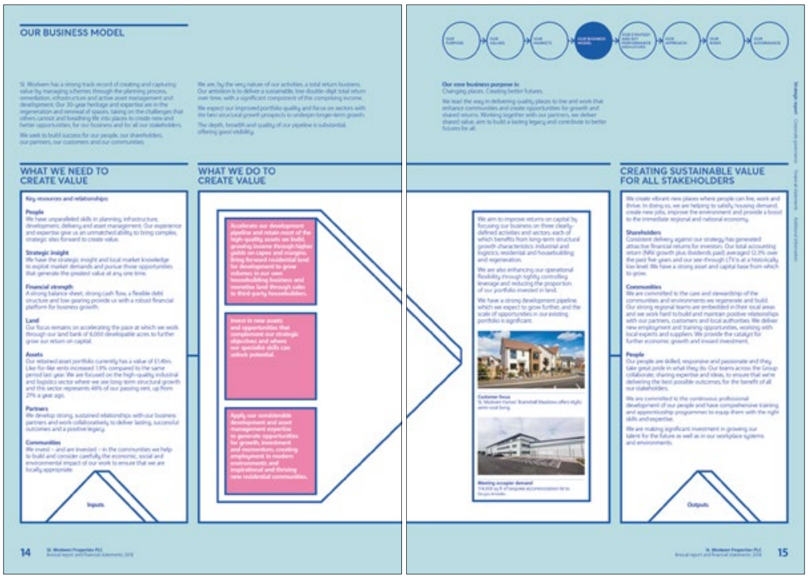
Capital allocation

OUR PURPOSE

OUR VALUES

St Modwen Properties plc identifies who their stakeholders are and sets out how value is created for each.

St Modwen Properties plc


OUR BUSINESS MODEL

WHAT WE NEED TO CREATE VALUE

WHAT WE DO TO CREATE VALUE

CREATING SUSTAINABLE VALUE FOR ALL STAKEHOLDERS

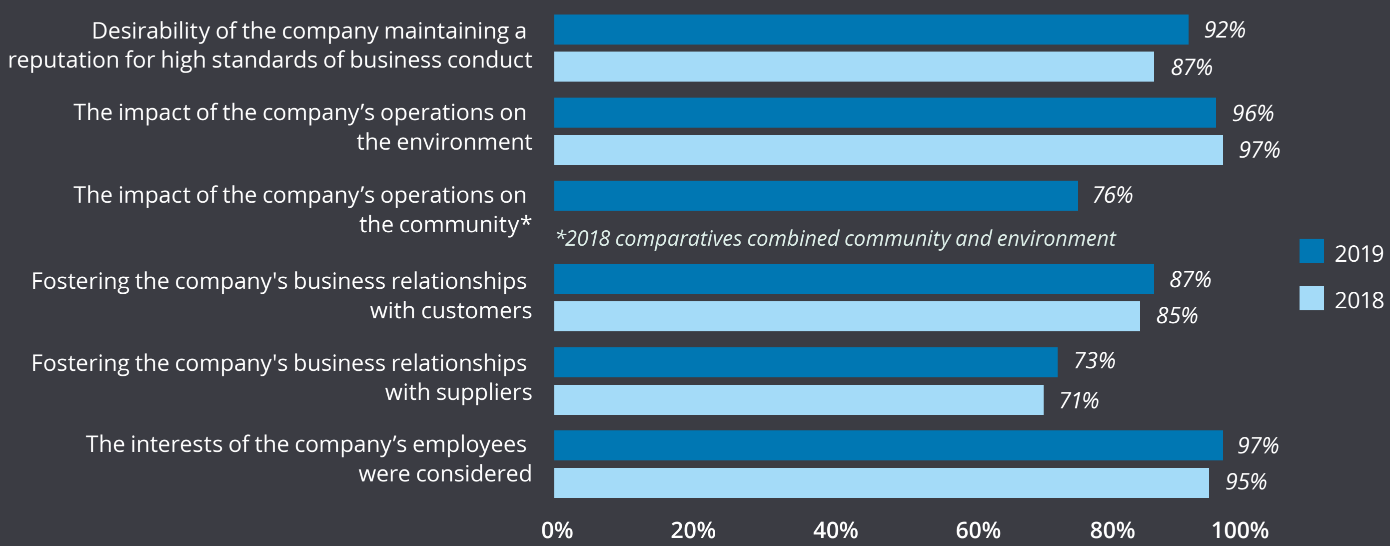
See more examples of disclosure in the electronic version of this publication.

6. Stakeholders

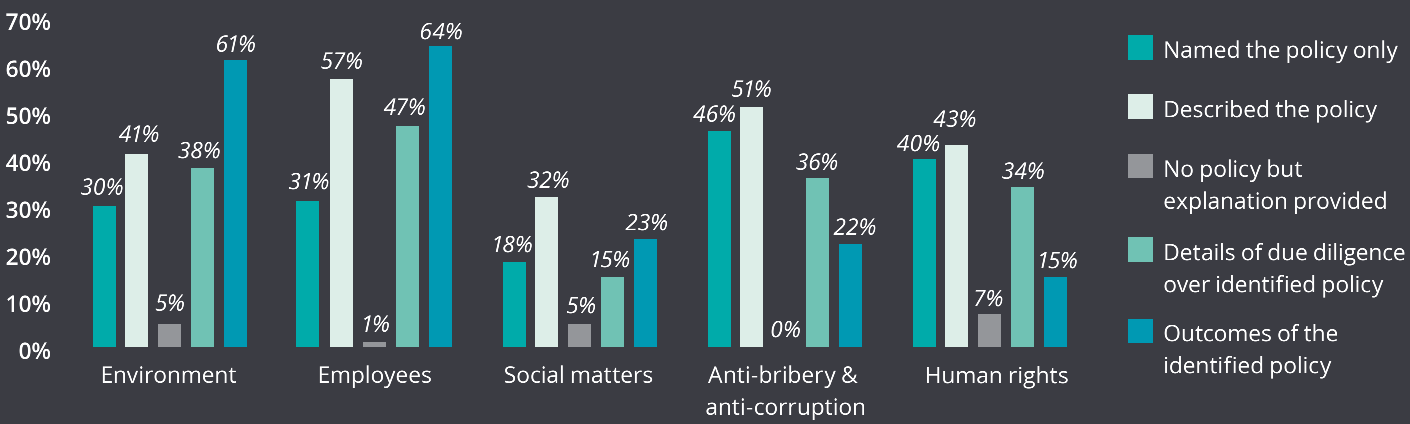
31 Companies refer to **s172** (2018: 29) in their annual report

64% of companies in scope provided a **separate non-financial information statement**

There was an indication that the following s172 considerations were considered within the annual report



Of those companies in scope, which elements of the NFR Directive were identifiable?



Compliance - positive trends

Stakeholder relationships are an integral part of any company's business model. It is important that boards identify and engage with the company's key stakeholders in order to understand its dependency on those stakeholders and, in turn, the impact the company has on those stakeholders. The FRC's Lab identified value created for stakeholders (other than shareholders) that supports economic value generation as being a key part of the business model that investors want disclosed.[9]

97 companies (2018: 94) identified stakeholders other than investors and, as the graphic opposite shows, with the most common 'other' stakeholders being employees and customers.

Stakeholder engagement is key to translate stakeholder needs into company goals and to inform both strategy and the business model. There was no legal requirement to disclose detail around stakeholder engagement in the reports being surveyed this year but, as discussed later in this section, this is set to change with the Companies (Miscellaneous reporting) Regulations 2018. From 1 January 2019 companies need to include a s172 statement in the strategic report and two additional disclosures in the directors' report: one relating to engagement with employees and one relating to engagement with suppliers and customers (see the Regulatory Overview in Appendix 4).

90 companies described their engagement with employees, which was mostly through employee engagement surveys, while 64 described how they had engaged with customers. 43% of companies identifying suppliers as a key stakeholder described how they engaged with them, while 34 companies described their engagement with other stakeholders (such as regulators, local communities and operational partners). The most insightful disclosures around engagement were those that presented the full picture: identifying each stakeholder group, describing their engagement with each, what the subject of engagement was, explaining why this was relevant or how it linked to strategy and then summarising any responses to the engagement.

Stakeholder relationships are at the heart of integrated reporting. An integrated report should provide insight into the nature and quality of the organisation's relationships with its key stakeholders, including how and to what extent the organisation understands, takes into account and responds to their legitimate needs and interests. The <IR> Framework states that by doing so, the integrated report enhances transparency and accountability. Mears Group PLC explained how stakeholder engagement is central to its overall strategy and outlined how it has engaged with each stakeholder, their expectations and the relevance to its business model and strategy, therefore demonstrating its integrated thinking.

Insight from engagement activities then needs to find its way back to the boardroom, the board needs to react to this feedback, develop high level intentions and translate them into more precise policies for the company (see below for NFR directive disclosures). Looking at the strategic report, where discussions on strategy and business model tend to reside, there was little evidence to suggest that stakeholder feedback had any impact on Board decision-making. Just over a quarter of companies described, in their strategic report, the outcome of an engagement activity with stakeholders other than investors and what they had done differently as a result. Nearly all of the descriptions of outcomes were in response to employee or customer feedback. One example was feedback and an idea from an employee resulting in an operational change to reduce water consumption and save over $1m. One other company carried out a "Positive Impact Plan" in response to feedback from colleagues, customers, suppliers and external stakeholders, involving an entire overhaul of branding, image, culture and values.

Turning to the corporate governance disclosures provided by companies, which often provide further insight into Board level activity, a similar proportion (32%) provided a clear explanation of the way that the Board took broader stakeholders into account.

Compliance – problem areas

87 companies surveyed fell within the scope of the NFR Directive, which requires companies to disclose in their strategic report certain information about five areas: environmental matters, employees, social matters, respect for human rights, and anti-corruption and anti-bribery matters. Principal risks (see section 9) and non-financial KPIs (see section 7) relating to these areas are required to be disclosed, as well as a description of policies relating to these matters, due diligence over those policies and the outcome of the policies.

The NFR Directive is an opportunity for companies to challenge their existing disclosure in the strategic report and focus on meaningful information on how they relate to their stakeholders. However, given the overlap with the previous requirements of the strategic report, it appeared that many companies either thought they had already addressed the matters, or solely tinkered around the edges.

The FRC's Guidance has confirmed that companies are expected to provide a separate "non-financial information statement" (NFI statement) in the strategic report. This statement should either contain the information required by the NFR Directive or it should provide cross-references to where the required information can be found elsewhere in the report. Given the overlap between the information required under the NFR Directive and other requirements for disclosures within the strategic report and other parts of the annual report, companies are encouraged to integrate the information throughout the strategic report to 'tell their story' in a more holistic manner, and provide cross-references from the NFI statement to avoid duplication.

Including a separate statement makes clear that the NFR Directive has been taken on board, and also helps in making sure all the relevant criteria are met. It was disappointing to see only 56 of the 87 companies in scope produced a separate NFI statement. It appeared there was some confusion about where this statement should be included, with a number appearing in the directors' report. Anglo American plc included their NFI statement upfront on page 1 of their strategic report with a cross reference to where further information can be found; the majority of the other companies included the statement in a separate corporate, social and responsibility (CSR) discussion.

Most companies that did provide a non-financial information statement used a tabular approach, providing a summary of the requirements and cross references to where the relevant information was disclosed in the annual report. The usefulness of these statements varied widely. Some were incomplete with requirements being missed, some cross-references were to information that didn't seem to fulfil the requirements (particularly in the case of due diligence) and for some it wasn't always clear what their policies were, instead referring to intentions, objectives or aims without further clarification.

Nearly half of the NFI statements clearly identified policies (whether simply named or else described), but often no link was made to any other text to demonstrate how they had been applied and the outcome of the policy. Others named a policy in their statement but noted that the policy was not available externally and did not seem to go on to describe it. Morgan Sindall Group plc was one of the few companies which included the detail of due diligence and outcomes within their statement.

If a company does not pursue policies in relation to any of the NFR Directive matters, it must provide a clear and reasoned explanation for the company's not doing so. Provision of such explanations was rare in practice, with only four companies doing so in relation to the environment, one for employees, four for social matters and six for human rights. Evraz plc was one of a handful of companies for whom a description of a policy was identifiable across every element of the NFR Directive.

Despite the difficulties in identifying specific policy descriptions, all companies discussed the environment and employees to some extent. There was an increase in the number of companies discussing the other elements (social matters, anti-bribery and human rights), including those companies out of scope of the NFR Directive. 97% of companies in scope (2018: 83%) described or named a policy on anti-bribery and anti-corruption, while 83% of companies in scope (2018: 70%) described or named a policy on human rights. These policies were much easier to identify than those of the other elements primarily because of the specific terminology used, but also possibly because some of these are matters which are not required to be disclosed specifically by other regulation and so could be easier for preparers to draft from scratch and 'drop in' to the report.

The area of most difficulty continued to be disclosure of social matters, possibly because it is not defined in law and can be more widely interpreted than the other elements. Many more companies than last year clearly named or described a social policy, however this still only totalled 51% (2018: 33%). For those industries where social capital is naturally significant in their business model, identifying and describing social policies is relatively straight forward. For example, mining and extractive companies often have a significant impact on the local communities where they operate and similarly are dependent on those communities as a workforce; companies delivering food and beverage products have a significant responsibility to broader society (the end consumer) with regard to the health of the population and food safety.

Many companies include a lot of information about their interaction with local communities, most commonly their charitable fundraising efforts, although it could be questioned whether such detail is always material in the context of the annual report. For those where there was not clear linkage to strategy or business model, it raised the question of whether these descriptions related to how their operations impact or create value for the community, or whether they were solely philanthropic acts.

Clear descriptions of due diligence processes in pursuance of the relevant policies also remains a challenge. However, there was a marked increase in the number of companies reporting on these processes across all five areas. Due diligence was addressed in relation to about half those policies disclosed for the environment and employees. However, just over 30% of those companies disclosing a policy for social matters and anti-bribery included any due diligence and just over 40% did for human rights. Not discussing the due diligence processes raises a question as to how the board gets comfortable that the policy is being adhered to.

Overall the level of detail provided varied from vague to extensive, and the extent of the due diligence ranged from internal reviews and internal audit to external assurance. For environmental policies, due diligence was often a review (either internal or external) or audit over GHG emissions or an ISO 14001 certification for some or all operating sites. Employee policies often included health and safety policies, with due diligence commonly being the monitoring of key safety metrics, internal safety audits of operating sites or ISO 14001 or OHSAS 18001 certification. Due diligence over social policies varied due to the differing nature of the policies between companies, but often board review of a relevant metric was noted. For anti-bribery and anti-corruption policies, due diligence was predominantly review by internal audit, with some companies referring to externally-managed whistleblowing hotlines. Human rights policies tended to focus on supply chain and due diligence was often carried out by internal audit.

Disclosure around outcomes of policies continued to vary. For environmental and employee matters, these were often metrics and the level of disclosure had improved on prior year, with over half of those in scope providing outcomes for their environmental policies and nearly two thirds for employee policies. For the other NFR Directive elements, where outcomes could be quantified in a metric (such as number of calls to a whistleblowing hotline), these were provided; in other cases it was a statement of negative assurance indicating that the processes in place had not identified any instances of activities out of line with the company policies.

Looking forward

There continues to be increased focus by investors, government, regulators and the media around directors' responsibilities under s172 of the Companies Act, specifically their duty to promote the long term success of the company taking into regard the impact on a broad group of stakeholders such as employees, customers, suppliers, the environment and community. This is because they are important to a company's sustainable long-term success and the contribution it makes to wider society (see section 8). Indeed, from 1st January 2019 new regulations[10] require large companies to include:

- a standalone statement in their strategic report explaining how the directors have carried out their duty under s172. BEIS[11] has indicated this is likely to include the issues, factors and stakeholders the directors have taken into account; the methods of engagement; and the effect this has had on company decisions and strategies;
- more information in their directors' report on the need to foster business relationships with suppliers, customers and others (and taken this into account in making principal decisions); and
- an explanation in their directors' report of how they have engaged with employees and had regard to their interests (and how this has been taken into account in making principal decisions).

Section 172 itself is not new, so for some companies this new reporting requirement will not require a significant change in the way they operate. However, the requirement to report on how it has been met this coming year may refocus minds and prompt companies to reflect on and strengthen their approach to this responsibility. Done well, the Section 172(1) Statement ('s172 statement') represents an opportunity for companies to show the complexity and thoughtfulness of business leaders in the exercise of their duties.

No company produced a full s172 statement this year, although eight (2018: nine) companies referred to s172 in their strategic report, of which five (2018: eight) then went on to provide a further comment to allow shareholders to get an indication of how the directors have performed their duty. A further 23 companies referred to s172 in their corporate governance statement. Given the new reporting requirements relate to directors' activities it isn't surprising that some are choosing to talk about this in their corporate governance reports.

The requirements of the strategic report, NFI Statement, directors' report and reporting on application of the Code, particularly in respect of stakeholder engagement, are becoming ever more connected, and even overlap in places. It is important that where a disclosure is included in a location other than the one where it is required (in order to enable a holistic story to be told and avoid repetition), that clear cross-references are included.

LSL Property Services plc noted in both their strategic report and Corporate Governance statement that they have been implementing improvements to reflect best practice set out in the joint guidance issued by the Investment Association and ICSA in relation to stakeholder engagement and the Guidance on directors' duties: Section 172 and stakeholder considerations issued by the GC100. As can be seen from the graph on the previous page, companies are discussing some aspects of s172 in their strategic report in some way, although not necessarily through the lens of explaining how directors themselves were involved, the impact on board decisions or to the level of detail which will now be required. These aspects will need to be borne in mind when preparing the new disclosures. Section 172 sets out the matters directors should have regard to in fulfilling their duty (indicated in **bold** in the following paragraphs).

Most included some meaningful commentary on the **impact of the company's operations on the environment** beyond the statutory requirement to disclose GHG emissions, with many companies focusing on energy and resource efficiency. 31 companies from across the FTSE went beyond what is required and disclosed their 'scope 3' GHG emissions, as well as the required scopes 1 and 2, although it was not always clear what was driving this extended disclosure (such as being material to the business model or strategy, or stakeholder pressure).

New Energy and Carbon Regulations effective for periods beginning on or after 1 April 2019 (see Appendix 4) will require quoted companies to disclose energy consumed and any steps taken to increase the company's energy efficiency during the period. 17 companies already disclose energy usage information and 39 discuss energy efficiency measures (ten of these discuss both). Cobham plc disclosed all of the information required under the new regulations within its directors' report, explicitly referring to the new requirements.

Unsurprisingly nearly all those with employees discussed how employees' interests were considered in some way. For some companies the reference to gender pay gap reporting (see section 4), and other employee performance metrics (see section 7) in some cases evidenced how **employee interests** are taken into account. Informa Plc included a case study in their Chairman's introduction highlighting how the board factored into their decision making the views of colleagues when considering a business acquisition and how it is subsequently being integrated into the existing group, stating that the "impact on colleagues and our culture was at the foremost of our minds". 86% provided evidence of **fostering relationships with customers** such as engaging with clients to understand their changing needs through surveys, workshops or meetings and monitoring Net Promotor Score (a common proxy for gauging customer satisfaction). In some cases companies gave an indication of what the effect this engagement had by explaining how the business model or product mix had evolved in response to this feedback.

Only 76 discussed the **impact of the company's operations on the community**. Discussions ranged from investing in local infrastructure to recognising that relations with the community could be a principal risk and how this was being mitigated. Anglo American plc discussed their use of a ground-breaking 'dialogue table' that was developed with host communities and was used to agree long-term social and environmental commitments.

66% of companies who identified **suppliers as a key stakeholder provided evidence of fostering their relationships with them**. Examples included ensuring policies in respect of human rights are adhered to throughout the supply chain, including creditor days as a KPI, discussing aspects of their payment practices reporting (mandatory reporting required outside of the annual report), hosting supply chain forums and acquiring certification to ISO44001 'Collaborative Business Relationships Management System'. Going forward directors will need to build on these examples and explain how they have engaged with suppliers (as discussed above) and how the outcome of that engagement was taken into account when making principal decisions.

Stakeholder relationships are not limited to those specifically identified in s172. Companies are encouraged to consider all relevant stakeholders in making the s172 statement, such as pension schemes, pensioners, regulators and their entire workforce. It was pleasing to see a number of companies discuss other stakeholder relationships not directly referred to in s172.

Section 172 is broader than stakeholder engagement as it talks about the impact of decisions in the long-term, high standards of business conduct and acknowledging the need to act fairly between members of the company.

The FRC's Guidance points out that capital allocation and dividend policy decisions are likely to have a particular impact on the long-term prospects of the business and will demonstrate how well the **board is considering the likely long-term consequences of their decisions**. See section 8 for details of how companies are responding to investor calls for more transparency on this.

89 companies disclosed clearly how they want to **maintain their reputation for high standards of business conduct**. This included discussion throughout the strategic report conveying the importance of earning a license to operate (see Lonmin Plc for an example of what this means to them), as well as potential damage to reputation often being mentioned in the discussion of principal risks.

Only a small proportion of companies discussed in their strategic report **how they act fairly between members of the company** - more discussed this in their corporate governance reports. It was usually demonstrated through the description of shareholder engagement explaining how the views of shareholders are taken account of outside of the AGM.

With increased pressure from investors for companies to recognise the impact of broader ESG factors on how they do business, effective stakeholder engagement and consideration of their views in the boardroom is vital if value is to be created in a responsible way.

What to watch out for

- [ ] Ensure processes are in place to enable the Board to provide the required information for the new s172 statement.
- [ ] Make sure that the newly required s172 statement is included in the strategic report for accounting periods commencing on or after 1 January 2019.
- [ ] Discuss how stakeholder engagement affected the board's decision-making.
- [ ] Consider whether policies and practices that address matters covered by s172 and the NFR Directive can withstand close public scrutiny.
- [ ] Look again at the requirements of the NFR Directive to make sure that not only the relevant policies are clearly identified, but due diligence and outcomes from those policies are also discussed. Where there is no policy in place, this must be explained.
- [ ] Remember to include a separate non-financial information statement in the strategic report and, where necessary, clear referencing to other parts of the annual report where the required content is covered. This is consistent with the approach required for the s172 statement.
- [ ] Think about how to link information on stakeholder engagement in the strategic report with the governance statement given it is likely these matters are relevant to both.

Examples of disclosure

National Grid plc was one of the few companies that referred to s172 in its strategic report. This linked to the corporate governance statement that described stakeholder engagement and provided examples of how the directors took into account feedback from stakeholders in their decision making.

National Grid plc

Directors' duties

In our effort to balance the relationship between National Grid and our key stakeholder groups, the Board has taken into consideration Financial Reporting Council guidance. We continue to be mindful of the need to create value. By considering our purpose, vision and values together with our strategic priorities, we balance outcomes for our suppliers, communities, employees, regulators and customers alongside long-term sustainable growth for our investors.

The Board, advised by the Group General Counsel & Company Secretary of our duty under section 172, determines the impact of our decisions on all stakeholders.

Further reading
Board engagement with stakeholders – pages 54 – 55

Stakeholder engagement and the Board's duty

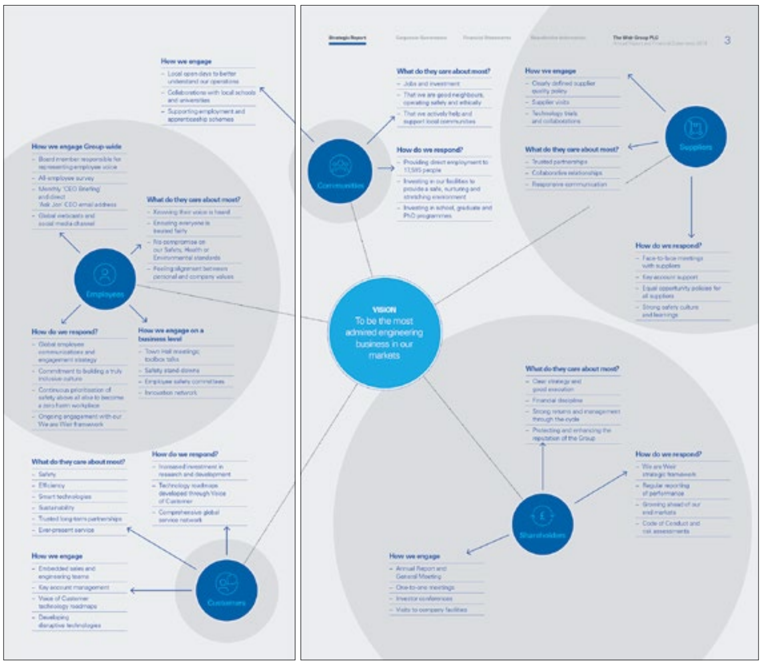
The role and effectiveness of the Board are essential in a successfully run company. During the year, we discussed the Board's duty under section 172 of the Companies Act 2006, with a significant focus on reviewing and mapping out our key stakeholder groups and discussing the Board's current level of engagement and incorporation of its views into decision-making. Our discussions around RIIO-T2, the Massachusetts gas labour dispute and workforce contingency plan, the Hinkley-Seabank Connection Project and our Business Plan are examples of how the Board has had regard to its duty under section 172, including ensuring we had regard for the interests of key stakeholders and the likely consequences of any decisions in the long term. You can read more about who our key stakeholders are and how they have influenced key decision-making on pages 54 – 55.

Mears Plc identified their six key stakeholder groups, summarised how they have engaged with each in the year and explained the relevance of this to their business model and strategy.

[Mears Plc]

The Weir Group PLC identified their five key stakeholder groups, summarised how they engaged with them, what their stakeholders care about most and how the company has responded.

[Weir Group PLC]



Evraz plc included their non-financial information statement in tabular format, summarising its approach to each element and cross-referencing to the description of the policy, related KPIs and principal risks.

Evraz plc

Requirement	The Group's approach and policies	Documents	Related KPIs	Related principal risks
Environment Further information: Environment, see pages 77–82 Energy efficiency, see page 83	Steel and mining production carry a high risk of environmental impact and incidents related to its production processes. That is why EVRAZ pays the closest attention to environmental matters in order to prevent or minimise any adverse impacts.	EVRAZ HSE Policy Code of Business Conduct	The HSE Committee adopted new five-year environmental targets: • Decreasing fresh water consumption by 10% • Recycling 95% of non-mining waste per year • Maintaining the greenhouse gas intensity ratio below 2 tonnes of carbon dioxide (CO_2) equivalent (tCO_2e) per tonne of steel cast	HSE: environmental see page 37
Employees Further information: Our people, see pages 84–89 Health and safety, see pages 72–76	EVRAZ strictly complies with national labour laws and best practices of business ethics concerning employee management. Discrimination related to a person's race, ethnic origin, gender, religion, political views, nationality, age, sexual orientation, etc is totally unacceptable throughout the Group, as well as at its subcontractors and suppliers. Due to industry-specific issues, EVRAZ employees and contractors face safety and health risks. Providing a safe work environment is one of the Group's main core values.	EVRAZ HSE Policy Code of Business Conduct	LTIFR (per 1 million hours) Labour productivity, steel (tonnes per person)	HSE: health and safety see page 37
Social policy Further information: Community relations, see pages 90–95	EVRAZ strives to make a meaningful contribution to local economies and to support communities wherever it operates. The Group supports infrastructural, sport, educational and cultural programmes with an aim to improve the quality of life in local communities.	Social Investments Guidelines	Fulfilment of the Group's social obligations towards its employees, which were fixed in the collective agreements. Interaction with local communities in the regions of the Group's presence during the implementation of various CSR related projects.	Global economic factors, industry conditions and cyclicality Business interruption see pages 36–37
Respect for human rights Further information: Our approach, see pages 72–73	EVRAZ commitments are based on internationally recognised standards and respect for all human rights. Child labour, bonded labour, human trafficking and other forms of slavery are strictly prohibited at all Group subsidiaries and their suppliers. EVRAZ rules also prohibit abusive, harassing, discriminatory, degrading or aggressive speech or conduct.	Code of Business Conduct Modern Slavery Transparency Statement	Zero tolerance to violation.	None of EVRAZ current principal risks relates to the aspects of human rights
Anti-corruption and anti-bribery Further information: Anti-corruption and anti-bribery, see pages 96–97 A short summary of relevant anti-corruption policies, see page 264	In accordance with the Group's policies and procedures, compliance managers scrutinise tender procedures, check potential and existing business partners, vet prospective new candidates, and ensure that the principles set forth in the EVRAZ Anti-corruption Policy and Code of Business Conduct are adhered to throughout its operations.	Code of Business Conduct EVRAZ Anti-Corruption Policy: • Anti-corruption training policy • Sponsorship and charity policy • Gifts and business entertainment policy • Candidate background and criminal record checks • Conflict of interest policy • Contractor/supplier due diligence checks EVRAZ Rules on Securities Dealings	Zero tolerance to violation.	None of EVRAZ current principal risks relate to the aspects of anti-corruption.

See more examples of disclosure in the electronic version of this publication.

7. Alternative performance measures and KPIs

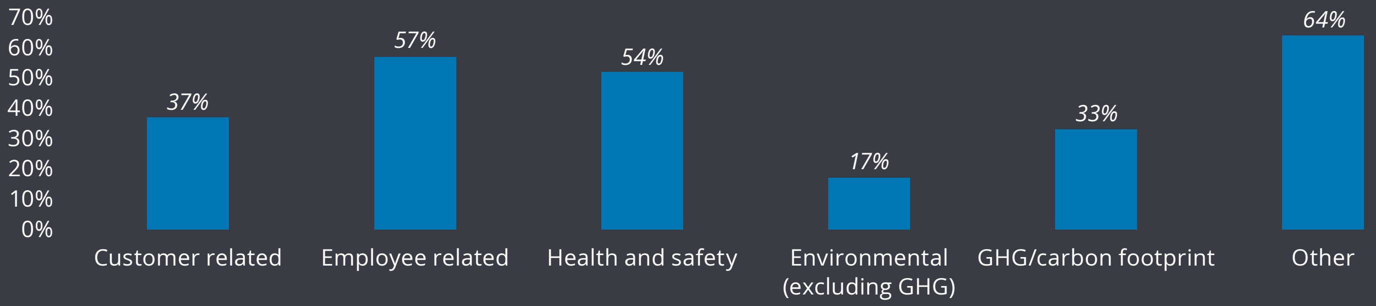
93 companies presented APMs in an up-front **highlights** section, with **88** including an **adjusted measure of profitability**

63 chairmen's statements and **78 chief executives'** statements contained APMs

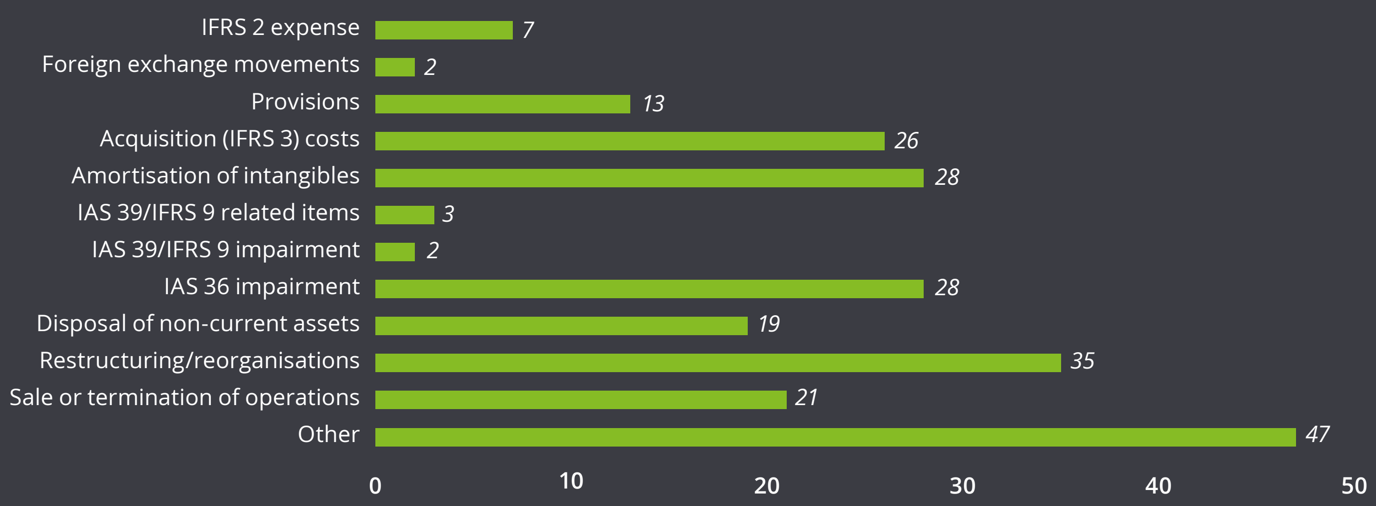
Those presenting KPIs included an average of **6 financial** and **4 non-financial** measures

66 companies presented an **adjusted profit measure** on the face of their income statement

Types of metrics where non-financial KPIs presented



Number of companies (out of 100) stripping items out when presenting adjusted measures in the income statement



Alternative performance measures (APMs) continue to be a common feature of UK companies' annual reports, with many believing that they serve a useful purpose in telling a company's story. ESMA's Guidelines on the use of APMs, together with FRC messaging provide the framework for companies to follow in using APMs in narrative reporting. The FRC has also published statements addressing non-GAAP measures presented in the financial statements. It is worth highlighting that concerns surrounding APMs were the second most commonly raised substantive issue by the FRC in their 2017/18 monitoring activity.

APMs in narrative reporting

93% of companies (2018: 96%) included APMs in their up-front summary/highlights pages in the annual report. The ESMA Guidelines require APMs to be reconciled to the most directly comparable amount appearing in the financial statements and the reason the APMs are useful should also be provided.

The table below summarises our findings in this regard for some of the most common metrics, indicating the number of companies out of 100 surveyed. Areas noted for improvement included providing an explanation for including 'net debt' metrics and, as noted by the FRC, the quality of the explanation in other instances. Across all of the metrics below, where explanations for including the metrics were provided the majority were unfortunately relatively generic in nature.

	Inclusion in summary/ highlights	Amount is in or reconciled to financial statements	Reason for inclusion provided
Adjusted profit measure(s)	88 (2018: 87)	86*	76
Adjusted sales measure(s)	32 (2018: 31)	26	27
Net debt	31	28	12
Ratio indicating shareholder return	24	22	21
Free cash flow	13	12	8

* This includes five companies that only reconciled some of the alternative profit measures they had presented.

One key requirement of the ESMA Guidelines is that APMs should not be given greater prominence than associated IFRS measures in the financial statements (which should also be provided). Of those companies providing adjusted sales measures in their highlights section, 84% also provided the IFRS revenue number.

Continuing with the prominence theme, encouragingly, 90% of those providing adjusted measures of profit in their highlights section also gave at least one IFRS measure of profitability. It did however seem as though companies may sometimes have struggled to identify an associated measure of profitability for all their various profit APMs, with some just providing the 'bottom line' profit figure per the financial statements.

Where companies had provided an associated IFRS profit measure in their highlights section, pleasingly only a minority appeared open to challenge in terms of giving undue prominence to their profit APMs through the use of graphs, differing font sizes and similar factors.

Moving on to the Chairman's statement, 63 contained APMs, with 52 including adjusted profit measures. In contrast to the above findings, 21 of the 52 providing adjusted profit measures failed to mention any IFRS measure of profit, which given the prominence of Chairmen's statements could be open to challenge. A further four companies also appeared open to challenge in terms of the prominence given to such APMs, for example pulling out adjusted measures as headlines in large font or displaying them in graphs, without doing the same for IFRS measures.

19 Chairmen's statements included adjusted sales measures, with eight failing to give the IFRS measure of revenue.

It was a similar story in Chief Executives' statements, with 78 including APMs, of which 67 included adjusted profit measures and 24 of those failed to give an IFRS measure of profit. Six of those providing IFRS profit measures appeared open to challenge in terms of the prominence given to profit APMs when considering the use of graphs, bold or larger fonts and similar.
27 included adjusted sales measures, with eight failing to give the IFRS revenue figure but, aside from failure to provide associated IFRS measures, just one company appeared open to challenge in terms of the APMs' prominence.

One increasingly common practice, adopted by 50% (2018: 46%), is to provide a dedicated appendix or similar for APMs used in the annual report, typically defining how the measures are calculated and why they are regarded as useful.

Given the judgement involved in using APMs and the scrutiny that they came under, it came as no surprise that 35 companies made clear that the audit committee had considered issues regarding the use of alternative performance measures, including the identification of 'exceptional' items or similar in the financial statements.

Key performance indicators

92 companies (2018: 90) clearly identified their key performance indicators (KPIs), of which 86 (2018: 89) included one or more APMs. The FRC's Guidance on the Strategic Report (the FRC's Guidance) calls for disclosure where there is a change to KPIs – 83 of those disclosing KPIs were silent as to whether there had been any changes to their KPIs, perhaps implying that there had been no changes. The FRC's Guidance also suggests that companies could discuss performance by reference to targets – only seven companies included targets for all of their KPIs, with most not providing any targets.

Of those companies identifying KPIs, there was an average of six financial KPIs (2018: six) and four non-financial KPIs (2018: three). On average, companies included three of their financial KPIs and one of their non-financial KPIs in their up-front highlights pages in the annual report, in some cases calling into question whether all the KPIs really were 'key'.

In a similar fashion, only 36 companies clearly linked all of their KPIs through to the company's strategy, evidencing the relevance of the metrics. A further 22 companies linked some of their KPIs and the remaining 32 companies disclosing KPIs didn't link any of those measures through to their strategy.

As discussed in section 8, investors are increasingly acknowledging the value of non-financial factors when considering a company's ability to generate sustainable value. It appears that different companies sometimes have different views as to what constitutes 'financial' vs 'non-financial. The most common types of non-financial KPIs are as illustrated in the graph above.

APMs in financial statements

66 companies (2018: 68) presented adjusted measures of profitability on the face of their income statement, often through use of additional columns. Companies adopting such an approach should look out for the IASB's exposure draft on their primary statements project, due before the end of the year, since the IASB are considering prohibiting the use of such columns.

The FRC has repeatedly called for appropriate terminology to be used in describing items being 'stripped out' in order to produce adjusted measures. 48 companies used a collective term of some sort and, as in previous years, the most popular term was 'exceptional items', which was used by 23 companies. Care should be taken to ensure that such a term is not misleading.

Given most companies in our survey had adopted IFRSs 9 and 15 for the first time (see section 15) it was perhaps surprising that only 14 companies gave some explanation of how new IFRSs had impacted their APMs - something which the FRC and ESMA have both called for in the past. Given the significant impact IFRS 16 has on many companies, this number might be expected to rise in the year ahead.

Another disclosure expected by regulators and users alike is an accounting policy explaining the use of exceptional items and similar non-GAAP measures in the financial statements. 53 companies were seen to provide such disclosure, although, as with the explanations described above, some were rather generic in nature.

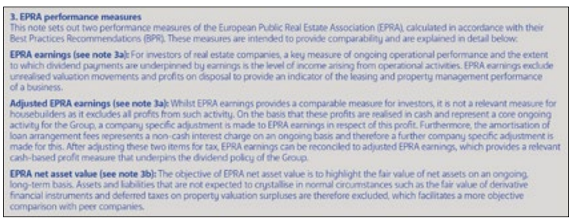
What to watch out for

- [ ] Ensure that APMs are not given greater prominence than associated measures in the financial statements. For example in the Chairman's and the Chief Executive's statements.
- [ ] Provide meaningful explanations as to why APMs are included and why they are regarded as useful.
- [ ] Identify whether KPIs are omitted from up-front highlights and if so assess whether they really are 'key' performance indicators.
- [ ] Assess whether appropriate non-financial KPIs have been identified and whether the link to the company's strategy is clear.
- [ ] Consider Standards issued by the Sustainability Accounting Standards Board (SASB) in November 2018. The Standards suggest measures that could be used to measure key environmental, social and governance (ESG) dependencies.
- [ ] Describe the impact of new IFRSs, including IFRS 16, on APMs.

Examples of disclosure

St Modwen Properties PLC provided disclosure explaining why industry-recognised APMs were regarded as useful and why adjustments had been made to one of those measures.

St Modwen Properties PLC



3. EPRA performance measures
This note sets out two performance measures of the European Public Real Estate Association (EPRA), calculated in accordance with their Best Practices Recommendations (BPR). These measures are intended to provide comparability and are explained in detail below:

EPRA earnings (see note 3a): For investors of real estate companies, a key measure of ongoing operational performance and the extent to which dividend payments are underpinned by earnings is the level of income arising from operational activities. EPRA earnings exclude unrealised valuation movements and profits on disposal to provide an indicator of the leasing and property management performance of a business.

Adjusted EPRA earnings (see note 3a): Whilst EPRA earnings provides a comparable measure for investors, it is not a relevant measure for housebuilders as it excludes all profits from such activity. On the basis that these profits are realised in cash and represent a core ongoing activity for the Group, a company specific adjustment is made to EPRA earnings in respect of this profit. Furthermore, the amortisation of loan arrangement fees represents a non-cash interest charge on an ongoing basis and therefore a further company specific adjustment is made for this. After adjusting these two items for tax, EPRA earnings can be reconciled to adjusted EPRA earnings, which provides a relevant cash-based profit measure that underpins the dividend policy of the Group.

EPRA net asset value (see note 3b): The objective of EPRA net asset value is to highlight the fair value of net assets on an ongoing, long-term basis. Assets and liabilities that are not expected to crystallise in normal circumstances such as the fair value of derivative financial instruments and deferred taxes on property valuation surpluses are therefore excluded, which facilitates a more objective comparison with peer companies.

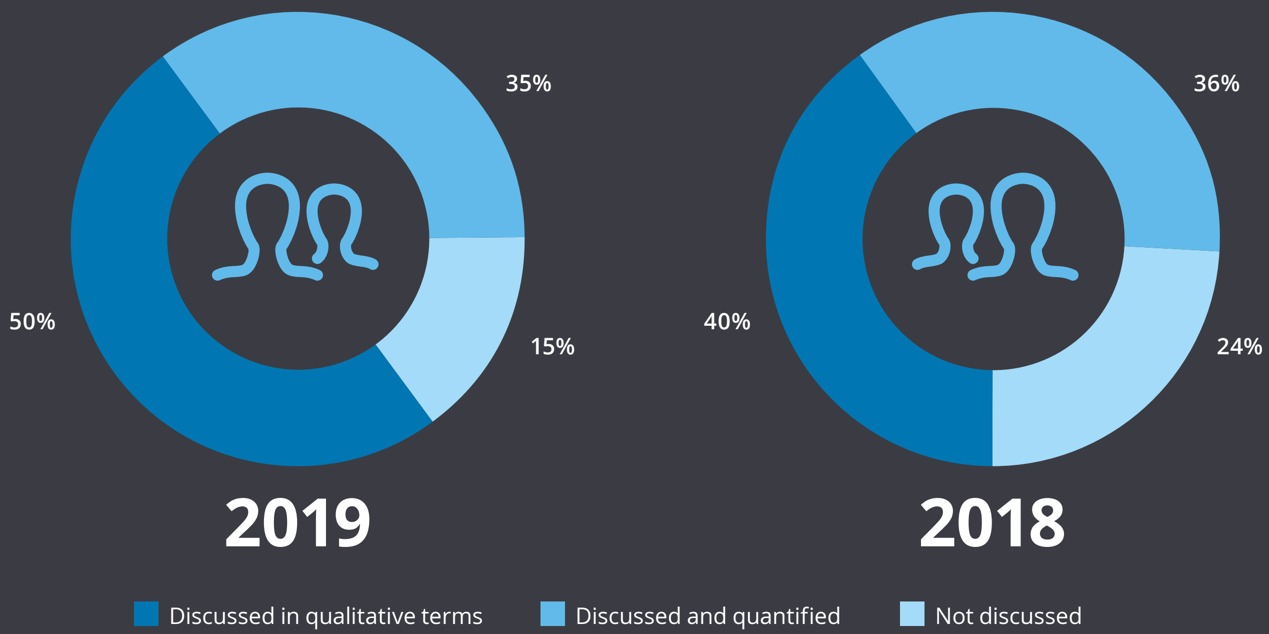
Acacia Mining PLC set out how their KPIs were relevant to different parts of their strategy and how they were linked to directors' remuneration, as set out below.

Acacia Mining PLC

See more examples of disclosure in the electronic version of this publication.

8. Long term value creation

Was value creation for stakeholders other than investors discussed?



24

Companies refer to the UN's Sustainable Development Goals

30

Companies refer to assurance over non-financial information disclosed

The success of a company is dependent on its ability to generate and preserve value over the longer term and the strategic report needs to reflect this throughout. A company's purpose sets out the broad types of value the company strives to create and, as discussed in section 5, the strategy and business model are central to demonstrating how a company uses its resources to create value both for its shareholders and other key stakeholders. Other areas, such as discussion of principal risks and uncertainties (see section 9) or market trends, help to highlight how external factors may create or erode value. Long-term value creation and preservation is therefore a key consideration for almost all areas of the strategic report and provides a common thread by which the various sections and requirements of the narrative reporting may be drawn together.

The use of KPIs and alternative performance measures in discussing the company's long term value creation is considered separately in section 7. However, these have historically tended to focus on value creation for investors. In describing, measuring and monitoring a company's ability to generate and preserve value over the long term, the consideration of broader stakeholders is essential if investors are to have a full understanding of the business, and this is an area where companies continue to improve overall. As set out in section 6, 97 companies identified in their strategic report their broader key stakeholders. And, as shown in the graph opposite, 85 companies discussed the value created for at least one type of stakeholder other than investors, compared to 76 in 2018, although the majority did not quantify the value created.

Companies that did quantify value creation for other stakeholders did not always do so for all stakeholders identified. Most commonly quantification tended to be in relation to employees, where companies typically disclosed numerical information such as the number of training hours received or the number of internal promotions. Quantified value creation for other stakeholders included examples such as working capital extended to customers as part of their credit terms, time spent on community initiatives and number of apprentices hired from the local community. National Grid plc discussed how they have begun work on assessing total societal impact with the aim of identifying metrics to measure their broader contribution in a meaningful way.

Five companies attempted to give some idea of how total value generated has been allocated between stakeholders. For example, Acacia Mining plc used bar charts to set out a) how value has been distributed to international suppliers, local suppliers, tax authorities and employees, and b) how much capital is available for reinvestment in the group in comparison to amounts set aside for dividends and financing borrowings.

In terms of returns to shareholders, 70 companies were disclosing their dividend policy, with 48 of those companies making clear what it meant in practice (reflecting recommendations of the FRC's Financial Reporting Lab). Eighteen companies disclosed potential restrictions that could prevent them from paying dividends but only nine companies linked their discussion of dividend policy to their discussion of principal risks and uncertainties. Similarly, only 13 companies linked dividend policy disclosures and their viability statements, although slightly more (28) companies linked dividend policy to their strategy or business model.

Many investors are keen to have insights into the level of distributable profits a company has, from which dividends can be paid. 26 companies (2018: 32) explicitly disclosed a 'single figure' for their level of distributable profits, with a further 14 (2018: four) instead describing which of their equity reserves were distributable. Only five companies indicated that directors were mindful of the requirement to consider the availability of distributable profits at the time a dividend is paid, i.e. not just by reference to the balance sheet date of the 'relevant accounts'.

The board-level decisions made around allocation of capital, including setting a dividend policy, are an example in the FRC's Guidance which companies may wish to refer to in their s172 statement (see section 6). A number of companies explain how they plan to allocate capital going forward, although often this disclosure is relatively high-level or generic in nature and focuses on capital investment. In general, these disclosures tend to be qualitative rather than quantitative, although this is not always the case. For example, Weir Group plc committed to spending 2% of revenues on R&D investment in more innovative products for customers, even featuring this as a factor within its risk appetite statement. It is particularly helpful where companies discuss both the planned investment and the stakeholders for whom the investment will create value; Kingfisher plc set out its plans to 2020 and explained how these developments will help to create value for its customers and employees.

When looking forward, it is also useful for companies to explain how value will be created in the short term as well as in the long term. Seven companies (2018: eleven) did not appear to address how value is created in the short term, while 26 companies (2018: 21) focused on short term profits at the expense of discussing long-term strategy, growth and sustainability.

The forthcoming requirement to prepare a separate s172 statement should help users to understand better how directors have performed their duties to shareholders and wider stakeholders and in particular how directors have created and preserved value in the company. As discussed further in section 6, no company produced a full s172 statement this year, but there is some evidence that companies are thinking about this and starting to include enhanced disclosures in line with the new requirements. At this stage, however, the focus seems to be on describing engagement with stakeholders, rather than extending this to value creation. The s172 statement is discussed in more detail in section 6.

A commitment to doing business in a sustainable way – often set out in a company's purpose as discussed in section 1 - can enhance the company's reputation across stakeholder groups and reinforces the view that the company is aiming to create and preserve long-term value, not just in terms of financial gain but in terms of its wider impact. Almost a third of companies continue to refer to a separate sustainability report to address this area in more detail. However, in line with IOSCO's reminder to issuers that ESG matters can be material financial reporting matters[12], investors are increasingly making use of non-financial information in their investment decisions. Companies may wish to reconsider whether they have struck the right balance on providing sustainability information in the annual report.

One way in which companies can approach their discussions of broader value creation is to use the UN's Sustainable Development Goals (SDGs) to help articulate the areas where they can have a positive impact. Just under a quarter of companies referred to the SDGs within the report. Often this was in a separate CSR section but the better examples integrated the SDGs throughout. The level of detail varied; some companies merely mentioned the SDGs, stating that they supported them or were committed to incorporating them in their long-term plans. Other companies set out the SDGs which they considered to be particularly relevant to the business, explained why they were relevant and gave examples of the actions taken by the company in each area.

G4S plc included a section which dealt with relevant SDGs in detail but also included case studies throughout the report demonstrating how it is acting on these SDGs to create sustainable value that goes beyond profit. IP Group plc identified six key SDGs that are most relevant to its business by mapping them to its various activities and explaining what actions it is taking in respect of each, together with the supporting case studies.

Because investors are increasingly considering non-financial information and metrics in making investment decisions, the perceived expectation gap - that the information in the strategic report is of equal quality to that included in the financial statements and subject to the same level of assurance – is becoming increasingly apparent. Traditionally many companies have sought limited assurance on their sustainability reports, but where this information is also used in the strategic report it is not always made clear what assurance, if any, has been obtained.

In general it remains relatively uncommon for companies to state that non-financial information has been assured, with 30 companies (2018: 25) making reference to assurance of non-financial or sustainability information provided. Of these, half obtained assurance over non-financial metrics, but in most cases the assurance standard used was not clearly stated. Intertek plc obtained limited assurance over its GHG emissions figures under ISAE 3000 and included the assurance report in the annual report.

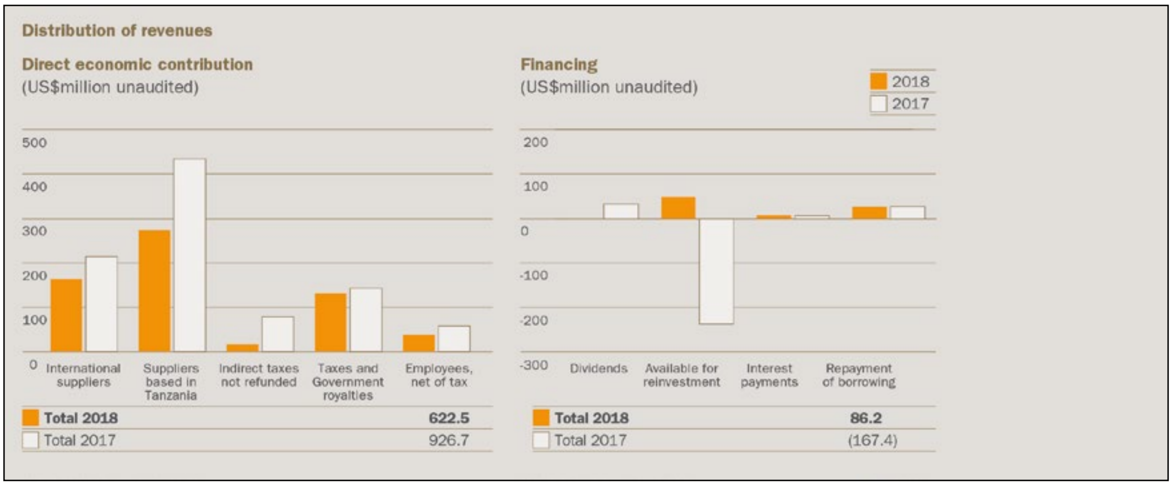
What to watch out for

- [ ] Identify specific areas of value creation and quantify value created in the year.
- [ ] Check there is appropriate balance between discussion of value creation over both the long and the short term.
- [ ] Look at the FRC's Guidance for ideas on how to explain capital allocation and dividend policy decisions as well as value created for broader stakeholders.
- [ ] Assess how the business creates and preserves value beyond pure profit and consider how best to bring this out in the strategic report.
- [ ] Challenge whether the information provided in the strategic report is truly "investor-grade" and consider whether additional assurance over material non-financial metrics and internal controls or processes should be introduced.

Examples of disclosure

Acacia Mining plc used bar charts to set out how value is distributed.

Acacia Mining plc



G4S plc made use of the UN's SDGs throughout the annual report to demonstrate how it is creating long term, sustainable value beyond profit.

G4S plc

SUSTAINABLE DEVELOPMENT GOALS

SUSTAINABLE DEVELOPMENT GOALS

The United Nations Sustainable Development Goals (SDGs) call upon business to advance sustainable development through the investments they make, solutions they develop and the practices they adopt. We have identified fifteen social and economic impacts where G4S supports the broad realisation of the Goals and makes a positive difference to society and communities around the world. Within these, we have a specific focus on Goal 8 (Decent Work and Economic Growth) with 'Health and wellbeing' and 'Job creation' and Goal 16 (Peace, Justice and Strong Institutions) with 'Prevention of crime' which closely align with our strategy and operational expertise.

Social-economic impact

Supporting criminal justice system
Providing care
Privacy vs security balance
Protection of assets
Consulting on risks
Employee wages and benefits
Support in post-conflict zones
Health and wellbeing
People development
Taxes paid
Support of economic reconstruction
Job creation
Interest and dividends paid
Raising industry standards
Prevention of crime

LOW MEDIUM HIGH

Relevant significance

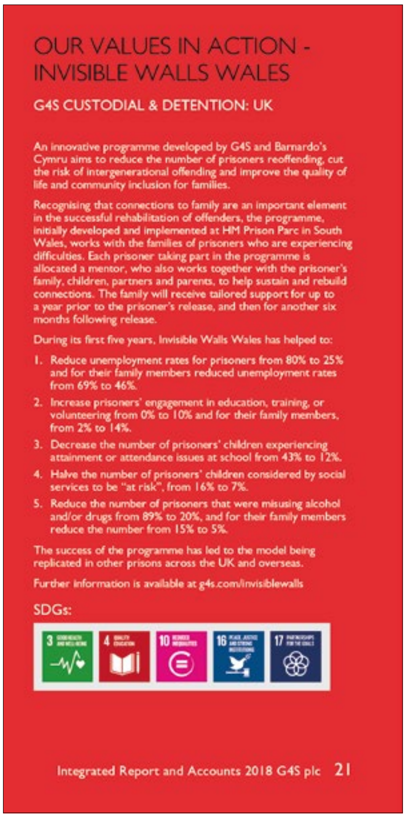
Priority sustainable development goals for G4S

Health and Wellbeing
The nature of G4S' work and the environment in which we operate may become hazardous. Mitigating this risk so that our people and those in their care can remain safe and secure every day is a strategic priority for the Group. G4S is investing in safety awareness training and intervention as part of an ongoing programme to enhance the safety culture of the company and security industry and achieve its goal of zero harm.

Job Creation
G4S provides direct employment to 546,000 people around the world. Through its supply chain and employee expenditure, G4S indirectly supports the creation of hundreds of thousands of further jobs worldwide. In helping to create safer environments in which businesses may prosper, G4S can also contribute to the attractiveness of investment by businesses into new communities and the creation of further employment opportunities.

Prevention of Crime
G4S delivers a wide range of specialist security services that mitigate the risk or impact of criminal behaviour and help to create safer communities. A key focus of our Care & Justice Services operations is to confront and address offender behaviour and work towards their rehabilitation and positive reintegration in the community.

Integrated Report and Accounts 2018 G4S plc 37



OUR VALUES IN ACTION - INVISIBLE WALLS WALES

G4S CUSTODIAL & DETENTION: UK

An innovative programme developed by G4S and Barnardo's Cymru aims to reduce the number of prisoners reoffending, cut the risk of intergenerational offending and improve the quality of life and community inclusion for families.

Recognising that connections to family are an important element in the successful rehabilitation of offenders, the programme, initially developed and implemented at HM Prison Parc in South Wales, works with the families of prisoners who are experiencing difficulties. Each prisoner taking part in the programme is allocated a mentor, who also works together with the prisoner's family, children, partners and parents, to help sustain and rebuild connections. The family will receive tailored support for up to a year prior to the prisoner's release, and then for another six months following release.

During its first five years, Invisible Walls Wales has helped to:

1. Reduce unemployment rates for prisoners from 80% to 25% and for their family members reduced unemployment rates from 69% to 46%.
2. Increase prisoners' engagement in education, training, or volunteering from 0% to 10% and for their family members, from 2% to 14%.
3. Decrease the number of prisoners' children experiencing attainment or attendance issues at school from 43% to 12%.
4. Halve the number of prisoners' children considered by social services to be "at risk", from 16% to 7%.
5. Reduce the number of prisoners that were misusing alcohol and/or drugs from 89% to 20%, and for their family members reduce the number from 15% to 5%.

The success of the programme has led to the model being replicated in other prisons across the UK and overseas.

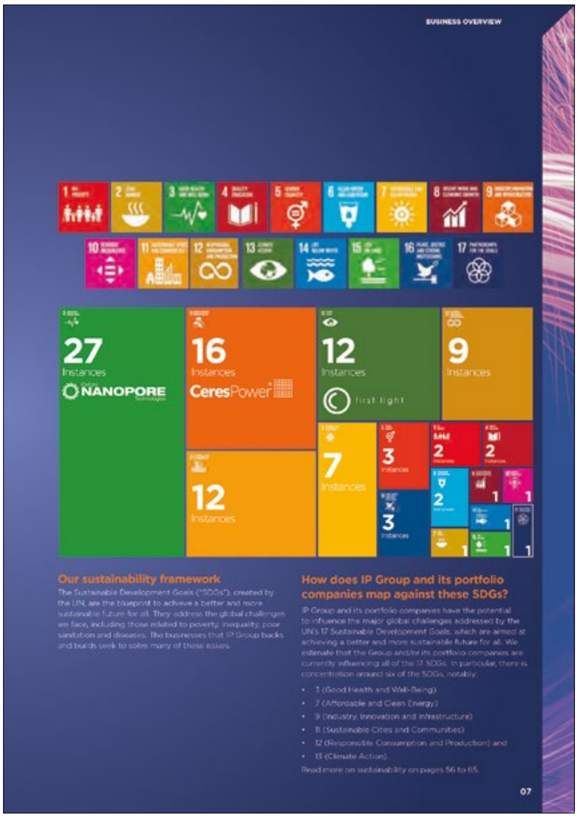
Further information is available at g4s.com/invisiblewalls

SDGs:

Integrated Report and Accounts 2018 G4S plc 21

IP Group plc identified six key SDGs that are most relevant to its business by mapping them to its various activities and explaining what actions it is taking in respect of each.

IP Group plc


BUSINESS OVERVIEW

27 Instances
NANOPORE
16 Instances
CeresPower
12 Instances
first light
9 Instances
12 Instances
7 Instances
3 Instances
2 Instances
2 Instances
3 Instances
2 Instances
1
1
1
1
1
1

Our sustainability framework

The Sustainable Development Goals ("SDGs"), created by the UN, are the blueprint to achieve a better and more sustainable future for all. They address the global challenges we face, including those related to poverty, inequality, poor sanitation and diseases. The businesses that IP Group backs and builds seek to solve many of these issues.

How does IP Group and its portfolio companies map against these SDGs?

IP Group and its portfolio companies have the potential to influence the major global challenges addressed by the UN's 17 Sustainable Development Goals, which are aimed at achieving a better and more sustainable future for all. We estimate that the Group and/or its portfolio companies are currently influencing all of the 17 SDGs. In particular, there is concentration around six of the SDGs, notably:

- 3 (Good Health and Well-Being)
- 7 (Affordable and Clean Energy)
- 9 (Industry, Innovation and Infrastructure)
- 11 (Sustainable Cities and Communities)
- 12 (Responsible Consumption and Production) and
- 13 (Climate Action).

Read more on sustainability on pages 56 to 65

07

National Grid plc discuss how they have begun work on assessing total societal impact with the aim of identifying metrics to measure their broader contribution in a meaningful way.

National Grid plc

Future intent

We plan to set a science-based target for carbon emissions and are currently reviewing our 2050 greenhouse gas target.

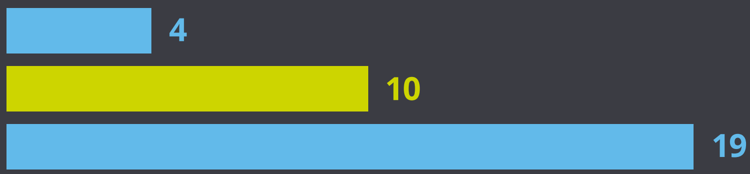
The Group has begun work on a programme to assess its total societal impact. Our analysis extends to consider our human capital contribution, and the role that innovation and reliability play in our wider contribution to society.

We plan to identify a number of metrics that measure our wider contribution in a meaningful way, and, as a result, will be used to drive decision making to ensure we can sensibly assess trade-offs between different stakeholders and take actions that benefit society as a whole. We expect to report further progress in next year's TCFD disclosure.

See more examples of disclosure in the electronic version of this publication.

9. Risks and opportunities

The number of principal risks ranged from **4** to **19** with an average of **10**

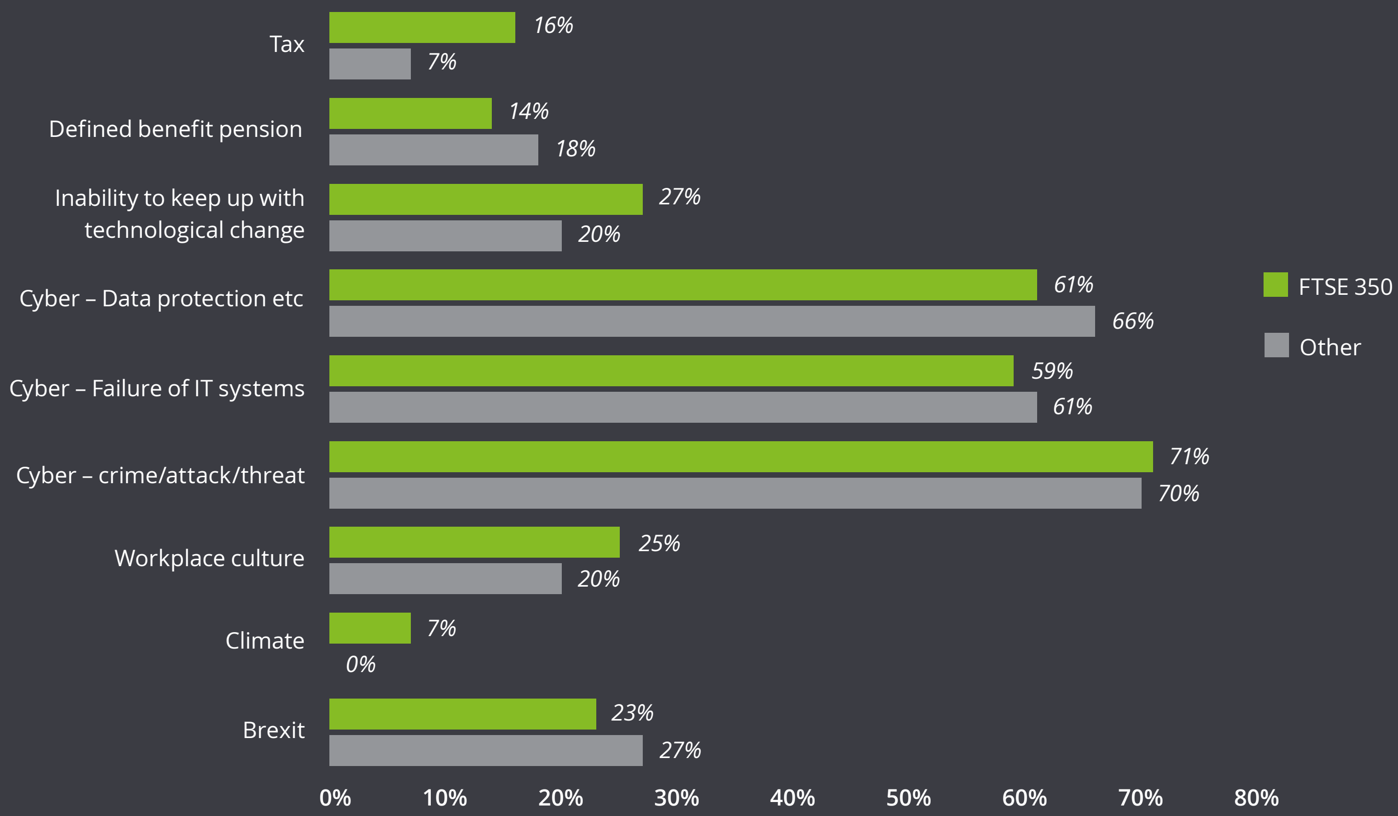


27
Companies included a diagram indicating the **impact and likelihood** of each principal risk

48
Companies disclosed **linkage between principal risks** and stragegy of the company

14
Companies clearly identified emerging risks, **10 of which were within the FTSE 350**

Common principal risks



Companies are required to disclose the principal risks and uncertainties which could affect their operations. Management must also explain their risk identification process and activities performed to comply with the Companies Act and the UK Corporate Governance Code. The NFR Directive, which became effective for periods commencing on or after 1 January 2017, expanded on this to require that non-financial information statements include any principal risks relating, as a minimum, to environmental matters, social and employee matters, respect for human rights and anti-corruption and anti-bribery matters. These disclosures must include, where relevant and proportionate, the company's business relationships, products or services which are likely to cause an adverse impact in those matters.

In late 2017 the FRC reporting lab ('the Lab') issued a report detailing information that investors are focused on and find most valuable in risk management disclosures.

In the current UK reporting landscape, two areas of business risk have been at the forefront of investor interest - the effects of climate change and Brexit uncertainty. As such, insights from our survey on these areas have been collated into sections 2 and 3 respectively.

Compliance - positive trends

One area of investor interest highlighted by the Lab report, is how a company's risk profile has changed in the period. The trend noted in previous years of increasing numbers of companies outlining how each risk had changed in significance in the year appears to have plateaued, with 75% (2018: 76%) of reports surveyed disclosing the change to each risk. Interestingly 82% of the FTSE 350 companies surveyed included this information, whilst only 66% of those outside the FTSE 350 included an indication of how risks had changed in significance in the reporting period.

Whilst 72% (2018: 59%) of companies include some narrative on risk appetite, an increase on previous years, there continues to be wide diversity in practice with regard to the level of detail provided. 45 (2018: 22) companies provided a short generic statement, while nine (2018: ten) companies provided a detailed analysis of risk appetite for each principal risk identified. A further 18 (2018: 22) fell somewhere in between, providing more than just a short generic statement but not going to the lengths of setting out risk appetite on a risk-by-risk basis.

Compliance – problem areas

Although companies have improved their reporting of the likelihood and possible impact of principal risks, as suggested by the FRC Guidance on risk management, there remains room for improvement. 33 companies (2018: 26) disclosed the likelihood of principal risks materialising. 32 (2018: 28) companies disclosed the magnitude of possible impacts of principal risks. Interestingly of the 29 companies that disclosed both likelihood and magnitude of principal risks, 27 companies (2018: 24) did so through use of a heat map or similar diagram. This, when provided with narrative disclosure, can be used as a succinct method of communicating compound aspects and allows the user to isolate easily which of the principal risks would be expected to have the largest impact on the business.

Linkage between principal risks and strategy continues to be one area where companies should look to improve. Only 48% (2018: 47%) of companies made clear linkage between their strategy and the principal risks faced in delivering that strategy.

Whilst the majority of companies continued to explain how risks are mitigated, in most annual reports it was unclear if risks were presented 'net' or 'gross' of mitigating activities. Per the Lab report, investors do not have a preference in this regard but they do want clarity as to which approach a company is adopting. Only four (2018: four) entities clearly presented risks on a gross basis and 15 (2018: eight) clearly did so on a net basis. Six (2018: four) entities clearly presented on both a gross and net basis, perhaps feeling it was helpful to provide insight into how effective their mitigation activities are thought to be.

Companies have also struggled to provide information required by the NFR Directive in terms of the company's business relationships, products or services which are likely to cause an adverse impact on specific risk areas, at least where those are identified as principal risks. In terms of the risk categories referred to in the NFR Directive, by far the most commonly identified category of principal risk was employee-related risks (79 companies). Although a workforce is obviously an integral part of most businesses, it came as a slight surprise to see so many companies expressing this level of concern over, typically, employee retention. However, despite workplace culture being a hot topic, only 23 companies identified principal risks in this area.

Most companies provided insight on mitigating activities and how the risks are managed, which was already required prior to the NFR Directive becoming effective. However, less information tended to be provided when it came to the NFR Directive's newly required information on business relationships, products and services which are likely to cause an adverse impact on the areas of risk identified.

Looking forward

The new UK Corporate Governance Code 'the new Code' is effective for periods commencing on or after 1 January 2019. The new Code extends the requirement for the Board to undertake a robust assessment of 'principal' risks to also capture 'emerging' risks. Whilst the requirements of the new Code are not yet effective, 21 companies disclosed their process for assessing emerging risks. 14 companies specified what the emerging risks were - these were typically focused around Brexit and/or climate change matters.

Cybersecurity continues to dominate company risk registers with 71% (2018: 73%) of companies identifying cybercrime as a principal risk and 63% (2018: 54%) specifically identifying data protection as part of their principal risks. The WEF's Global Risk Report identified cyber-attacks and data theft and fraud risks to be on the rise in terms of prevalence, potential disruption and financial loss and so it is encouraging to see companies making the above disclosures. Moreover, companies also gave consideration to different types of cyber risks, including the impact of system failures, which 60% (2018: 46%) also disclosed.

What to watch out for

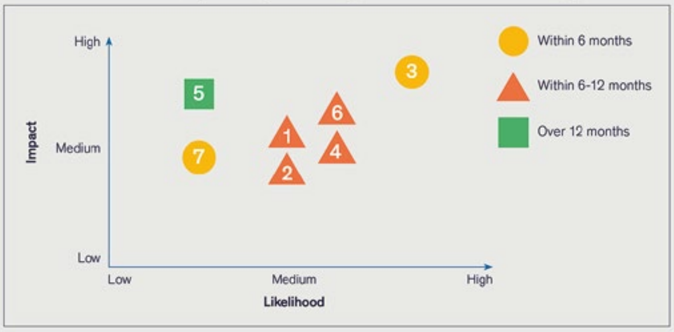
- [ ] Consider whether the principal risk disclosures link with the viability statement, business model and strategy, so the annual report tells one story.
- [ ] Explain the likelihood and potential impact of principal risks.
- [ ] Consider the NFR Regulations' requirements to describe activities that may have an adverse impact on the principal risks.
- [ ] Monitor developments in Brexit negotiations (see section 3) and climate change (see section 2), providing appropriate company specific information regarding any principal risks in these areas.

Examples of disclosure

Lookers plc provided a graphical representation of the likelihood and impact of all principal risks, and the time period over which each risk would crystallise.

Lookers plc

The assessment of the likelihood, impact and crystallisation timing of the identified risks is shown in the graph below:



The assessment of the likelihood, impact and crystallisation timing is consistent with the prior year assessment with the exception of risk 3 which has moved into the high likelihood, high impact and within 6 month category.

EnQuest PLC gave a good example of risk appetite information being specific to each risk.

EnQuest PLC

RISK

HEALTH, SAFETY & ENVIRONMENT ('HSE')

Oil and gas development, production and exploration activities are complex and HSE risks cover many areas including Major Accident Hazards, personal health and safety, compliance with regulatory requirements, asset integrity issues and potential environmental harm, including those associated with the impacts of climate change.

Potential impact – Medium (2017 Medium)
Likelihood – Low (2017 Low)

There has been no material change in the potential impact or likelihood and the Group's overall record on HSE remains robust.

Related KPIs – A, B, C, D, E, F, G

APPETITE

The Group's principal aim is Safe Results with no harm to people and respect for the environment. Should operational results and safety ever come into conflict, employees have a responsibility to choose safety over operational results. Employees are empowered to stop operations for safety-related reasons.

The Group's desire is to maintain upper quartile HSE performance measured against suitable industry metrics.

MITIGATION

The Group maintains, in conjunction with its core contractors, a comprehensive programme of HSE, asset integrity and assurance activities and has implemented a continual improvement programme, promoting a culture of transparency in relation to HSE matters. HSE performance is discussed at each Board meeting and the mitigation of HSE risk has been enhanced through further emphasising the role of HSE oversight within the Risk Committee's terms of reference. During 2018, the Group continued to focus on control of Major Accident Hazards and 'Safe Behaviours'.

In addition, the Group has a positive and transparent relationship with the UK Health and Safety Executive and Department for Business, Energy & Industrial Strategy, and the Malaysian regulator, Malaysia Petroleum Management.

EnQuest's HSE Policy is now fully integrated across our operated sites and this has enabled an increased focus on Health, Safety and the Environment. There is a strong assurance programme in place to ensure EnQuest complies with its Policy and Principles and regulatory commitments.

See more examples of disclosure in the electronic version of this publication.

10. Viability

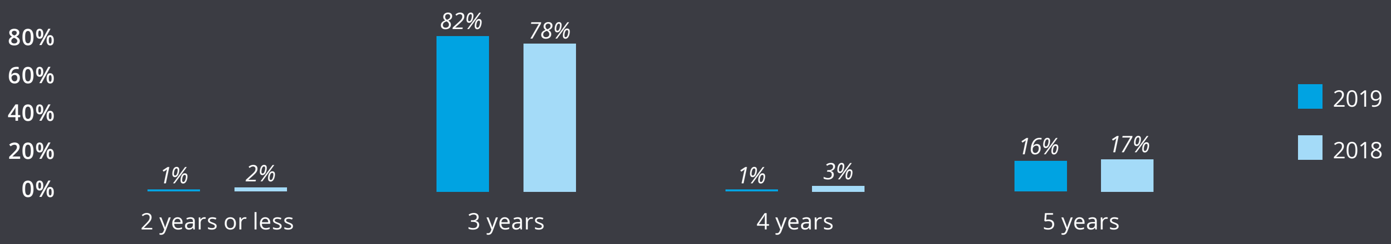
Only **16%** of companies clearly differentiated their discussion of **future prospects** within the viability statement

41% discussed the **risk and resilience** of the business model within the viability statement

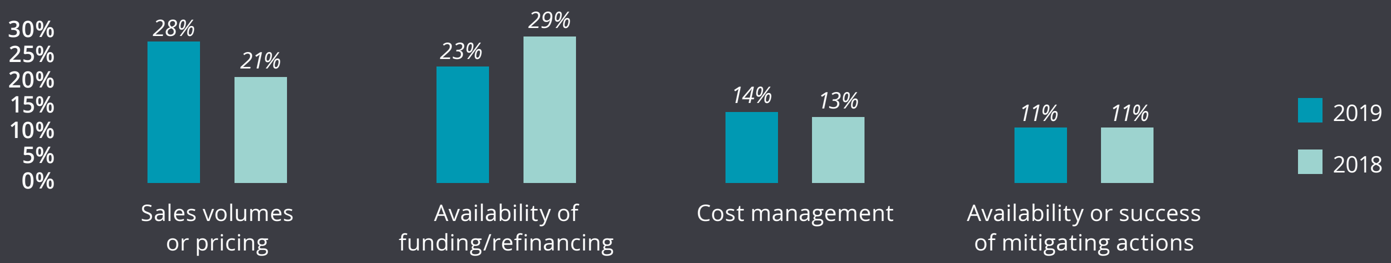
79% included the **longer term viability statement alongside the principal risks disclosures** in the strategic report

17% reported on a **lookout period spanning more than three years**

Number of companies using different lookout periods



What qualifications or assumptions were disclosed?



51% disclosed the **qualifications and assumptions** underlying their assessment

16% disclosed **assumptions relating to Brexit**, compared to 1% last year

Compliance - positive trends

This is the fourth year that companies have been required to provide a longer term viability statement as required by the UK Corporate Governance Code, Provision C.2.2 (in the 2018 Code this will be Provision 31).

There has been little change between the 2016 and the 2018 versions of the Code. The 2018 version reads:

Taking account of the company's current position and principal risks, the board should explain in the annual report how it has assessed the prospects of the company, over what period it has done so and why it considers that period to be appropriate. The board should state whether it has a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

In addition to the board's statement that it has a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due, the viability statement should therefore include:

- An explanation of how the board has assessed the longer term prospects of the company
- The lookout period for the viability statement and why the board considers that period to be appropriate
- How the analysis of viability has been performed
- Any qualifications or assumptions as necessary

The decision making process and analysis underlying these statements is explored further in *Governance in brief: Brexit and viability disclosures – a timely reminder.*[13]

The trend is for most viability statements to be included in the strategic report, alongside the disclosure on principal risks, which is the location suggested by the FRC. 79% of companies included their statement in the strategic report this year (2018: 74%). This makes sense as the potential impact of the company's principal risks is a key part of the directors' assessment of longer term viability.

Encouragingly, only three companies this year included no explanation at all of the length of the lookout period they selected, down from seven in 2018. 82% justified the period based on their planning cycle. Other factors referenced to justify the length of the selected lookout period:

- 31% of companies discussed the nature of the business or its stage of development;
- 11% cited the periods over which they invest in the business; and
- 31% drew a comparison with another time horizon used in the annual report, for instance debt repayment or technology development periods.

96% of companies referred to the nature of the analysis they undertook to support the statement (2018: 91%). It is a requirement of the Code to report on how the directors have performed their analysis.

Of the 96 companies providing a description of the nature of the analysis they undertook, 94 (2018: 90) discussed performing modelling, stress testing, sensitivity analysis or scenario planning with ten of these indicating that they had performed a more robust process still by also applying reverse stress testing.

Reflecting the increased uncertainty in the UK market, only 17% of companies reported on a lookout period spanning more than three years, down 5% over the past two years.

16 companies reported on specific assumptions or uncertainties relating to Brexit in their viability statement as they approached 29 March 2019 and the anticipated end of the two year negotiation period offered by Article 50. Companies also described Brexit-related scenarios as part of their sensitivity analysis and included cross-references to other Brexit disclosures. See section 3 for further detail.

Compliance – problem areas

The FRC has explained that it envisages a two stage process to meet Code Provision C.2.2, with reporting on each stage – the first being about the assessment of the prospects of the company, the second being the directors' reasonable expectation of viability for the period of their assessment. The expectation from both investors and from the FRC is that the period over which directors assess the prospects of the company will be longer than the period for the viability assessment.

In October 2018, the Financial Reporting Council suggested that companies should provide a "distinct discussion" in these areas and explained: "Applying the two-stage process and more detailed disclosure of stress and scenario testing will, in due course, help companies to fulfil Provision One of the 2018 [Code] which asks boards to consider the risks to future success and the sustainability of the business model and to report on these."[14]

Although there has now been additional time for implementation and some good examples of future prospects disclosures cited by the FRC's Financial Reporting Lab and others, only 16 companies this year provided the anticipated "distinct discussion" about future prospects – just three more companies than in 2018. Of these, only a small number indicated that they had considered future prospects over a clear time period. Where a time period was given, all but one company explained that future prospects had been assessed over the same period as the viability statement lookout period – which is not the approach intended by the FRC.

41% of companies discussed the risk and resilience of the business model to some extent (2018: 32%), including 13 of the 16 that had a clearly differentiated disclosure of future prospects disclosure. This can be particularly helpful for users of the annual report as it illustrates how robust the viability statement assessment has been.

Despite the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting calling for principal risks to be considered both individually and in combination when looking at the effect on longer term viability, only 41% of companies made it clear that they had taken this step (2018: 45%).

Only 51% of companies chose to disclose any qualifications or assumptions underlying their assessment (2018: 54%). This year, the majority of companies disclosing assumptions focused on sales volumes, pricing, and the success of sales or brand strategies (28%) – the first time that availability of funding or refinancing has not been the principal assumption disclosed (23%; 2018: 29%).

No companies disclosed any qualifications or assumptions relating to climate change and no companies explicitly described running scenarios to incorporate the effects of climate change, either physical effects or possible regulatory change.

Looking forward

Sir John Kingman's Independent Review of the Financial Reporting Council[15], published in December 2018, stated that "viability statements are not performing an effective role" and that while they continue to consist largely of boilerplate statements, they will provide little meaningful insight.

This is in line with the findings of this year's survey. Although a handful of thoughtful, detailed and informative viability statements were identified from companies both within and outside the FTSE 350, the majority were very similar indeed to statements the previous year, leading to very similar levels of findings year on year.

If viability statements cannot be made more effective, the Kingman Review suggests that serious consideration should be given to abolishing them.

One suggestion from the review is including more details on specific stress testing. This year, in our judgement, 28 companies set out clear scenarios they had used to test the model for their viability statement and 15 presented a conclusion covering each scenario (2018: 26 and 13). Again, this area has not shown a significant improvement.

In October 2018, the FRC's Financial Reporting Lab issued an implementation study: Business model reporting; Risk and viability reporting – where are we now?[16] This incorporates insight from investors around the elements of viability reporting that are most useful for them, practice examples, and questions for boards to consider regarding disclosures. Questions in our survey included two areas of particular interest which are mentioned both by the Lab's report and are recommendations in the Investment Association's Guidelines on Viability Statements.

- 47% of companies were found to have made the link from the viability statement to specific principal risks; a further 21% stated they had taken into account all principal risks. Of these, 32% named specific risks and a further 8% made the link to particular principal risks obvious through their description of the scenarios they used to test the resilience of their forecasting; the remainder used other methods such as using an icon in the principal risks table to indicate where a risk was assessed for viability purposes.

- 18% were found to have made the link from the viability statement to the sustainability of dividends (2018: 11%). Of these, only three companies included useful detail on policy or expected resilience of dividend payments, with the others simply mentioning withholding or reducing dividends as a mitigation strategy in the case of principal risks occurring.

What to watch out for

- [ ] Consider whether the principal risk disclosures link with the viability statement, business model and strategy, so the annual report tells one story.
- [ ] Explain the risk and resilience of the business model so that investors understand to what extent this affects the viability assessment.
- [ ] Explain the analysis undertaken and consider whether that could be made more robust by assessing principal risks in combination and/or performing reverse stress testing.
- [ ] Presenting testing scenarios that incorporate clear sensitivities applied to the base case can be a helpful addition to the disclosure, particularly if mitigating strategies and conclusions are explained for each of those scenarios.
- [ ] Remember that in most cases the viability assessment will make assumptions about any financing arrangements continuing, which should be disclosed.

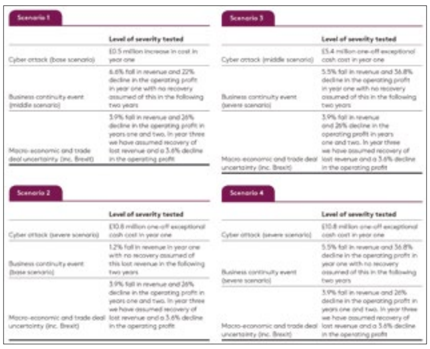
Examples of disclosure

Persimmon Plc clearly differentiates between its assessment of prospects and its assessment of viability, explaining the basis on which it considers the future prospects of the business in different areas: current position, resilience of the business model, and associated principal risks. This is the first of two pages of the disclosure.

Persimmon Plc

Essentra Plc provides clear scenarios on specific stress testing they have used to test their model for longer term viability, including the ways in which they have tested principal risks in combination.

Essentra Plc



Scenario 1

	Level of severity tested
Cyber attack (base scenario)	£0.5 million increase in cost in year one
Business continuity event (middle scenario)	6.6% fall in revenue and 22% decline in the operating profit in year one with no recovery assumed of this in the following two years
Macro-economic and trade deal uncertainty (inc. Brexit)	3.9% fall in revenue and 26% decline in the operating profit in years one and two. In year three we have assumed recovery of lost revenue and a 3.6% decline in the operating profit

Scenario 3

	Level of severity tested
Cyber attack (middle scenario)	£5.4 million one-off exceptional cash cost in year one
Business continuity event (severe scenario)	5.5% fall in revenue and 36.8% decline in the operating profit in year one with no recovery assumed of this in the following two years
Macro-economic and trade deal uncertainty (inc. Brexit)	3.9% fall in revenue and 26% decline in the operating profit in years one and two. In year three we have assumed recovery of lost revenue and a 3.6% decline in the operating profit

Scenario 2

	Level of severity tested
Cyber attack (severe scenario)	£10.8 million one-off exceptional cash cost in year one
Business continuity event (base scenario)	1.2% fall in revenue in year one with no recovery assumed of this lost revenue in the following two years
Macro-economic and trade deal uncertainty (inc. Brexit)	3.9% fall in revenue and 26% decline in the operating profit in years one and two. In year three we have assumed recovery of lost revenue and a 3.6% decline in the operating profit

Scenario 4

	Level of severity tested
Cyber attack (severe scenario)	£10.8 million one-off exceptional cash cost in year one
Business continuity event (severe scenario)	5.5% fall in revenue and 36.8% decline in the operating profit in year one with no recovery assumed of this in the following two years
Macro-economic and trade deal uncertainty (inc. Brexit)	3.9% fall in revenue and 26% decline in the operating profit in years one and two. In year three we have assumed recovery of lost revenue and a 3.6% decline in the operating profit

See more examples of disclosure in the electronic version of this publication.

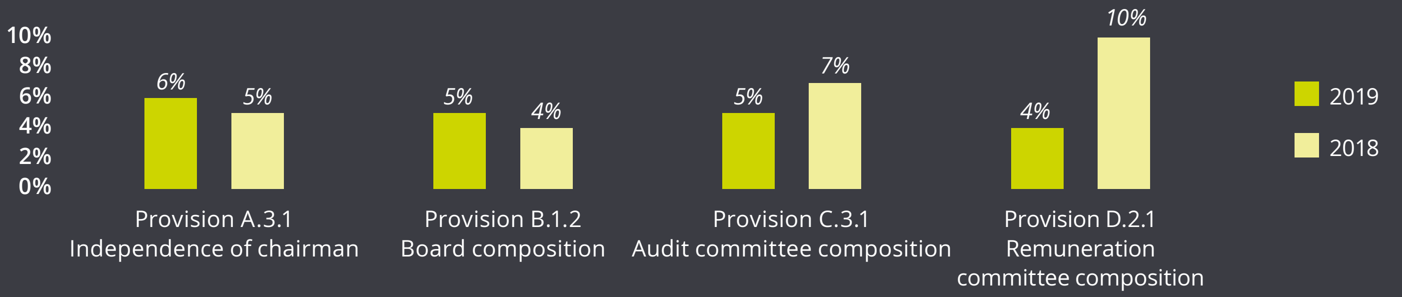
11. Board and director stewardship

73% included a statement indicating how they applied the **Main Principles of the Code**

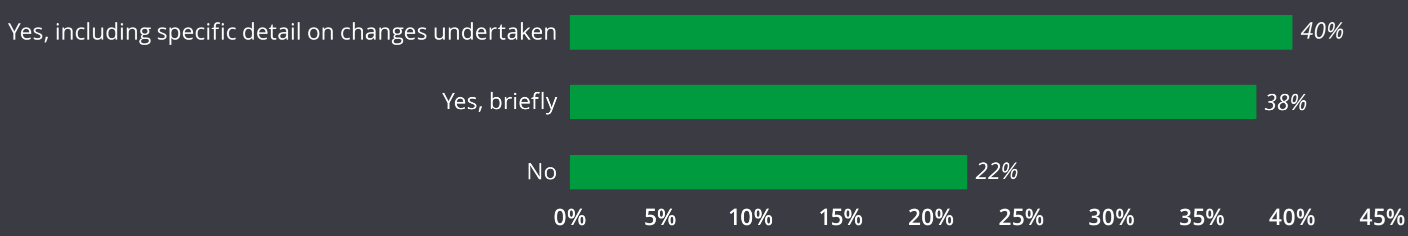
this rose to **79%** of companies, **an improvement from 68% in 2018**

71% reported **full compliance with the provisions of the Code** throughout the year. 71% of those reporting partial compliance provided an adequate explanation

Common Code non-compliances disclosed



Does the corporate governance statement discuss the impact on the company of the changes in the 2018 UK Corporate Governance Code?



33% of companies included some explanation of **how the company's governance contributes to the delivery of its strategy.**

31% of companies **undertook an external board evaluation** during the year (2018:29%). Of these, **84%** described the nature and extent of the external evaluator's contact with the board and individual directors

24% of companies that had undertaken either an **external or internal board evaluation** explained how that evaluation had influenced or would influence board composition

Compliance - positive trends

The Listing Rules require companies with a premium listing of equity securities to make two disclosures in respect of the UK Corporate Governance Code. The first disclosure is a statement of how the listed company has applied the Main Principles set out in the Code, in a manner that would enable shareholders to evaluate how the Principles have been applied. The second is a statement on compliance with the provisions of the Code, and where there has been a departure from one or more provisions, the Listing Rules supported by FRC guidance indicate that a meaningful explanation should be provided, affording the reader the opportunity to understand the company's governance journey. This approach to the second statement is known as "comply or explain".

The quality of explanations given for departures from Code provisions during the year remained high, with 71% of those companies that did not fully comply with the Code providing a meaningful explanation (2018: 89%). (With the proportion of companies reporting full compliance increasing, this reduction in the proportion of high quality explanations only represents three companies.)

There was a significant reduction this year in the number of provisions that had high levels of non-compliance. In 2018 company reports indicated that six individual Code provisions had a level of non-compliance exceeding 5% of the sample. In 2019 this had halved to three provisions. Some companies have reported on board composition planning in advance of reporting for the first time under the 2018 UK Corporate Governance Code, which could contribute to this reduction.

There were some strong board evaluation disclosures this year, with 37% of companies explaining the findings of the evaluation and related action points (2018: 35%). A further 12% of companies described just the findings of their evaluation (2018: 17%) without related action points – this means that a total of 49% of companies included informative disclosure regarding their evaluation (2018: 52%). The omission of action points was in some cases driven by the timing of the board evaluation, for instance there were several disclosures that explained that actions were to be agreed at an upcoming board meeting or board strategy day.

It is particularly helpful to be able to see the benefits companies have derived from their board evaluation and it demonstrates transparency, openness to change and commitment to the running of an effective board when they are prepared to discuss areas for improvement in the annual report.

Of the 98% of companies that had completed either an external or an internal board evaluation during the year (2018: 94%), 68% of companies made it clear in the annual report that their board evaluation processes had covered all of board, board committees and individual directors (as laid out in Code Principle B.6) (2018: 80%).

Corporate culture has been an area of focus for the FRC in recent years, since the publication of its report on 'Corporate Culture and the Role of Boards' in July 2016, indicating the importance of board focus on this topic in order to hold management to account. As well as an encouraging 82% of companies mentioning culture or values in their strategic report, 68% mentioned culture or values in their corporate governance statements (2018: 86% and 74%).

34% of companies offered a detailed discussion of culture in the strategic report (2018: 32%) and 15% in their corporate governance statements (2018: 11%). High quality disclosures acknowledge people and values as a key company asset and provide a clear, detailed explanation of how their culture works, the value derived from that, how it is monitored and how it is supported by the company structures, including the board.

31% of companies included some detail on the tools and techniques the board uses to monitor culture (2018: 23%) and 10% indicated that the board obtains some type of assurance regarding corporate culture – a substantial increase compared to 4% in 2018. Disclosures on the assurance the board receives reference deep dives on culture, investigations in response to specific issues, and in several cases, an external evaluation or "health-check" of culture or values in the business.

12% of companies disclosed action taken by the board to address issues during the year around culture – for example, introducing new training on values, formal studies on the nature of culture in different parts of the business, revisiting of values and behaviours, and action to address findings regarding culture arising from an employee engagement survey.

Disclosure focusing on the tools and techniques the board uses to monitor the cultural environment in the group helps the reader to understand how seriously the board takes the topic of understanding, developing and improving the culture and values embedded in their organisation – as does disclosure on the actions the board is taking to fix perceived cultural issues in the company.

Compliance – problem areas

As discussed above, the Listing Rules require premium listed companies to provide a statement regarding how they apply the Main Principles of the Code in a manner that would enable shareholders to evaluate how the principles have been applied. These principles are key to corporate governance in the UK as they represent a broad structure within which companies can develop the specific governance arrangements that works best for them.

Only 73% of companies included a statement clearly indicating how they applied the Main Principles of the Code, down slightly from 74% in 2018. In the FTSE 100 companies surveyed, this rose to 79% of companies, an improvement from only 68% in 2018.

A disappointingly low seven companies mentioned climate change in the corporate governance statement this year. Five of these were in the FTSE 100, representing 26% of our sample of FTSE 100 companies. Disclosures included decisions on including climate change in principal risks, the potential of damage to the reputation of the business, and plans for future implementation of the TCFD recommendations.

Looking forward

The world of governance continues to move quickly and government, regulators and investors look for boards to respond promptly and with foresight. This year, all annual reports were drafted with knowledge of the final contents of the new 2018 UK Corporate Governance Code, which was published in July 2018 effective for periods commencing on or after 1 January 2019.

Around four fifths of companies in the survey sample were already subject to the 2018 UK Corporate Governance Code at the time this year's annual report was published and will need to report under that Code this coming year. In that context, it is surprising that only 40% of companies provided specific detail of changes they have made or plan to make in order to apply and comply with the new Code. Almost the same number of companies made only a generic statement about implementation or that they would report in accordance with the new Code in their next annual report.

A few companies also reported on actions taken or changes made without linking these explicitly to the implementation of the 2018 UK Corporate Governance Code – this was most commonly found in disclosures in the strategic report regarding workforce engagement, whistleblowing or emerging risks.

Of the companies providing specific detail about current or planned implementation of the new Code, whether or not explicitly referenced as such:

- 43% reported on a particular workforce engagement mechanism (2018 Code Provision 5), most commonly a designated non-executive director (22%), then an alternative mechanism not described in the Code (10%), a works council (7%), a combination of mechanisms (3%) or an employee director (1%).

- 33% reported on how the company's governance contributes to the delivery of its strategy (2018 Code Provision 1). Good disclosures explained in some detail the way in which the board determines strategy and oversees specific implementation, linking board activities to strategic pillars and in some cases also the associated principal risks.

- 31% of companies mentioned corporate purpose in the corporate governance statement, compared to only six in 2018 (2018 Code Principle B).

- 23% referred directly to section 172 of the Companies Act 2006 (s172) or included a quote or paraphrase from its wording (2018: 21) – this anticipates the introduction of a provision of the Code requiring companies to report on how the matters in s172 have been considered in board discussions and decision-making (2018 Code Provision 5).

- Also linked to s172 of the Companies Act, 32% explained in the corporate governance statement how the board takes into account the interests of broader stakeholders.

- 19% of companies this year indicated that stakeholder feedback had been taken into account in decision-making, compared to 10% in 2018.

An area of focus both for the 2018 UK Corporate Governance Code and for Government has been board evaluation. At the request of the Department for Business, Energy and Industrial Strategy, ICSA published a consultation[17] in May 2019 regarding the effectiveness of independent board evaluation in the UK listed sector, including new proposals for disclosure guidance to assist listed companies in providing shareholders with annual report disclosure that they would find useful in assessing how diligently the board is seeking to improve its effectiveness. The following are findings on some of the areas identified as potentially useful to shareholders, in addition to the long-standing disclosures discussed earlier in this chapter:

- 31% of companies undertook an external board evaluation during the year (2018: 29%). Of these, 84% described the nature and extent of the external evaluator's contact with the board and individual directors. Some of these disclosures made it clear that the evaluator had no contact beyond setting a questionnaire in collaboration with the chair and / or the company secretary, whilst others had attended board and committee meetings and met individually with each director and a selection of senior management – meaning that the disclosure is critical for readers to understand the nature of the board evaluation process undertaken.

- 24% of companies that had undertaken either an external or internal board evaluation explained how that evaluation has influenced or will influence board composition – a disclosure requirement of the 2018 UK Corporate Governance Code.

- One company explained that it had provided its description of the external board evaluation and its findings to the external evaluator and received confirmation that the disclosure was "a fair summary of the review and its outcomes".

A significant minority of companies have started to bring environmental, social and governance aspects of their activity to life through the work of a sustainability committee. This year eleven companies reported on the work of a sustainability committee, most of these being main board rather than executive board committees. Ten of these companies were in the FTSE 350. Showing the importance placed on ESG factors, most of these companies covered topics such as workforce engagement, the link between governance and strategy, how the board takes into account the interests of broader stakeholders. Almost all companies in our sample with a sustainability committee indicated that stakeholder feedback had an impact on board decision making during the year.

What to watch out for

- [ ] Provide disclosures under the 2018 UK Corporate Governance Code, for years commencing on or after 1 January 2019, including a statement of compliance that covers the whole year.

- [ ] Remember to provide a clear statement of appliance of the Code's main principles in addition to a statement of compliance with the provisions.

- [ ] Corporate culture is an area of continued focus – it is key for boards to understand their companies and ideally to explain how they monitor that the company's values are applied consistently and what they do to improve matters where misalignment is identified.

- [ ] On board evaluation, clear disclosure of findings, actions and how the board evaluation works in practice are important to demonstrate that the board is taking its own performance seriously.

- [ ] Climate change is an area of increasing concern for regulators, investors and other stakeholders, who would like to understand how the board is managing and/or mitigating this risk.

Examples of disclosure

The Unite Group PLC explains how its governance supported its strategy during 2018, tracing a clear link between strategic objectives, the board's governance role in implementing those objectives, and providing a link to principal risks.

Unite Group PLC

How governance supported our strategy during 2018

Strategic objective	Board's governance role	Link to principal risk	2018 Board activity
Quality properties	**Active property recycling** Board oversight on portfolio recycling activity – ensuring value obtained and proceeds recycled efficiently.	**Property market cycle risk on page 30**	The successful disposal of 14 properties, comprising 3,436 beds, reducing the average age of our estate. Read more about **Asset disposals on page 40**
	Development pipeline Board scrutiny of city and site selection for new developments against backdrop of increasing competition for the best sites. Governance of developments/acquisitions to ensure they run to budget and schedule and are earnings accretive.	**Property/Development risk on page 30**	Seven new student residences (3,074 beds) opened on time and to budget. The beds are fully let to students attending mid- to high-ranking universities with 52% of these beds secured on nomination agreements with an average life of 10 years. Read more about **Development activity on pages 14 to 16**
	Health & Safety As we develop our brand through the implementation of Home for Success, the risk of a health and safety incident damaging our reputation increases. The Board's governance of the health and safety, wellbeing and security of the 50,000 students who make Unite Students their home is critical to the Group's continued success and trusted reputation.	**Operational risk – Major health and safety incident in a property or a development site on page 29**	The Board reviews the safety of our students, visitors and employees, as well as contractors at our development sites, at each Board meeting. During 2018, this has included monitoring the Hackitt Review, developing best practice following the Grenfell Tower tragedy and regulatory change. The Health & Safety Committee, a sub-Committee of the Board, focuses on: – **fire**, our biggest safety risk, and our work with the Avon Fire Authority, our Primary Fire Authority lead – **external safety assurance** through The British Safety Council, our external safety auditor – **physical security review** of our properties by WSP Parsons Brinckerhoff. Read more about the **Health & Safety Committee report on page 72**
Quality service platform	Governance to ensure our market-leading service platform is robust, reliable and also developed further to meet our customers' increasing expectations.	**Market risks – supply and demand on page 28**	Oversight that PRISM delivers: – a robust booking system – an improved and scalable platform for revenue management and customer engagement – enhanced service levels for both Universities and students – market differentiation. Read more about the **Operations review on page 32**
	Affordability and value for money	**Market risks – supply and demand on page 28**	Analysis of the Higher Education accommodation sector and ensuring we continue to offer an affordable and value-for-money product. Read more about **Affordability on pages 26 and 28**
	Information security and keeping our customers' and employees' personal data safe and secure.	**Market risks – supply and demand on page 28**	As our engagement with our digital native customers moves increasingly online – and we develop apps to enhance this – it is more important than ever that we keep their personal data safe. As part of our Digital Media strategy, the Board led a review of our information security and its governance, in particular having regard to the General Data Protection Regulation (GDPR) which came into effect during 2018. The Audit Committee also reviewed our information security/GDPR compliance matrix as part of its remit to review our risk management and controls framework.
	Leadership development and succession planning/talent pipeline. D&I initiatives.	**Market risks – supply and demand on page 28**	The Nomination Committee focuses not only on Board succession, with two Directors joining the Board in 2018 (Ilaria del Beato and Richard Akers), but also our broader talent pipeline and leadership development.
Quality University partnerships	Board scrutiny of our developments and portfolio recycling to ensure we partner with the right Universities and enhance our long standing relationships.	**Market risks – supply and demand and Property Development risk on pages 28 and 30**	60% of our total beds are now under nomination agreements. Exposure to high and mid-tier Universities on track to reach 90% on completion of our secured pipeline. Higher Education review and our growth strategy having regard to developing new University partnerships transactions. Read more about **Quality partnerships on page 11**

TBC Bank Group PLC explains that it undertook an externally-facilitated board evaluation exercise, why it chose the particular provider, the contact with the board and individual directors that took place as part of the evaluation exercise, the actions the board has agreed to take and that the report has been confirmed with the external evaluator.

TBC Bank Group PLC

ANNUAL BOARD EFFECTIVENESS EVALUATION

During 2018, an externally-facilitated Board evaluation was conducted by Independent Audit Limited (IAL), an independent specialist. The review was carried out at the initiative of and with the participation of the Corporate Governance and Nomination Committee, which selected the evaluator from a shortlist of leading evaluation companies that submitted proposals in response to an RFP. The evaluator was selected following detailed interviews and consideration of relevant sectorial and geographical experience.

The evaluation process included review of board papers, interviews and observation of meetings. The evaluators carried out in-depth individual interviews with all Board members in Tbilisi and London, as well as follow-up interviews where necessary. Independent Audit also interviewed key management personnel and various functional heads to discuss their views of the Board, experience of interacting with it and the information they provided to the Board. Independent Audit attended meetings of the Board and most Committees to observe the Board's processes and the dynamics between the various Board members and attendees.

A full report of IAL's findings was discussed with the Chairman, the Deputy Chairman of the Board and the Chairman of the Corporate Governance and Nomination Committee. The report was then circulated to all Directors. Subsequently, the Committee and the Board discussed the report, with the evaluator participating by conference call, and formulated an action plan for 2019.

The report noted that the Company aims to meet the highest international standards, and highlighted the strong foundation on which the Company can develop further its governance structures. The report found that the Board benefits from a highly experienced Chairman, an open and constructive management team, and a co-operative relationship between executives and the non-executive Directors. Executives value both input and challenges from the non-executive Directors. According to the evaluation report, these factors were complemented by a strong secretarial presence supporting the Board processes.

During the Board meeting in February 2019, the Board agreed an action plan for 2019. The principal areas to be addressed are:

Succession planning and Board skills
Continue to develop robust succession plans for both non-executive and executive board members, based on a clear view of the full range of skills currently available to it and potentially required in future.

Information flow to the Board
Work on improving information flows to the Board. In particular, management to aim to produce more focused Board papers, and to give the Board more exposure to key managers.

The Board's focus
Increase the Board's focus on the Group's strategic development, while continuing to maintain robust oversight of the underlying culture and risk environment.

Adjustments to the Board and Committee meeting structure
Implement various organizational changes to maximise the Board's allocation of time on key issues, including adjusting the length and agendas for the meetings, and holding joint committee meetings on topics of interest to more than one committee.

During 2019, the implementation of the detailed action plan (as adopted by the Board in February 2019) will be monitored by the Corporate Governance and Nomination Committee and progress will be reported in the 2019 Annual Report, alongside the outcome of the annual Board evaluation for 2019. The Company intends to continue to undertake regular annual Board reviews in line with the requirements of the Code.

IAL has confirmed that this report is a fair summary of the review and its outcomes.

The Weir Group plc puts a spotlight on the independent non-executive director designated to lead the board's employee engagement work, giving her the opportunity to explain her role, her plans to engage employees and the board, and the journey the business is making towards bringing the employee voice into the boardroom.

Weir Group plc

Mary Jo Jacobi to lead the Board's employee engagement work

- Strengthening the links between employees and the Board.
- Building employee engagement to promote an open and transparent culture.
- Working to ensure that all Weir employees can have a voice in our future success.

Mary Jo Jacobi
Employee Engagement Non-Executive Director

Why do you think it is important that the voice of employees is a part of Board room discussion?
As a Board member my job is to offer constructive challenge informed by my experience. I have spent much of my career helping organisations to communicate effectively and a key lesson is to listen first. The success of every enterprise depends on its people, and for the Board to operate effectively the views and feedback of our employees are vital.

At Weir, I have always admired the candour of people across the organisation and am delighted to be able to help build on the broader engagement strategy already in place to ensure those perspectives are represented in our decision-making. It is an honour for me to represent the views of the workforce around the Board table.

What does your role involve?
I see the job first as listening and then articulating and advocating the views of the employees to help the Board make better informed decisions based on the broad perspectives of the workforce, as well as other stakeholders. Weir Board members have always had great conversations when we visit facilities but we are formalising that process to ensure there is greater consistency to gathering employee feedback and promoting two-way conversations.

How will you ensure that the views of employees are integrated into the work of the Board and the strategy of the business?
Weir's global engagement strategy involves ensuring regular and constructive dialogue between employees and leadership.
As Non-Executive Directors specifically, we have regular and varied engagements with employees, including site visits such as those we undertook in Portland and Madison in 2018, and the engagement undertaken during the onboarding of our newest Non-Executive Directors which presented excellent opportunities. From 2019 onwards we're going to go further by setting up new 'Employee Voice Forums' to share feedback with the Board and Group Executive.

These forums will be organised geographically, in line with our Board and Group Executive meeting schedule. They will comprise a diverse range of employees who will meet with us to discuss a range of business topics where employee feedback will help drive the Company forward and improve how we do things. The employee voice representatives participating in these forums will be encouraged to gather a broad range of their colleagues' voices before meeting with the Board, and they will be prepared to provide feedback after the meetings.

This approach to employee voice forums will also align with our plans to introduce regional employee AGMs in line with our all employee share plan launch in 2019.

In addition to these structured events, we are developing mechanisms for less formal engagement between the Board and Weir teams around the world, such as encouraging travelling Non-Executive Directors to visit sites.

Why has the Board decided that this is the most effective way to bring employee voice to the Board table?
This is the start of a long journey that will include a variety of mechanisms to build on Weir's broader employee engagement approach. We will monitor our progress and refine our approach to ensure we get good results. We will know what's working because people across the Group will tell us, and we'll be listening. Weir's culture is a great advantage for us in these endeavours.

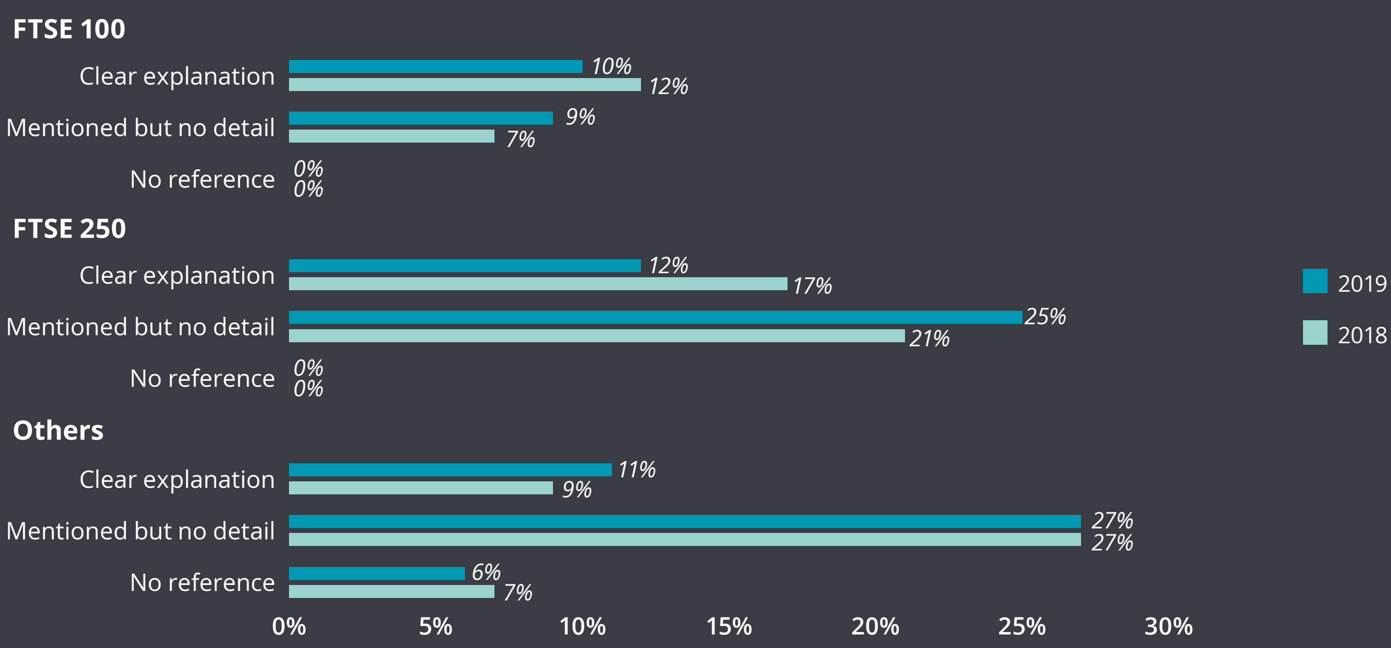
See more examples of disclosure in the electronic version of this publication.

12. Succession and diversity

72% of nomination committees were involved in appointing a new director during the year; all of these committees held at least one meeting and **75% of them described the process used for specific board appointments during the year**

68% of nomination committees stated that they use an **executive search firm to help identify candidates**. No nomination committees reported that they used external advertising

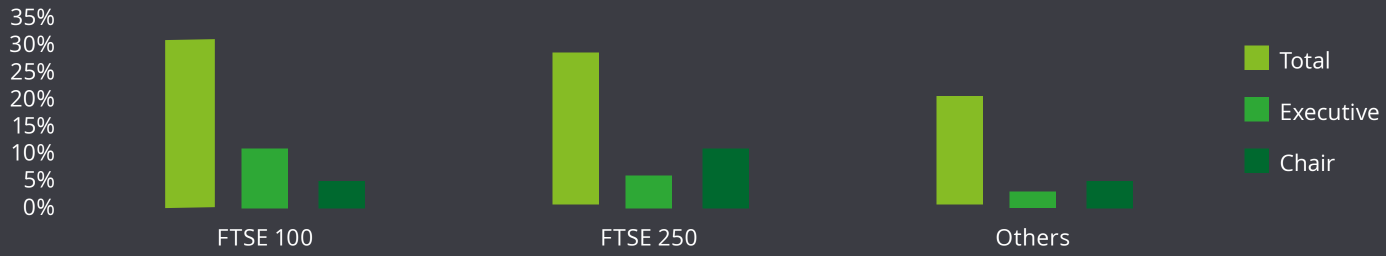
How did boards disclose activity around succession planning? (Number of companies)



30% of companies indicated they had diversity targets for the board, **up from 22% in 2018**. This year, **48%** of companies met the DTR requirements to describe the **board diversity policy** (2018: 29%)

The proportion of women on boards reached **25%** this year, **up from 22% in 2018**

What proportion of women were on the board?



Compliance - positive trends

Nomination committees have continued to provide good quality disclosure around succession planning. The 2018 Guidance on Board Effectiveness offers additional insight on information that could add value to succession planning disclosures.

94% of boards disclosed activity around succession planning (2018: 93%). However, over the past two years, only 33% of companies in each year included disclosures that explained clearly the processes the board has in place to maintain good succession planning such as use of a skills matrix and how regularly it is reviewed and regular updates provided on succession planning for senior management and the pipeline to the board.

Only 9% of companies had disclosures that clearly showed how the succession plan and the talent programme were connected to the corporate strategy (2018: 19%).

2016 Code provision B.2.4 lays out the requirements relating to nomination committee reporting. These were still not fully met this year by the companies in our sample, although there have been small improvements.

- 95% of companies this year met the requirement for a separate section of the annual report describing the work of the nomination committee (2018: 88%).

- Of the 72% of companies that appointed a new board director during the year, 75% of nomination committees described the process used for those specific appointments, in line with the Code provision asking for disclosure of "the process used in relation to board appointments." (2018: 75% and 87%). However we have not considered this to represent a deterioration since an unusually high proportion of these directors were appointed early in the financial year and the disclosure about their appointment process was included in the prior year annual report.

With regard to the appointment of directors:

- In total, 68% of companies disclosed the use of executive search agencies, either in relation to a current year director appointment or a description of their general appointment process (2018: 67%).

- No company this year reported that they had used external advertising as a means of finding directors.

- Other methods described by companies to find new directors included appointment of internal candidates; personal connections; information on candidates from previous shortlists.

Compliance – problem areas

The requirements of the Non-Financial Reporting Directive regarding diversity disclosures in the corporate governance statement (implemented in the UK through the Disclosure Guidelines and Transparency Rules) should not be very different from the Code requirements for "a description of the board's policy on diversity, including gender, any measurable objectives… and progress on achieving the objectives." Complying with the new DTR was a requirement for large listed companies with periods commencing on or after 1 January 2017, so this is the second year in which companies are applying this requirement.

This year, almost half of companies met the diversity requirements of the DTR, a substantial improvement. However, over half are not yet fully compliant with this legal requirement. Of the companies that complied, seven companies disclosed that they did not have a board diversity policy and provided reasons why. Within the FTSE 100 specifically, the proportion of companies that met the requirements rose to 74%, with one of those companies disclosing that it did not have a board diversity policy and why (2018: 53%; one).

In order to meet the DTR requirements, boards should aim to describe the policy itself rather than the processes in place or actions taken during the year – although of course knowing about these is also valuable to the reader! It is not sufficient to provide a cross-reference to a disclosure about the diversity policy applying to the organisation as a whole without further clarification of whether or how it relates to the board itself. Boards should be clear about measurable objectives and should comment clearly on the outcomes during the year. Ideally the policy should look beyond gender diversity – the DTR also refers to age, educational background and professional background, with the goal to promote diversity of thought at board level.

Companies in our sample also disclosed other information regarding diversity in their nomination committee reports and corporate governance statements, to varying degrees:

- 30% of companies indicated they had diversity targets for the board, up from 22% in 2018.
- 11% of companies included disclosure on the level of ethnic diversity on their board, up from 6% - this is likely to increase again next year as companies approach the 2021 target date mentioned in the Parker Review.
- 39% of companies disclosed the gender diversity in the executive committee and their direct reports, in line with the Hampton-Alexander review's expectations (2018: 15%). 50% of FTSE 350 companies met the requirement. Next year this becomes a disclosure requirement in the 2018 UK Corporate Governance Code.

Of companies that did not meet the disclosure requirements of the Hampton-Alexander review, some did disclose the level of gender diversity in the executive committee. Others also disclosed "leadership" or "senior leaders" or "managers" categories, however it was not possible to tell whether these groups represented the executive committee and their direct reports. Reporting on diversity is an area where companies explaining the terms they use would be helpful to users of the annual report.

Looking forward

Diversity and inclusion will be an area of focus for the board and the nomination committee under the 2018 UK Corporate Governance Code, which supplements the previous diversity asks from both Code and DTR with additional disclosure requirements around policies, objectives and outcomes regarding diversity and inclusion for the organisation as a whole. It also increases the focus on diversity in disclosures on succession planning and board evaluation exercises. The addition of inclusion to the requirements indicates that this is not simply about who is employed but also about ensuring everyone is welcomed in the organisation and enabled to work effectively and to succeed.

This year, 22% of companies explained how their approach to succession planning supports developing a diverse pipeline – including for instance internal programmes supporting women or people of colour, requesting gender balanced longlists for board positions, or only using executive search agencies that are signed up to the Voluntary Code of Conduct on diversity.

Under the 2018 UK Corporate Governance Code, companies are required to explain for each board member why their contribution is, and continues to be, important to the company's long term sustainable success. This year, 63% of companies included informative disclosure regarding individual contributions of board members (2018: 55%, 2017: 35%). 61% of disclosures were in the "Board of Directors" section, where individual biographies are moving towards contribution and away from a list of current and previous appointments. Practices observed in the survey sample included lists of skills and experience mapped against each board member and quotes from board members describing their contribution in their own words.

The 2018 Code appears already to have had an impact on independence and succession considerations for the companies in our sample. The new Code requirement is for at least half the board, excluding the chair, to be non-executive directors whom the board considers to be independent. The chair should also be independent on appointment with a maximum tenure of 9 years on the board.

In respect of the survey sample:

- 14% of companies disclosed that their chair was not independent on appointment (2018: 10%).
- 15% of companies had chairs who had served on the board for more than 9 years – a significant reduction from the 25% in 2018. A further 2% did not clearly disclose the tenure of the chair.
- Eight of the companies with long-serving chairs had chairs who were disclosed as not independent on appointment.

- Four of the companies with long-serving chairs (27%) acknowledged that this would be a departure from a provision of the 2018 UK Corporate Governance Code. Only one of those explained that it planned to recruit or appoint a new chair of the board to address the departure, with the others explaining the value contributed by the current chair.

- Companies have clearly been working on meeting the independence requirements of the new 2018 UK Corporate Governance Code. At least half of the board (excluding the chair) is comprised of independent non-executive directors for 91% of companies this year, a jump from 69% of companies in 2018. This rises to 98% of the FTSE 350 companies surveyed and 100% of the FTSE 100.

What to watch out for

- [ ] Nomination committees should put thought to the disclosures they will need to make about the work of the committee under the 2018 Code.

- [ ] Topics on the agenda should include succession planning, the tenure of directors and refreshment of the board, director appointment, diversity in board and company, and the accompanying disclosures.

- [ ] On succession planning, informative disclosures are specific to the company and to the year and cover the link between succession and strategy, the process, tools and advisors used by the nomination committee, an insight into the quality and diversity of the internal pipeline, and the work the board is doing to improve that internal pipeline.

- [ ] Boards are now expected to pay more attention to the diversity and remuneration of executive committees and their direct reports, along with reporting on those matters.

- [ ] Focus on gender pay and pressure from investors regarding board diversity suggest that boards should consider carefully their policies and disclosures in this area.

- [ ] Finally, most boards continue not to meet the required disclosures under DTR 7.2.8A regarding the board diversity policy, objectives and outcomes during the year. If this is a difficult disclosure to write, consider whether there is an issue with the underlying policy or how it is tracked.

Examples of disclosure

National Grid plc's nomination committee provides DTR diversity disclosure including board diversity policy, objectives, and outcomes. It describes clear targets for board gender and ethnic diversity and plans to achieve those targets. It also includes the Hampton-Alexander and 2018 UK Corporate Governance Code disclosure around the gender diversity on the executive committee and its direct reports.

National Grid plc

Diversity and Board Diversity Policy

National Grid is fully committed to supporting diversity and inclusion in the Boardroom which we believe supports the attraction and retention of talented people, improves effectiveness, delivers superior performance and enhances the success of the Company.

Our Board diversity policy continues to promote an inclusive and diverse culture and we value diversity of thought, skills, experience, knowledge and expertise including of educational and professional backgrounds, alongside diversity criteria such as gender, age and ethnicity.

The policy applies to the Board, Executive Committee and direct reports to the Executive Committee. It does not apply directly to diversity in relation to the remaining employees of National Grid as this is covered by other policies and the National Grid Inclusion Charter.

As set out in our Board diversity policy:

- All Board appointments and succession plans are made on merit and objective criteria, in the context of the skills and experience that are needed for the Board to be effective and to guard against "group think";
- We will only engage executive search firms who have signed up to the UK Voluntary Code of Conduct on Gender Diversity; and
- We will continue to make key diversity data, both about the Board and our wider employee population, available in the Annual Report and Accounts.

We will continue to review our progress against the Board diversity policy annually and report on our progress against the policy and our objectives (set out below) in the Annual Report and Accounts. We will also include details of initiatives to promote gender and other forms of diversity in our Board, Executive Committee and other senior management.

Examples of the initiatives to promote and support inclusion and diversity throughout our Company are set out below and on page 43.

Objectives	Progress
The Board aspires to meet the target of 33% of Board and Executive Committee positions, and direct reports to the Executive Committee, to be held by women by 2020.	**Objective ongoing:** there are currently 27.3% women on the Board. In our Executive and Non-executive Director searches we take this into consideration; however, all appointments are made on merit. We currently have 33.3% women on our Executive Committee and 26.6% women direct reports to the Executive Committee. These figures have been taken as at the date of this report. We are undertaking the following actions to help achieve our target: • All senior external recruitment requires a diverse list of candidates to be considered as part of the selection process; • All talent meetings have inclusion and diversity moments at the start to ensure an inclusive mindset when discussing talent moves and promotions; and • All Executive Directors have diversity targets.
The Board aspires to meet the Parker Review target for FTSE 100 boards to have at least one director from a non-white ethnic minority by 2021.	**Objective met:** we currently have two Directors from a non-white ethnic minority on the Board. Additionally, our mandatory requirement for a diverse candidate pool should ensure that we continue to have the opportunity to recruit further from non-white ethnic minorities.

The Paragon Banking Group PLC provides succession planning disclosures that include consideration of emergency vacancies as well as regular succession planning, link to the strategy of the business and includes focus by the nomination committee on levels below the board.

Paragon Banking Group PLC

Succession planning

The succession plans for the Board were reviewed during the current financial year following the Group's strategic reorganisation at the end of September 2017. The tenure of the non-executive directors is monitored by the Committee. Emergency cover is in place for the executive directors and their direct reports.

The Human Resources department has a wider succession development plan for senior management roles across the Group, prioritising those positions likely to require recruitment within the next five years. This data has been considered against internally identified individuals with high potential and the capability to fulfil those roles as they become vacant, to ensure that succession requirements can be met. Internal individuals will be developed for future senior roles and this will be complemented with external recruitment at a senior level where necessary, to balance the required skills and experience of the senior management team and ensure continuing success in the future. Following review work in 2016, which considered approximately 100 roles, internal development has been undertaken to enhance succession planning with consideration given to possible 'at risk' roles as well as to the development of potential future senior management candidates.

A review of the effectiveness of this approach took place during the year which concluded that whilst there was a robust method to identify the risk and impact of a particular role becoming vacant, the identification of potential internal successors could be quite subjective and consequently a revised methodology will be adopted going forward including the introduction of a formal assessment and development cycle for senior and critical roles.

Risk mitigation will continue to include the ongoing development of employees, as well as work to further validate potential candidates for senior positions. Development work on potential candidates occurs with those employees remaining in their current roles, as this training is undertaken so as to minimise business impact while ensuring that candidates are enabled to undertake a more senior role in due course. The Group's preference, where possible, is that internal candidates are developed and supported to undertake senior roles as this assists in the ongoing maintenance of its strong cultural focus on its people.

See more examples of disclosure in the electronic version of this publication.

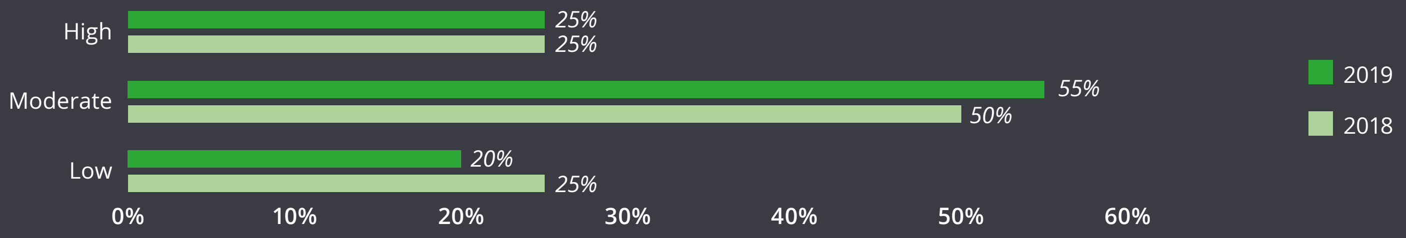
Nomination committees should put thought to the disclosures they will need to make about the work of the committee under the 2018 Code.

13. Accountability and internal control

93% of audit committee chairmen showed **clear ownership of their committee's report**, in most cases through a personal introduction or through signing the full report (2018: 89%)

On average, how many significant financial reporting issues were identified by the audit committee?

What was the level of quality of the description of significant financial reporting issues and how they were addressed?



84% of audit committees disclosed how they had assessed the **effectiveness of the external audit process**

Only **57%** of companies with an internal audit function explained how they had assessed the effectiveness of the internal audit function

Of the **16 companies** with no internal audit function,

6 included some explanation of **how internal assurance was achieved in the absence of internal audit**

The **ratio of non-audit fees** compared to audit fees continued to be low this year at

24%, compared to 25% in 2018 and 62% in 2017, which was the year before the introduction of the FRC's Revised Ethical Standard for auditors

Compliance - positive trends

Each of the factors regarding significant issue disclosures from the FRC's A&A Lab report[18] on Audit Committee Reporting were assessed to determine whether disclosures were comprehensive and useful. These factors are: informative context to be provided for each significant issue, including quantification where appropriate; a description of the actions carried out by the audit committee during the year; the conclusion on each issue and the rationale behind that conclusion; and suitable cross-references to elsewhere in the annual report.

Based on these criteria, it appeared that only 25% of companies provided high quality disclosures adding substantially to the reader's understanding of those issues and how the audit committee has considered and challenged them (2018: 25%). In general, audit committees could have provided more detail on their actions and level of challenge and comparatively few explained the rationale underlying their conclusions regarding the significant issues. A minority described that they relied exclusively on the auditor's assessment of these issues, suggesting that this took the place of the audit committee reaching its own conclusion. One company described the significant issues as "audit risks".

The FRC's A&A Lab report also indicates that investors would find it helpful to have clarity in the audit committee report regarding the role the audit committee plays in internal control. 81% of companies met this standard, up slightly from 78% in 2018. However, almost all companies included sufficient disclosure somewhere in the annual report to make the role of the audit committee in internal control sufficiently clear. Companies could consider whether to rearrange the location of their disclosures in order to meet investor preferences.

Another responsibility of the audit committee relates to the relationship with the external auditor. This year 24% of companies mentioned that they had read the FRC's Audit Quality Review Team (AQRT) report on their audit firm (2018: 22%). 14% referred to a specific AQRT inspection of their company's audit (2018: 17%), and almost all of those explained whether there were significant issues identified and, if so, that they had discussed the report with the auditor and agreed appropriate actions.

With respect to the disclosures regarding non-audit services provided by the external auditor:

- 9% of companies indicated their auditor did not provide any non-audit services (2018: 8%).

- For those that did provide non-audit services, the average ratio of non-audit fees to audit fees[19] over all companies was 24% (2018: 25%). This compares to 62% in 2017 and indicates a substantial shift following the FRC's Revised Ethical Standard for auditors taking effect.

- Only seven companies disclosed a ratio of non-audit fees to audit fees exceeding 70%. Of those, six companies (86%) explained why the company had decided to engage their auditor to provide the services in question.

- Although not as prevalent as in 2018, in some cases the auditor's fees for the review of the interim report were still included by audit committees as audit fees when calculating the ratio – these are classified as non-audit fees under the Ethical Standard.

- Companies are providing more and better information on their consideration of non-audit services. This information included non-audit services provided or contracted for since the end of the financial year, plus the nature and quantum of non-audit services provided by audit firms that were not yet the company's statutory auditor.

Compliance – problem areas

In the wake of public attention on both external and internal audit, it is notable that audit committee disclosures regarding internal audit have not moved on to the same degree as those regarding external audit. It continues to be possible to see several pages of disclosure regarding the audit committee's consideration of external audit, yet only a few sentences regarding internal audit.

Government and regulatory bodies have been encouraging boards to spend more time ensuring internal audit is established properly with independent lines of reporting, a clear remit, coverage of key risks to the business and suitable access to the rest of the organisation. The Institute of Internal Auditors published a consultation in July 2019 on reinforcing the role of internal audit, including a proposal that internal audit provides an independent view to the audit committee regarding an assessment of the overall effectiveness of the governance, and risk and control framework of the organisation, and its conclusions on whether the organisation's risk appetite is being adhered to.

It is to be hoped that this will lead to more informative disclosures regarding internal audit activities in the annual report:

- Of the 84% of companies which have an internal audit function, almost all audit committees confirm that they have reviewed the plans and work of internal audit.
- 47% stated that internal audit plans had been set with reference to the key risks of the business (2018: 52%).
- 57% of audit committees in companies with an internal audit function explain how they have assessed the effectiveness of the internal audit function (2018: 60%).

Looking forward

The 2018 UK Corporate Governance Code, which is effective for years commencing on or after 1 January 2019, includes a new provision regarding disclosure around internal assurance in the absence of an internal audit function. Under the new Code, companies without internal audit will be expected to explain how, in the absence of an internal audit function, internal assurance has been achieved, and the impact on external audit:

- Out of 16 companies without an in-house or outsourced internal audit function, 15 met the current expectation for the audit committee to determine why one is not considered necessary.
- 35% of audit committees provided an explanation of how internal assurance is achieved where there is no internal audit function.
- Only one company mentioned any impact on external audit, and this related to providing the external auditor with other evidence of how the audit committee gained internal assurance.

In addition, the 2018 UK Corporate Governance Code introduced a change regarding whistleblowing which has moved whistleblowing to be a board responsibility. An encouraging number of audit committees mentioned this change in their annual report, in some cases explaining that responsibility for whistleblowing is either going to be considered by the board as a whole in the future, or describing how delegation to the audit or the risk committee will work in practice.

89% of companies included some mention of whistleblowing in the annual report, of these 75% in the audit committee report (2018: 91% and 76%). 26% of companies that mentioned whistleblowing shared disclosures that went beyond "boilerplate" (2018: 23%). Better disclosures brought out the importance of a robust speaking-up process to the company. They were company-specific and year-specific and could include the operation of the whistleblowing process, its independence and reporting lines, changes during the year, external assurance on its effectiveness, reporting statistics, and the nature of reports received and acted upon. Two companies included an interview with someone responsible for dealing with whistleblowing reports in the company, helping to bring it to life.

The Government is expected to consult in autumn 2019 regarding the possibility of a legislative strengthening of the framework around internal controls for UK companies. In the light of this upcoming consultation, findings relating to internal controls included:

- 7% of companies indicated that their company had experienced some form of significant internal control breakdown during the year (2018: 6%)
- 43% of those that had experienced a control breakdown provided a good disclosure regarding the actions that have been or are being taken to remedy any significant failing or weakness, in line with the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (2018: 67%)
- 40% of companies indicated that there had not been any significant internal control breakdowns during the year, often with board or audit committee describing the internal control environment as "effective". It would be helpful for audit committees to describe further the underlying work they have performed to reach their conclusions.

What to watch out for

- [ ] Explain each significant issue affecting the financial statements clearly and disclose the actions the audit committee has taken during the year, how the audit committee has applied challenge to management's conclusions, the conclusion the audit committee itself has reached and its underlying rationale.
- [ ] Investors are keen to know that audit committees prioritise audit quality and audit committees should consider this when discussing a tender of the external audit.
- [ ] Assess whether disclosures regarding the effectiveness of the internal control environment include enough information for investors to understand how the audit committee or board undertakes its stewardship responsibilities to assess the internal control framework.
- [ ] Clearly describe actions that have been or are being taken to address identified control failings or weaknesses.
- [ ] Consider enhancing disclosures regarding the internal audit function and demonstrating the level of oversight applied by the audit committee in areas such as scope, relationship to key risks, resourcing and skills and internal audit effectiveness.
- [ ] Where there is no internal audit function, consider how to explain the way the audit committee achieves internal assurance and the impact on the work of the external auditor.
- [ ] Disclosures on the whistleblowing process should avoid boilerplate and instead demonstrate to employees and other stakeholders that it is robust, independent, and that reports are listened to and acted upon.

Examples of disclosure

The Unite Group Plc's audit committee disclosure on significant issues affecting financial reporting includes context, the evidence reviewed and actions taken by the committee, the conclusions reached and rationale.

Unite Group Plc

Property valuations

The Group's principal assets are investment properties and investment properties under development that are either owned on balance sheet or in USAF or LSAV. The investment properties are carried at fair value based on an appraisal by the Group's external valuers who carry out the valuations in accordance with the RICS Red Book valuation guide, taking into account transactional evidence during the year. The valuation of property assets involves significant judgement and changes in the core assumptions could have a significant impact on the carrying value of these assets.

Management discusses the underlying performance of each asset with the external valuers and provides detailed performance data to them including rents, University lease agreements, occupancy, property costs and costs to complete (for development properties). Management receives detailed reports from the valuers and performed a detailed review of the valuations to ensure that management considers the valuations to be appropriate. The valuation report is reviewed by the Chief Financial Officer and the Property Director prior to sign-off.

During the year, the Committee and/or the Board met with members of the Group's valuer panel and challenged them on the basis of their valuations and their core assumptions, including the yield for each property, rental growth and forecast costs. The Directors questioned the external valuers on market trends and transactional evidence that supports the valuations. The Audit Committee was satisfied that the Group's valuers were appropriately qualified and provided an independent assessment of the Group's assets. The Audit Committee was satisfied that an appropriate valuation process had taken place, the core assumptions used were reasonable and hence the carrying value of investment and development properties in the financial statements was appropriate.

Lonmin plc provides disclosure regarding internal audit explaining the audit committee's interaction with the function, its assessment of internal audit's effectiveness and that the internal audit plan is set with reference to the risks of the business. Lonmin plc also explains how its whistle-blowing hotline operates, including the number and nature of reports received by the hotline.

Lonmin plc

Internal audit

Within Lonmin, the internal audit function, risk management, investigations and whistleblowing are organised under the umbrella of Lonmin Business Assurance Services (LBAS), the purpose of which is to bring a systematic and disciplined approach to evaluate and improve the effectiveness of Lonmin's governance and internal controls. To ensure independence, the Head of Assurance and Risk reports functionally to the Chairman of the Audit & Risk Committee and administratively to the CFO and he has unrestricted access to the Chairman of the Board.

Lonmin has adopted a partially co-sourced model for the internal audit function, supported by the South African arm of PwC. The internal audit plan, approved in September 2017 by the Committee, reflects a risk based approach targeting financial and operational processes. The main objective is to test the robustness of the mitigating controls and identify improvement opportunities. A total of 38 audits were undertaken during the year. The audits were conducted in accordance with International Standards for the Professional Practice of Internal Auditing focussing on business critical and high risk areas which were prioritised by the internal auditors with input from management and the Committee.

Audit findings and the related management actions are tracked by internal audit, and verified periodically after being reported by management as complete. The Committee is provided with reports on material findings and recommendations and regular updates on the progress made by management in addressing the findings are also provided. All action points are recorded on a Company-wide database to facilitate monitoring and accountability.

The effectiveness of the internal audit function was assessed through a variety of ways, including review of quality assurance questionnaires completed by auditees and a wider review involving senior management, the Exco, the Committee, other Board members and the external auditors. An independent external peer review is also carried out every five years. Having considered the results of the effectiveness review and a number of other factors, including the quality of reporting to the Committee and impartiality of the internal audit function, the Committee concluded that the internal audit function was effective.

Whistleblowing

The Company's Whistleblowing Policy, approved in 2017 and available on the Company's website, www.lonmin.com, encourages and protects legitimate whistleblowing. An independent third-party whistleblowing helpline allows employees and other stakeholders to report concerns about any suspected wrongdoing or unethical behaviour occurring within the business or about the behaviour of individuals. All calls are treated confidentially and anonymously, if preferred.

Any matters reported are initially reviewed by the Head of Assurance and Risk and investigated by the LBAS – fraud and investigations function. Cases are also referred, where appropriate, to Lonmin Security Management for investigation. Where necessary, certain matters are escalated to the CFO, CEO or Exco and reported regularly to the Committee.

The following table provides a summary of the calls that were reviewed in FY2018:

	FY2017	FY2018
Bribery	1	4
Company Procedure violations	25	10
Corruption	10	10
Forgery	5	5
Fraud	19	25
Theft	8	11
Unethical behaviour	25	21
Conflicts of interest	0	4

See more examples of disclosure in the electronic version of this publication.

14. Judgements and estimates, tax and pensions

The average number of **critical judgements** and key sources of estimation uncertainty remained at

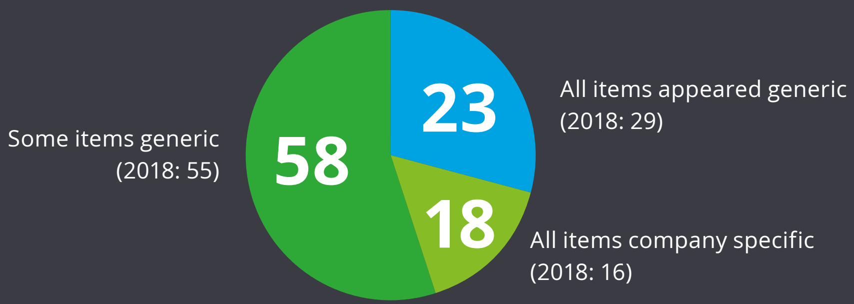
5

When distinguished, on average there were:

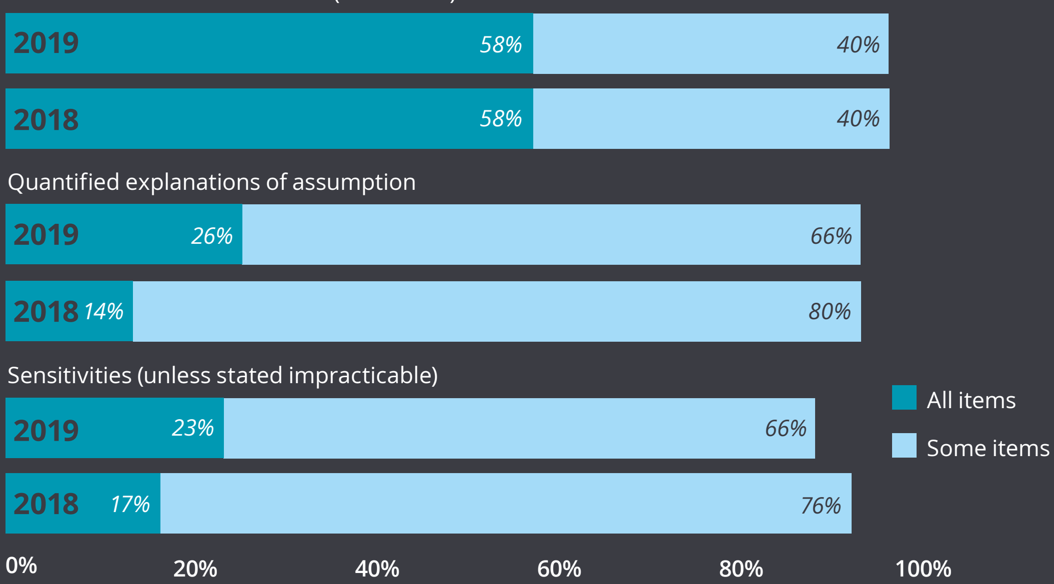
2 judgements (2018: 2)

3 estimates (2018: 3)

Do those items appear to be company-specific?



Disclosures on estimation uncertainties*



*of the 99 companies appearing to disclose key sources of estimation uncertainty

66 Companies had defined benefit pension schemes

49 Companies provided information on tax strategy or governance

Since 2016 the FRC has published various feedback reports on its thematic reviews of financial statements including the areas of critical judgements and key sources of estimation uncertainty, tax and pensions. The FRC continues to identify ways where companies can continue to enhance their disclosures in these areas. The below focuses on the main topics where the FRC is seeking improvements.

Critical accounting judgements and key sources of estimation uncertainty

Critical accounting judgements and key sources of estimation uncertainty are two disclosures that have often mistakenly been merged together, despite IAS 1 requiring separate and different disclosure for each. Disclosure of accounting judgements under IAS 1 specifically excludes those involving estimations, which are covered by the estimation uncertainty disclosures. The differing disclosures required for each mean this distinction matters. Also, the key estimates disclosures apply only where there is a significant risk of material adjustment in the next year due to changes in assumptions and estimates, so not all areas of estimation are covered.

It is clear that companies have reviewed the presentation of these disclosures, with 78% of those surveyed (2018: 66%, 2017: 52%) now making clear which items they regard as estimates and which as judgements. 88% of those companies made the distinction by using sub-headings. Where a distinction was presented it appeared to us that only seven companies had either presented estimates as judgements or vice versa, an improvement on 18 last year.

The FRC remains concerned about the use of boilerplate text and continues to identify examples of generic disclosures that do not describe the specific judgements and estimates made. 23% of companies we looked at (2018: 29%) only provided narrative that was so generic that it could have been applied equally to any other company, for example in relation to goodwill impairment testing, defined benefit pension assumptions and uncertain tax positions. Providing sufficiently granular information to understand the judgement, or the source of estimation uncertainty, and its effect on the accounts, is key to avoiding regulatory challenge, and improving users' understanding of the disclosures.

Only 18 companies (2018: 16) disclosed items that all appeared suitably company-specific. The FRC has again commented that the better quality reports identify a smaller number of judgements and estimates and noted that audit committee reports and auditors' reports often provide more granular information in respect of significant judgements and richer information regarding the particular estimates and assumptions made, which is consistent with our findings.

When critical judgements were distinguished, the maximum was nine, with an average of two. 21 companies (2018: 15) clearly indicated that they had no critical judgements. Nine companies presented one or more judgements where it was not obvious, based on the information provided, how those judgements could have a significant effect on the financial statements and how that conclusion has been reached.

When sources of estimation uncertainty were distinguished, the maximum was eleven, with an average of three. For 71 companies it was unclear to us, for one or more items identified as key sources of estimation uncertainty, how they could realistically give rise to a material adjustment within the next 12 months.

As set out in their 2017/18 Annual Review of Corporate Governance and Reporting, in relation to key sources of estimation uncertainty, the FRC expects to see disclosures in line with paragraph 129 of IAS 1. In terms of these disclosures, 69% of companies disclosing key sources of estimation uncertainty disclosed some quantification of assumptions underlying estimates, with only 26% disclosing quantification for all items. This information is important to investors as it enhances understanding of the assumptions underlying estimates. 90% disclosed insight into sensitivities and ranges of reasonably possible outcomes for some of the items identified as a key source of estimation uncertainty, although this was typically by virtue of disclosing information required by other standards, such as IAS 36 and IAS 19.

Tax

The amount of tax companies are paying and the use of overseas tax structures are subject to a high level of scrutiny by the public and by HMRC, and the FRC continues to note areas for improvement in companies' tax disclosures and transparency.

Large UK companies are required to publish their UK tax strategy, either as a separate document or as part of another. In the annual reports we surveyed, 49 companies (2018: 40) provided information on tax strategy or governance. 18 of these gave detailed insight, 20 provided fairly generic disclosures and eleven cross-referenced to a company website. A summary of the main elements and cross-reference to website disclosure may be an effective approach, whilst avoiding duplication.

The majority of companies (81%, 2018: 81%) discussed the current year effective tax rate in the strategic report, although only 41% provided company-specific insight on the factors that would influence the expected future effective tax rate. Providing information in addition to generic disclosure of statutory tax rate changes is encouraged. Of the 66 companies that showed adjusting items on the face of the income statement, only 31 of these analysed the tax impact of these in the tax reconciliation note to the accounts.

One area of concern raised by the FRC is around uncertain tax positions, which are relatively common in large entities given the complexity of many tax regimes. 31% of companies (2018: 34%) provided an accounting policy on uncertain tax positions, ahead of IFRIC 23 *Uncertainty over Income Tax Treatments* becoming mandatorily effective for periods commencing on or after 1 January 2019.

45% (2018: 37%) identified provisions for uncertain tax positions as a key source of estimation uncertainty (although in some cases this appeared to be mis-categorised as a critical accounting judgement). However, of those 45 companies, only 25 (2018: 18) quantified their uncertain tax provisions to provide useful information to the reader on the extent of estimation. The FRC has previously stated that justification for non-quantification will continue to be an area of regulatory focus, with the 2017/18 Annual Review of Corporate Governance and Reporting also raising this specific point.

28% (2018: 23%) of companies disclosed contingent liabilities related to tax, including several in respect of the recent European Commission investigation into state aid relating to UK group financing exemptions, with the majority providing quantified indication of the potential effect as required by IAS 37. Companies should continue to monitor developments regarding the EC's investigation and consider carefully the potential impacts in their next annual reports.

Pensions

The majority of companies have closed their defined benefit schemes to new entrants or future accrual, however the ongoing obligations to fund such schemes are often significant with 66 companies surveyed (2018: 67) having such schemes. One company in the sample had wholly immaterial obligations and assets remaining, meaning that they did not provide detailed disclosures.

Most of the companies surveyed disclosed information about contributions expected to be paid in the future, however the level of insight provided continues to vary. 32 (2018: 31) appeared to quantify future contributions over the whole period covered by the schedule of contributions, while 18 (2018: 21) only disclosed expected contributions for the following year. No companies in the sample (2018: two) mentioned an increase in dividend payments triggering an increase in pension contributions.

The FRC has previously reported scope for companies to better articulate their schemes' strategy for matching assets and liabilities as part of their thematic review into pension disclosures. We saw an increase in companies including such disclosure with 40 (2018: 24) including their asset-liability matching strategies such as annuities or longevity swaps. 46 companies (2018: 42) clearly identified and explained the risks inherent in the investment strategy.

35 companies (2018: 40) had one or more schemes in surplus on an IAS 19 basis with 32 (2018: 37) recognising the surplus as an asset. Justification for recognition of an asset was explained by 24 companies (2018: 21), in all but one case on the grounds of an unconditional right to a refund. None of the companies sampled recognised an additional liability for a minimum funding requirement that would give rise to an irrecoverable surplus.

Most companies analysed plan assets by major category with 62 providing more informative disclosure, as required by IAS 19, by disaggregating the analysis for which plan assets have a quoted market price or not.

IAS 19 requires disclosure of "significant" actuarial assumptions and sensitivities for those same assumptions. Companies were not always explicit as to which assumptions they regarded as "significant" - only 46% of those with defined benefit pension disclosures provided sensitivity analysis for all the assumptions they had quantified, with a further 48% providing sensitivities for some of the quoted assumptions. 6% provided no sensitivity analysis.

37 companies (2018: 26), have had assumptions move in the current year compared to the prior year by more than the reasonably possible change per the sensitivity disclosure. This may appear inconsistent for a reader assessing the extent of estimation, as the extent of reasonably possible changes would typically be expected to be consistent with recent variations, rather than just having standard variations of plus or minus 0.1% for example.

What to watch out for

- [ ] Make the judgements and estimates disclosures company specific and meet the FRC's expectations for all the accompanying detail, such as sensitivity information.
- [ ] Only include the most complex or subjective judgements that have the most significant effect on amounts recognised.
- [ ] Only include the assumptions and other sources of estimation uncertainty where there is a significant risk of material adjustment to the carrying amounts of assets or liabilities within the next year.
- [ ] Provide transparent and quantified disclosures around uncertain tax positions.
- [ ] Consider IFRIC *23 Uncertainty over Income Tax Treatments*, effective for periods commencing on or after 1 January 2019.
- [ ] Provide tailored comment on tax strategy and governance, or a website cross-reference.
- [ ] Disclose company-specific insight into the future expected tax rate.
- [ ] Provide justification for recognition of a pension asset where the scheme is in surplus.
- [ ] Disclose significant assumptions and sensitivity information for those same assumptions.
- [ ] Consider the reasonably possible changes in all key pension assumptions, and whether the disclosed ranges are consistent with recent variations.

Examples of disclosure

Paragon Banking Group plc provided insight into their tax strategy.

Paragon Banking Group plc

Taxation policy and payments

The Group's tax strategy is to comply with all relevant tax obligations whilst cooperating fully with the tax authorities. The Group recognises that in generating profits which can be distributed to shareholders it benefits from resources provided by government and the payment of tax is a contribution towards the cost of those resources. The Group will only undertake tax planning that supports commercial activities and in the UK context is not contrary to the intention of Parliament.

As a group containing a bank, the Group is subject to The Code of Practice on Taxation for Banks (the 'Bank Tax Code') published by Her Majesty's Revenue and Customs ('HMRC') in March 2013. The Group has previously confirmed to HMRC that it was unconditionally committed to complying with the Bank Tax Code, and formally re-approved the Group's tax governance policies and the tax strategy outlined above.

During each financial year the Group publishes a tax strategy document for that year on its website, in accordance with the Finance Act 2016. This document addresses the following matters:

- The approach of the Group to risk management and governance arrangements in relation to UK taxation
- The attitude of the Group towards tax planning (so far as affecting UK taxation)
- The level of risk in relation to UK taxation that the Group is prepared to accept
- The approach of the Group towards its dealings with HMRC

The second such statement was published during the year and can be found in the investor relations section of the Group's website.

The published strategy is owned by the Board collectively in accordance with HMRC's published expectations.

The Group has an open and positive relationship with HMRC, meeting with their representatives on a regular basis, and is committed to full disclosure and transparency in all matters.

The Group is resident and operates in the UK and its tax payments to the UK authorities include not only corporation tax but also substantial payroll taxes. The amounts of the Group's cash payments to UK national and local tax authorities in the year, including Pay As You Earn ('PAYE') and National Insurance ('NI') contributions deducted from employee wages and salaries were as follows:

	2018	2017
	£m	£m
Corporation tax	**32.0**	28.9
PAYE and NI	**28.0**	24.3
VAT	**1.6**	0.3
Stamp duty	**0.2**	0.5
Total national taxation	**61.8**	54.0
Business rates	**1.1**	1.2
	62.9	55.2

Lloyds Banking Group PLC provided insight into their asset-liability matching strategies as part of their defined benefit pension disclosures.

Lloyds Banking Group PLC

Asset-liability matching strategies

The main schemes' assets are invested in a diversified portfolio, consisting primarily of debt securities. The investment strategy is not static and will evolve to reflect the structure of liabilities within the schemes. Specific asset-liability matching strategies for each pension plan are independently determined by the responsible governance body for each scheme and in consultation with the employer.

A significant goal of the asset-liability matching strategies adopted by Group schemes is to reduce volatility caused by changes in market expectations of interest rates and inflation. In the main schemes, this is achieved by investing scheme assets in bonds, primarily fixed interest gilts and index linked gilts, and by entering into interest rate and inflation swap arrangements. These investments are structured to take into account the profile of scheme liabilities, and actively managed to reflect both changing market conditions and changes to the liability profile.

At 31 December 2018 the asset-liability matching strategy mitigated 105 per cent of the liability sensitivity to interest rate movements and 106 per cent of the liability sensitivity to inflation movements. In addition a small amount of interest rate sensitivity arises through holdings of corporate and other debt securities.

See more examples of disclosure in the electronic version of this publication.

15. Other financial statement disclosures

13

companies identified **critical judgements** or key sources of estimation uncertainty relating to IFRS 9

14

companies applying IFRS 9 continued to follow **IAS 39's hedge accounting requirements**

39%

of those adopting **IFRS 15 reported an impact on amounts at transition**

12

companies identified critical judgements or key sources of **estimation uncertainty relating to IFRS 15**

34

companies reported **business combinations**, with **33 recognising goodwill**

8

Accounting policy disclosures lasted an average of **8 pages**

IFRS 9

IFRS 9 *Financial Instruments* became mandatorily effective for periods commencing on or after 1 January 2018, replacing IAS 39. 80 companies in our survey had adopted the new standard, including a small number of early adopters. All those that had adopted IFRS 9 took advantage of the relief that allows entities to avoid restating comparatives upon transition.

Perhaps the biggest change that IFRS 9 made was to replace IAS 39's incurred loss model for impairment of financial assets with an expected loss model. However, only 16 companies quantified changes in their loss allowances at the point of transition to IFRS 9, with many others merely stating that the change on adoption of IFRS 9 was not material. Of those 16 companies that did quantify their changes, loss allowances increased by an average of 69% compared to the historical IAS 39 position, although this average is skewed upwards by some changes that were large in percentage terms but small in absolute terms.

One of the most commonly held financial assets is trade receivables. A simplification permitted and in many cases required by IFRS 9 sees lifetime expected losses recognised for such assets, rather than following the general approach under which changes in credit risk since initial recognition must be monitored. No corporates surveyed were identified as applying the aforementioned general impairment model to their trade receivables.

13 companies identified critical judgements or key sources of estimation uncertainty in their IAS 1 disclosures relating to the application of IFRS 9, often in connection with determining loss allowances.

IFRS 9 also amended IAS 1's list of required line items in the statement of profit or loss to include impairments determined under IFRS 9. Only twelve companies presented such a line item on the face of the statement of profit or loss, with others perhaps omitting it on the grounds of materiality.

Another change made by IFRS 9 was one that made it easier, generally speaking, for entities to put in place arrangements that are eligible for hedge accounting. However, of the 46 companies that had transitioned to IFRS 9 and were commenting on hedge accounting, 14, including a number of banks, explicitly stated that they had elected, as permitted, to continue applying the hedging provisions of IAS 39 for the time being. Of the other companies evidently applying IFRS 9's hedge accounting provisions, five presented separate reserves within equity for 'costs of hedging'.

IFRS 15

IFRS 15 *Revenue from Contracts with Customers* also became mandatorily effective for periods commencing on or after 1 January 2018, replacing a risks and rewards model for revenue recognition with one based on control. 83 companies in our survey had adopted the new standard, again including a small number of early adopters.

Only 16 companies that applied the new standard elected to do so with full retrospective effect and restated comparatives. The remaining companies either indicated that IFRS 15 had no material impact or that they had adopted the modified retrospective approach. Aside from disclosure items and renaming / reclassifying line items, 32 of the companies (39%) that had transitioned to IFRS 15 showed an impact on amounts reported at the point of transition.

12 companies were seen to be disclosing critical judgements or key sources of estimation uncertainty under IAS 1 in relation to IFRS 15 and revenue recognition, including a range of topics such as assessing recognition of revenue as principal or agent and estimating levels of returns for goods sold.

In terms of disclosure, IFRS 15 calls for a disaggregation of revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. It seemed that many companies felt that their IFRS 8 segmental reporting already provided such information. Only 29 companies provided a disaggregation of revenue that was separate from their reportable segment disclosures.

IFRS 16

Looking ahead, the forthcoming reporting season will be the first time that many will have prepared annual financial statements following the adoption of IFRS 16 *Leases*, which is effective for periods commencing on or after 1 January 2019. The new standard sees lessees bringing most of their operating leases on balance sheet.

Although only three companies surveyed had early adopted the new standard, it seems that many had heeded the FRC's call for informative disclosure, including quantification, ahead of adoption in accordance with IAS 8. It appeared that all companies had either started or completed an assessment of the impact that IFRS 16 would have, with only a quarter stating that they expected the impact to be immaterial. 67 companies, compared to just eight last year, quantified the anticipated impact, eight doing so by providing a range rather than a single number. Only a further five companies (2018: 36) tried to give an indication of the impact by cross-referring to their operating lease commitment disclosure.

As with IFRSs 9 and 15, the relief offered from full retrospective application on transition looks like it will be a popular option. One of the three early adopters had transitioned using the fully retrospective approach and a further eleven companies indicated that they would be doing so. 26 companies were either undecided or unclear on which transition approach they were applying, with the remaining 62 companies applying one or other or a combination of both the modified retrospective approaches offered under IFRS 16.

48 companies indicated that they were or would be applying practical expedients or recognition exemptions offered under IFRS 16 – often this included the ability to keep low value and short term leases off balance sheet.

It is worth remembering that the FRC has undertaken a thematic review of IFRS 16 disclosures in interim accounts during 2019, the findings from which, once published, will no doubt prove helpful for preparers ahead of 2019 year-ends.

Financing

Understanding an entity's financing is an important area for many investors, with many companies identifying measures of debt or net debt as important metrics. IAS 7 requires an entity to provide disclosures on the movements in liabilities arising from financing activities. 75 companies surveyed provided such information - many of those that didn't present such information had little or nothing in the way of relevant liabilities.

42 of those presenting this information included cash balances as part of the disclosure, in a fashion similar to net debt reconciliations presented under UK GAAP (both historically and under FRS 102 following the triennial review). However, IAS 7 requires movements in liabilities to be disclosed rather than the 'net debt' position. As explained in IAS 7.44E, where relevant, companies should clearly indicate the portion of such disclosure that provides the required information. At present practice was mixed in terms of the level of clarity in this regard.

In their Annual review of Corporate Governance and Reporting 2017/18 the FRC highlighted a concern over the lack of transparency around supplier financing arrangements. Only seven companies included disclosures indicating the existence of such schemes within their organisation. The best of these provided quantification of the amounts payable under such arrangements and a clear rationale supporting their classification of liabilities in the balance sheet and payments in the statement of cash flows.

Goodwill

Recognition of goodwill and subsequent impairment testing is an area requiring judgement and one to which auditors and regulators will often pay close attention, with the FRC having announced that it will be undertaking a thematic review of impairment disclosures in 2019/20. 34 companies (2018: 39) had undertaken business combinations during the year, with 33 (2018: 31) recognising goodwill as part of those business combinations. In the majority of cases those companies went on to provide a short description of the factors giving rise to goodwill, as required by IFRS 3, although some were perhaps open to challenge in making generic references to synergies and workforces.

82 companies (2018: 80) had goodwill balances recognised at the end of their financial reporting periods, although a few of these were relatively small amounts. Of the 78 companies providing disclosures on goodwill impairment testing, 69 were basing recoverable amount on value in use, seven used fair value less costs of disposal and two used different approaches for different cash generating units (CGUs). Pleasingly, all companies described key assumptions they had made to determine the recoverable amount, as required by IAS 36.

If a reasonably possible change in a key assumption used to determine recoverable amount would give rise to an impairment then IAS 36 requires disclosure of the amount of headroom in the CGU(s), the value of the key assumption and how much it would need to change by to give rise to an impairment. As in previous years a number of sensitivity analyses (25) appeared open to challenge, given they instead described the impact (or lack thereof) of changing key assumptions by set percentages.

In total 47 companies presented sensitivity analyses in some form, stating or, given the circumstances where the disclosure is required, potentially implying that a reasonably possible change could give rise to an impairment. 47 companies also presented potential impairment of goodwill as a key source of estimation uncertainty under IAS 1, indicating that there was a significant risk of a material adjustment to carrying values within the next year. However, only 35 companies presented both of these disclosures, with 24 companies presenting one and not the other and potentially being open to challenge where this indicated an inconsistency.

Parent company financial statements

49 (2018: 52) parent companies' separate financial statements were prepared under FRS 101, 44 (2018: 42) were prepared under full IFRS and just seven (2018: six) were prepared in accordance with FRS 102. Consistent with the previous year, just over half of the FRS 101 and FRS 102 reporters adapted the statutory formats of their primary statements to use IFRS titles.

What to watch out for

- [ ] Once adopted, provide all IFRS 16's required disclosures including, where relevant, those specifically required in the year of transition.
- [ ] Clearly segregate the disclosure required by IAS 7 on movements in financing liabilities from broader disclosure provided on movements in 'net debt'.
- [ ] Provide informative and transparent disclosure on complex supplier arrangements, including supplier financing arrangements.
- [ ] Where appropriate ensure consistency between disclosures, for example IAS 1's critical judgements and key sources of estimation uncertainty and the associated account balance notes.
- [ ] Ensure that sensitivity disclosures provided in relation to impairment of goodwill are in accordance with IAS 36's requirements, providing detail on what assumption changes would lead to impairment.

Examples of disclosure

Although any particular scheme should be considered carefully based on its terms and conditions, Compass Group PLC provided useful information on their supplier finance programme as set out below.

Compass Group PLC

The Group has Supply Chain Financing (SCF) arrangements in place. The principal purpose of these arrangements is to enable the supplier, if it so wishes, to sell its receivables due from the Group to a third party bank prior to their due date, thus providing earlier access to liquidity. From the Group's perspective, the invoice payment due date remains unaltered and the payment terms for suppliers participating in the SCF programmes are similar to those of suppliers that are not participating, and to the wider industry more generally. If a receivable is purchased by a third party bank, that third party bank does not benefit from additional security when compared to the security originally enjoyed by the supplier.

At 30 September 2018, the value of invoices sold under the SCF programmes was £478 million, with £444 million related to the Group's programme in the USA (2017: £438 million and £403 million respectively). These amounts are included within trade payables and all cash flows associated with the programme are included within operating cash flows as they continue to be part of the normal operating cycle of the Group.

See more examples of disclosure in the electronic version of this publication.

Appendix 1 – The preparation process

When implementing the recommendations set out in this document, it is important to work to an achievable timetable. Getting as much as possible done in advance of the year end, when there is less pressure on the timetable, reduces the burden during the post year end reporting cycle.
In order to help you achieve your objectives we have provided a suggested 2019/20 plan below, as well as suggestions for what could be on the agenda for your planning meeting.

A suggested timetable for 2019/20 (For December reporters)

October 2019
By mid October

- Planning meeting of contributors to agree responsibilities, process and governance, including how to assess whether the report is fair, balanced and understandable, plus decide the overall structure for the report
- Identify opportunities to make the report clearer and more concise

November 2019
Early to mid November

- Contributors draft templates for their areas of responsibility
- Structure of draft report pulled together and reviewed for duplication
- Areas for linkage identified and highlighted in the draft report

Late November/early December

- Auditors review the structure of the report and provide comments

December 2019
By mid December

- Disclosure Committee (or equivalent) approve overall structure and technical compliance of the report

January 2020

- Draft report presented to the Audit Committee for initial comment on key messages, themes and overall balance
- Report sections updated for final messages based on year end results
- Cross-check for consistency with other planned or existing public reporting

February 2020

- Audit Committee assesses annual report on behalf of the Board – is it comprehensive and is it fair, balanced and understandable?
- Remuneration report reviewed by Remuneration Committee
- Report sections formally presented for review
- Chairmen of Audit, Remuneration and Nomination Committees compose introductions to their reports

By late February/March

- Final report presented to Audit Committee, Remuneration Committee and Board for approval

Suggested agenda for annual report planning meeting

- Consider how you will ensure that all elements of your annual report meet the regulatory requirements and effectively convey strategically important information to shareholders
- Agree the key messages and themes that will flow through the report, as far as they are understood at this stage, getting Audit Committee and Board buy in at a sufficiently early stage
- Discuss and agree how materiality will be applied to the annual report as a whole
- With the design team, discuss the key messages and themes and how these can be brought to life through design
- With the website team, discuss your approach to digital communication alongside the key messages and themes, to agree any advance design work to be done on the website
- Plan how you will avoid the “silo effect”:

Appendix 2 – Timeline of key corporate reporting changes

Effective for periods commencing on or after:	
1 January 2018	• New IFRSs on revenue and financial instruments
1 January 2019	• New IFRS on leasing • New UK Corporate Governance Code and revised Guidance on Board Effectiveness • The Companies (Miscellaneous reporting) Regulations 2018
1 April 2019	• Energy and Carbon Regulations
1 January 2021	• New IFRS on insurance contracts

Other significant initiatives ongoing

The FRC's Clear & Concise Reporting initiative continues, aimed at ensuring that annual reports provide relevant information for investors.

The FRC's 2019/2020 thematic reviews include:

- impairment of non-financial assets;
- disclosures relating to the implementation of IFRS 16 Leases within 2019 interim accounts; and
- the effects of Brexit on companies' disclosures.

The FRC will be reviewing the whole annual report (including governance and directors' remuneration) for 2019 year ends.

The principles of the IIRC's **Integrated Reporting** (<IR>) Framework continue to gain traction.

The **FRC's Guidance on the Strategic Report** was revised in 2018 to include guidance around the NFR Directive disclosures and the forthcoming section 172(1) statement.

The IASB continues their discussion of a new accounting model for **rate-regulated activities** (exposure draft expected to be issued in 2019) and is considering **IBOR reform** and the effects on financial reporting.

The **FRC's Financial Reporting Lab** currently has ongoing projects on the digital future of reporting, and climate and workforce reporting.

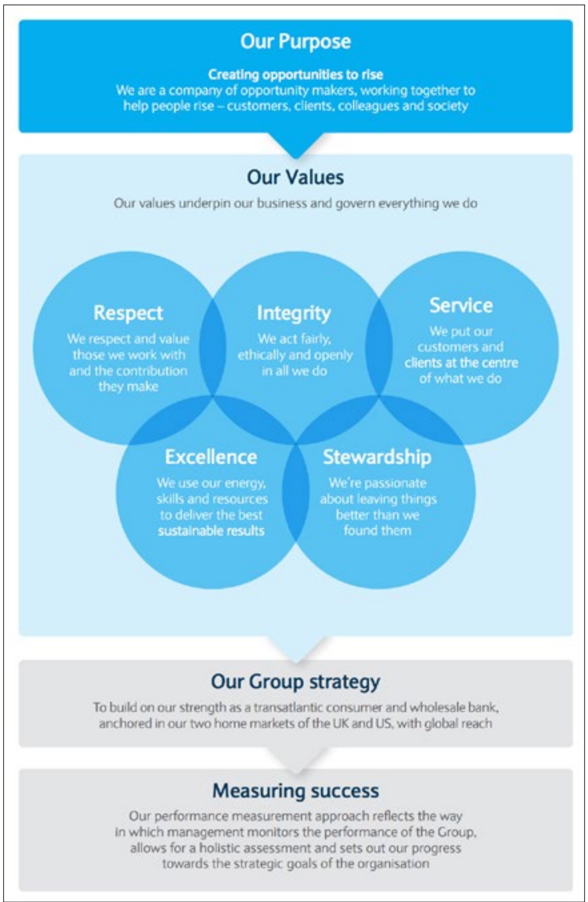
Although not enforced by regulation yet, the Government has set out its expectation for all listed companies and large asset owners to be disclosing in line with the **Task Force on Climate-related Financial Disclosures** recommendations by 2022.

Appendix 3 – Additional examples of disclosure

Purpose and culture disclosures

Barclays PLC

Barclays PLC summarise their purpose and link it to their values and strategy, before explaining it further in the narrative.



Climate change disclosures

Croda International Plc

Croda International Plc provided disclosure on the opportunities presented by climate change.

In a fragile world we must be part of the solution

The continuing accumulation of greenhouse gases is described as the main cause of global warming, with the predicted result that sea levels will rise by at least 30cm by the end of the century, along with more frequent extreme weather. Both affect food and water supply just when the growing global population needs it most, bringing increased international pressure to restrict climate change.

This, along with ever more scarce natural resources, means a growing demand for innovative sustainable products produced using fewer and more effective ingredients, from bio-based raw materials, made using more environmentally and socially sensitive processes.

Our opportunities to make a difference

From our unique position focused on using bio-based raw materials, rather than petrochemical, we have a real opportunity to contribute directly to the targets supporting the United Nations Sustainable Development Goals (SDGs) as our ingredients are used in a wide variety of consumer products.

In our businesses, there are many examples of our ingredients bringing about major reductions in greenhouse gas emissions when included in customers' formulations; for example, in engine lubricants where one tonne of our Perfad™ friction modifier saves over 1,700Te of CO_2 emissions. In application, our Life Sciences products make a real difference to the lives of farmers in developing nations, addressing food supply and local economic development, and our drug excipients and newly acquired vaccine adjuvants business, Biosector, also directly address the SDGs for prevention of disease.

Reaching wider than our own products and operations, we are taking the opportunity to inform and shape future policy on climate change with our voice on industry committees. Being open and transparent, we also work to minimise environmental and social impact along our entire supply chains and report our performance publicly.

Croda Performance Technologies

Maximising positive impact

We are committed to minimising any negative environmental impact of our operations, but increasingly important are the positive impacts of our ingredients in customer applications.

Coupling performance advantages with increased bio-based content, our Home Care ingredients deliver sustainability and sensory effects across the whole value chain, from polymer fibre to end garment, at the same time reducing water and energy consumption in production. For example, our Coltide™ surfactants extend the lifetime of garments by keeping them looking newer for longer.

Croda Energy Technologies lead the way in lubricant fluids and in 2018 launched the new range of Perfad™ friction modifiers that enhance engine durability, fuel economy and emission reduction. The business is also investing in phase change materials. These can be used, for instance, in temperature controlled packaging and to store thermal energy, thereby saving energy and fuel in internal combustion engines, hybrid and electric vehicles, as well as to store heat generated by day in homes for use at night.

In Smart Materials, our environmentally friendly and durable Maxemul™ coating solutions are VOC free, reducing our carbon footprint. We also offer anti-scratch solutions to reduce the repair and replacement needs of high performance plastic components, reducing the use of scarce resources.

Minimising negative impact

Through a number of investments at our manufacturing sites, we have reduced our environmental impact. For example, our Performance Technologies sector benefits from the bio-fermentation plant at our Gouda manufacturing site in the Netherlands, which has reduced its external energy dependency by 25%. Our Chocques site in France uses energy from the city incinerator, and in Hull in the UK, our £27m capital expansion project is re-using 95% of building demolition materials to save energy, keep waste out of landfill and reduce greenhouse gas emissions.

In addition, we have invested in a pipeline that enables us to use landfill gases at our Atlas Point manufacturing site. This site also uses solar energy, as we do at our Edison offices in North America and our Thane site in India.

The Weir Group PLC

The Weir Group PLC provided disclosure on action taken in response to climate change, including that at a Board level.

Climate Change

The UN Intergovernmental Panel on Climate Change (IPCC) released a report in 2018 highlighting that "urgent and unprecedented changes" are needed to reach the target to limit global warming to a maximum of 1.5 degrees. The report says there must be rapid and significant changes in four big global systems including industry.

We have a clear commitment to reduce the impact we and our customers have on the environment through technology and innovation. Equally important is harnessing the substantial potential from all Weir employees worldwide thinking and acting sustainably.

We welcome and support efforts, such as those led by the Task Force on Climate-related Financial Disclosures (TCFD), to increase transparency and to promote investors' understanding of companies' strategies to respond to the risks and opportunities presented by climate change. In 2018, Our Group Exec and Board teams both participated in Carbon Economy risk and opportunity workshops as part of our annual strategic planning process.

In 2018 through the process of completing our CDP Climate Change Submission we were able to assess the areas in which we could improve, to meet the requirements of the TCFD recommendations. We believe that companies should be transparent about how they plan to mitigate and be resilient in the face of climate change.

We submit annual CDP reports to share our risk management approach to climate change and our greenhouse gas (GHG) emissions performance.

In 2018, we achieved a score of B improving on our score of C in in 2017, for changes implemented relating to business strategy, risk disclosure, opportunity disclosure and emissions reduction initiatives.

2018 CDP Climate Change Score

B

CDP
DRIVING SUSTAINABLE ECONOMIES

We are working to align our reporting with the TCFD recommendations related to Climate Change Governance, Strategy, Risk and Metrics and Targets to ensure effective disclosures which, where commercially possible, will be most relevant and useful to stakeholders.

Strategy and business model disclosures

International Personal Finance plc

International Personal Finance plc clearly identifies and describes the resources they have to create

Our resources

Relationships
Open and straightforward engagement with our stakeholders is critical, particularly the relationships with our customers to ensure they receive the products and services they want.

People
We resource the business with skilled, motivated and knowledgeable employees and agents, who implement our strategy and ensure our customers are served well.

Technology
Technology is fundamental to driving efficiency through agent mobile devices, supporting digital lending growth and making effective credit decisions.

Financial
We manage financial resources effectively to sustain our business and generate good returns for our investors.

Well-known brands
Our brands are well known and trusted by more than 2.3 million customers.

Hollywood Bowl Group plc

Croda International Plc provided disclosure on the opportunities presented by climate change.

FOCUS ON PEOPLE

Our people underpin our business. Attracting and retaining top talent is a key priority for the Group.

We continue to build on the success of our centre manager and assistant manager in training programmes. In FY2018, 61 management positions were filled internally, a 17.3 per cent increase on FY2017.

Our people
We have continued to invest in training to ensure that we can provide an even higher level of service to all of our valued customers. We are delighted that our Net Promoter Scores have been maintained, and our overall satisfaction scores have improved during FY2018. Our team continues to be an integral part of the success of our business, and to that end we have implemented Long Term Incentive Plans for centre managers, assistant managers and senior support centre team members. As a result of our strategy to support our team members in developing a rewarding career, 103 team members successfully completed our internal management training programmes during the financial year.

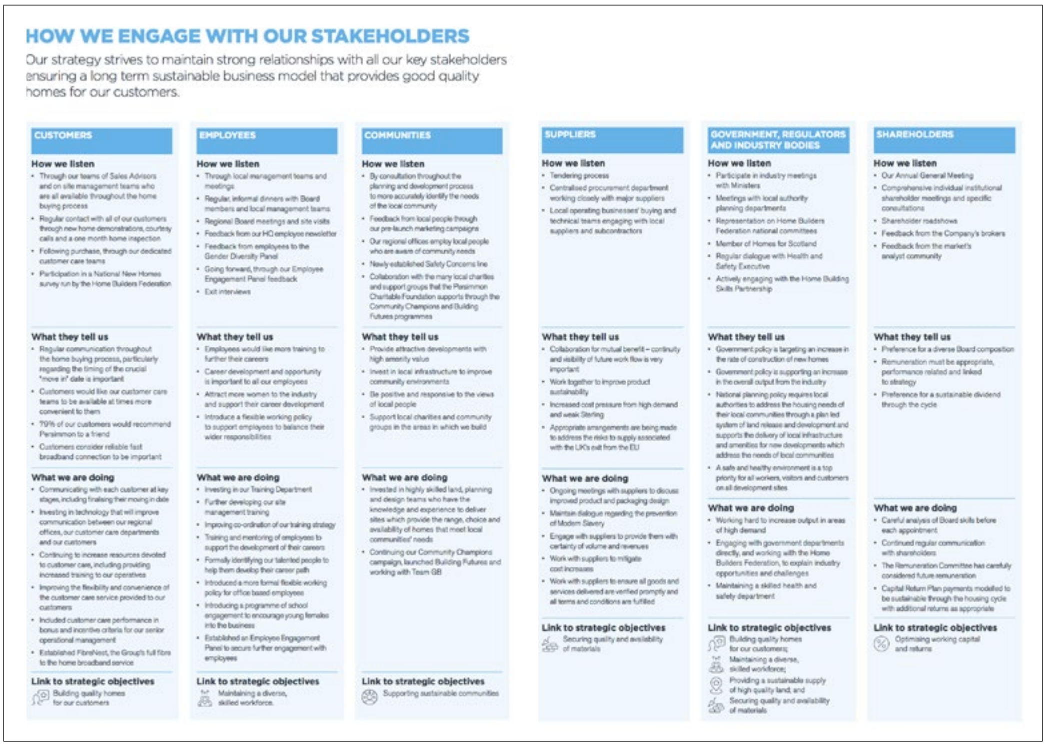
Rotork plc

Rotork plc clearly identify key sources of value and describe value created for a number of stakeholders in their business model.

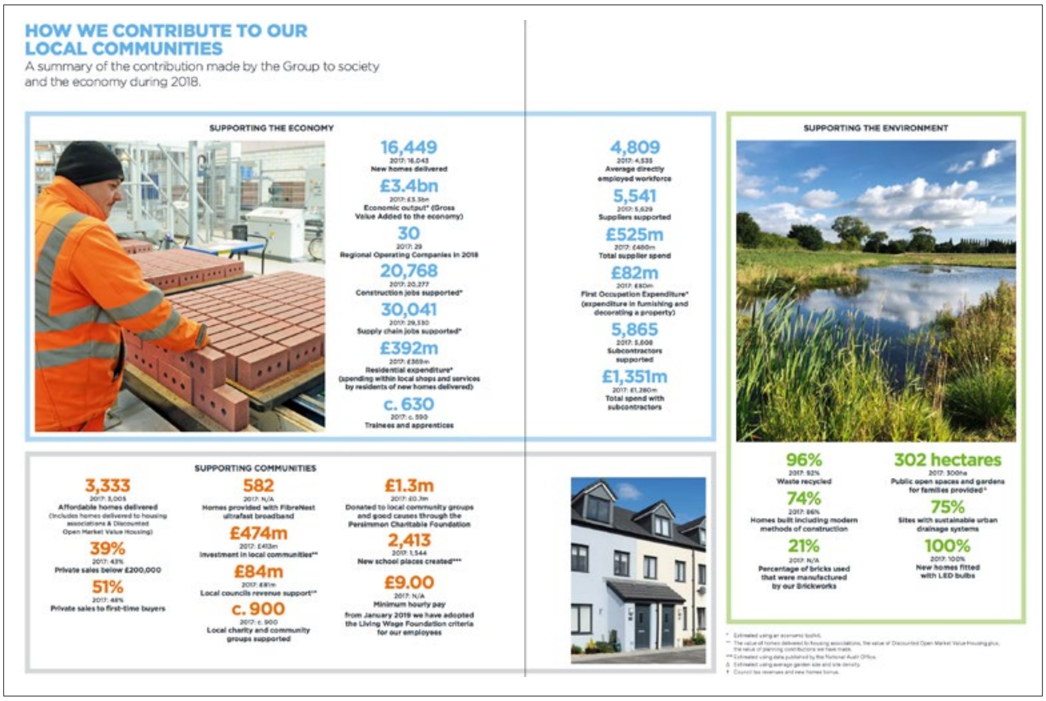
Stakeholder disclosures

Persimmon Plc

Persimmon Plc have clearly set out how they engage with all their stakeholders and how they have responded.



Persimmon Plc also provide a summary on how they have contributed to their communities, including metrics to demonstrate their impact.



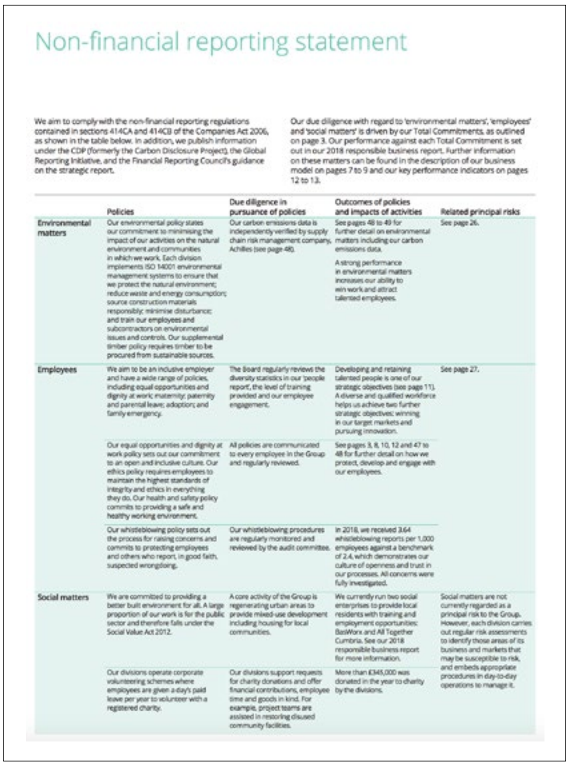
Anglo American plc

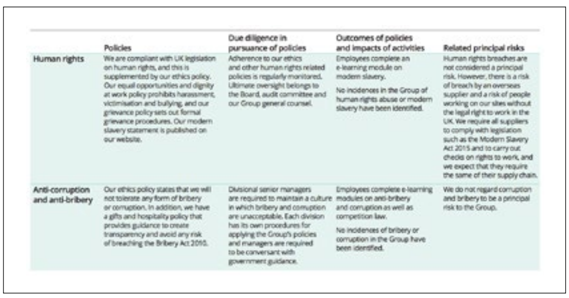
Anglo American plc included their non-financial information statement on page 1 of their annual report.

Reporting requirement	Policies and standards	Outcomes and additional information	Page reference
Environmental matters	Safety, Health and Environment (SHE) Policy and Way	Managing our environmental impacts	30
	Climate Change Policy	Disclosures related to the recommendations of the TCFD	31
	Energy and GHG Emissions Standard	Climate change	30-32
	Water Policy and Water Management Standard	Water	30
	Mineral Residue Technical Management Standard	Tailings storage facilities	30
Employees	Code of Conduct	Building a Purpose-led culture	39
	SHE Policy and Way	Safety	36
	Safety Golden Rules and Fatal Risk Standards	Safety	36
	HIV/AIDS Policy	Health	36 and 38
Human rights	Human Rights Policy	Human rights	33
Social matters	Social Way	Social performance	32-33
	Responsible Sourcing Standard for Suppliers	Supply chain	29
	Supply Chain Local Procurement Policy	Supply chain and Socio-economic development	29 and 33
Anti-corruption and anti-bribery	Code of Conduct and Business Integrity Policy	Building a Purpose-led culture	39
Principal risks and impact of business activity		Our business model	08-09
		Our material matters	16-17
		Managing risk effectively	42-47
Non-financial KPIs		Key performance indicators	48-49

Morgan Sindall Group plc

Morgan Sindall Group plc included the detail of due diligence over non-financial matters and outcomes within their statement.

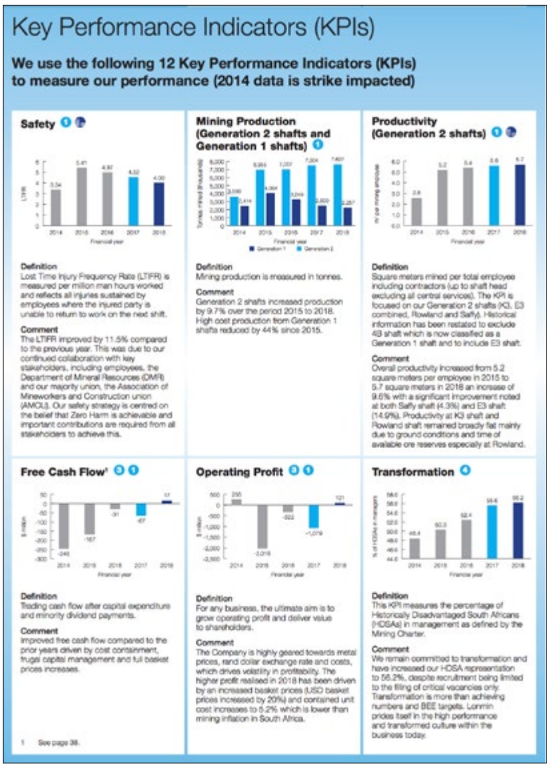




APMs and KPIs disclosures

Lonmin Plc

Lonmin Plc follow a number of recommendations from the FRC Guidance in their KPI disclosure, such as linking KPIs to strategy and remuneration, defining each KPI and providing commentary on the outcome, and providing sufficient number of comparatives to demonstrate a trend.



RPS Group Plc

RPS Group Plc present an explanation of what constant currency measures represent and how they are reconciled to previously reported measures.

Constant currency

The Group generates revenues and profits in various territories and currencies because of its international footprint. Those results are translated on consolidation at the foreign exchange rates prevailing at the time. These exchange rates vary from year to year, so the Group presents some of its results on a constant currency basis. This means that the prior year's results have been retranslated using current year exchange rates. This eliminates the effect of exchange from the year on year comparison of results. The difference between the reported numbers and the constant currency numbers is the "constant currency effect".

£000s	2017	Constant currency effect	2017 at constant currency
Revenue	630,636	(10,697)	619,939
Fee income	562,320	(9,742)	552,578
PBTA	53,941	(1,176)	52,765
Loss before tax	(1,600)	(754)	(2,354)

Long term value creation disclosures

Kingfisher plc

Kingfisher plc set out its capital investment plans to 2020 and explained how these developments will help to create value for its customers and employees.

2. Make our innovation more visible to customers

Our aim is to differentiate ourselves from competitors by leveraging our in-depth knowledge of our customers' lives, homes, improvement projects and style preference. We are focused on applying this knowledge to help customers realise their entire home improvement projects.

To enable this, in 2019/20 we will:

- Accelerate the design and development of our own unique and differentiated product;
- Deliver a series of global and coordinated marketing campaigns;
- Reinforce our everyday low price proposition;
- Launch new digital planning and design tools;
- Upskill our store colleagues;
- Trial innovative new store concepts; and
- Develop new in-store services.

Investing in our people gives them the expertise to fully understand the needs of our customers and their home improvement projects. Our Home Improvement Academy provides relevant product training and project knowledge, through seminars, practical sessions, and situational role plays, both in person and through digital channels, to help our store colleagues become range ambassadors and take information and ideas back to their stores. In the future, we aim to provide similar resources to customers both in-store and through our digital channels.

During the year we will be testing innovative new store concepts. Initially, these will focus on France and the UK.

Next plc

Next plc disclose the level of reserves available for distribution, identify the time limit imposed by application of the 'net assets' test and indicates that there are substantial resources in subsidiaries which can be passed up to return value to shareholders.

C7. Profit and Loss Account and Distributable Reserves

The Profit and Loss account ofthe Parent Company does notinclude any unrealised profits, howeverthe amount available for distribution under the Companies Act 2006 by reference to these accounts is effectively reduced by the ESOT reserve of £271.6m (2018: £231.6m). At January 2019,therefore,the amount available for distribution by reference to these accountsis £505.0m(2018: £516.7m). TheGroup also has substantial retained profitsin itssubsidiary companies which are expected to flow up to the Parent Company in due course,such thatsurplus cash generated can continue to be returned to our external shareholders.

Risks and opportunities disclosures

Marston's PLC

Marston's PLC identify emerging risks and how they will be responding to them over the coming year. The 2018 Code requires Boards to undertake a robust assessment of emerging and principal risks and, amongst other things, to confirm in the annual report that the assessment has been performed and to describe the principal risks.

Changes to the business that impact on risks

- Demand for our ales
- Demand for our drink supply services
- Popularity of our drink brands
- Site activity at depots and breweries
- Cyber and data security threats
- IT network resilience
- Pub menu development
- Brexit uncertainty
- Inflationary pressure
- Consumer nervousness
- Environmental public concern, particularly wastage

Examples of actions to decrease likelihood

- Increased production capacity within our breweries and new product development
- Expansion of our logistics capability (warehouse capacity, fleet performance, systems and teams)
- Expansion of our Health & Safety team
- Expansion of our food supplier auditing and raising the quality standards expected from our suppliers
- Deployment of our employee development programme (PCDR)
- Redevelopment of our data servers
- Upgrading our cyber defence monitoring
- Data protection systems developed and policies adopted and trained our people in preparation for GDPR (General Data Protection Regulation)
- Reduction in pub waste and emissions by developing new systems of control and monitoring

Weir Group PLC

The Weir Group PLC explain why each of their principal risks is important, linking it to their strategy and providing insight into changes during the year.

Market volatility

Changes in key markets, including commodity prices affecting mining and oil and gas, have an adverse impact on customers' expenditure plans. This may include delaying existing expenditure commitments. As markets improve we may fail to effectively upscale operations to meet customer needs.

Impact on strategy	Why we think this is important	How we are mitigating the risk	Changes during 2018
Risk trend	We need to remain sufficiently flexible to allow us to anticipate downturns, to allow us to adjust our operations accordingly, and equally to meet growth in demand when our customers' markets are buoyant and therefore capital investment is high. Otherwise, we are at risk of incurring unnecessary costs during downturns, and not maximising our potential for growth in buoyant markets. In challenging market conditions, our value chain risks are increased. These are described in more detail on page 53.	We maintain regular engagement with our customers to understand their needs and challenges, and ensure our business is appropriately aligned. Improved demand planning and forecasting including Sales and Operations Planning within VCE. Our strategic planning utilises extensive market intelligence to assist in forecasting opportunities and dips in markets. We maintain contingency plans for downturns.	Global macroeconomic concerns around demand and geopolitical concerns around supply have caused oil prices to decline sharply in last quarter of 2018. Other commodity markets are showing continued signs of recovery. We continue to focus on customer relationships, technology development and Value Chain Excellence to manage this risk.

Viability disclosures

McKay Securities Plc

McKay Securities Plc provided detailed rationale for the lookout period used in their viability statement.

Viability statement

In accordance with provision C.2.2 of the 2016 UK Corporate Governance Code (provision 31 of the 2018 Code) the Directors have assessed the viability of the Company beyond the 12 month period required by the going concern provision.

Assessment period

A five year period has been used for this assessment, with particular focus on years one to three. This timeframe is considered appropriate for the following reasons:

- The Company's internal modelling is for a five year period
- It is a reasonable period for matters including the assessment of income generation and the availability of debt funding
- The majority of the Company's contracted income expires within five years
- Clearing bank loans are currently for a five year term
- In the past, property has proved cyclical and a five year time horizon is considered a reasonable timeframe to assess future cycles
- The time taken from acquiring an asset, finalising a strategy, obtaining planning permission through to letting is approximately three to five years

Informa Plc

Informa Plc provided a statement on their prospects that was distinct from the directors' assessment of viability.

Informa's prospects and viability

As part of the Group's strategy of continued and consistent growth and performance, Informa's Directors, at all times, maintain a sharp focus on assessing the Group's long-term prospects and the Company's viability as a business on a three-year basis.

The Directors have specifically assessed Informa's viability over the next three years, which they believe is an appropriate time frame, since it is consistent with our three-year business planning horizon and its associated three-year financial forecast, the nature of Informa's business and the previous time horizons we have reported on.

Assessing Informa's prospects

Informa operates in the market for knowledge and information and has developed strong positions in many customer end markets that offer the potential for long-term growth. It has many of the elements necessary for greater future business success – valuable brands, strong customer relationships and market knowledge, talent and a culture of ideas with commercial focus.

The Group seeks to build on these strong foundations with continued investment in its products and customer platforms, alongside further expansion.

After GAP and through the combination with UBM, Informa is seeking to benefit from having increased reach and the specialist capabilities to capture the long-term growth potential of the expanding market for business-to-business information services.

Informa runs a rigorous annual business planning and strategy process, involving divisional and Group management with Board input and oversight. This produces Group and divisional strategic plans, which in turn generate three-year financial plans that drive the setting of in-year budgets.

This process, and the plans that result from it are a significant contributor to the assessment of the Group's prospects. Informa's current position, Group-level strategy, business model and the risks related to the business model are also used in the assessment, as shown in the table on page 74.

Structured strategic and financial planning process

The Group's prospects are assessed primarily through the annual strategic planning process, which involves the creation of business plans by divisional management that are then reviewed in detail by the Group Chief Executive, Group Finance Director and the Director of Strategy and Business Planning.

To create these plans, each Division assesses external factors, such as peers and their activity, broad and specific risks and market trends, and internal factors, including people, planning and product-focused matters – that influence the business's approach today.

Objectives are set with consideration for what is known about customer trends and demands, and emerging risks and opportunities over that period, plus an analysis of what each Division needs to do to achieve those objectives, whether that is launching new activities, securing additional capabilities or continuing existing programmes.

What results is a set of objectives and initiatives from which each Division will derive a three-year financial plan including detailed financial forecasts and a clear explanation of key assumptions and risks. Plans are updated at key dates and for significant events.

At its annual Board Strategy meeting, the Board reviews and challenges these strategic and financial plans.

The latest set of three-year business plans was reviewed and agreed by the Board in September 2018. The first year of these plans is used to inform the 2019 budget, itself approved by the Board in December 2018.

These detailed financial forecasts are also used as a basis for the annual impairment review, to inform treasury funding requirements and as an assessment of the liquidity available for reinvestment and to return to Shareholders through dividends. Divisional financial plans combine to produce the Group's overall financial forecast, where it is assumed that dividends grow by at least 6% in line with Informa's most recently stated commitment.

Kaz Minerals PLC

Kaz Minerals PLC provided a statement on their prospects that was distinct from the directors' assessment of viability.

In accordance with the UK Corporate Governance Code, the Board has assessed the Group's prospects and longer-term viability and has selected a period of three years, to 31 December 2021, for this assessment. This period is considered appropriate as:

- The Group's results are heavily dependent on the commodity price for copper which can fluctuate significantly and can be impacted by global macroeconomic developments. Copper prices are therefore difficult to forecast for an extended period;
- Exchange rates and inflation rates in Kazakhstan, important drivers of the Group's operating costs, are difficult to forecast beyond three years;
- The Group's existing debt facilities are amortising during the viability period, with scheduled repayments of $1.5 billion; and
- The Group is currently assessing the capital development, partnering and financing options for the construction of Baimskaya, the outcome of which will significantly impact the Group's capital expenditure and financing.

This viability statement should be read in conjunction with the going concern disclosure as set out on page 126.

Assessment of prospects

In assessing the Group's prospects, the Board has considered the current position of the Group including gross liquid funds of $1,467 million at 31 December 2018, the cost competitiveness of its operations, the performance to date of Bozshakol and Aktogay, future capital requirements including the Aktogay expansion, the acquisition and feasibility study of the Baimskaya project. The future development of the Baimskaya project is conditional upon the raising of separate new financing facilities.

The Group's operations are located in the CIS and its sales are made to customers outside of the UK and EU, therefore Brexit is not expected to have a material impact on the Group's viability.

The Board has considered all the principal risks set out on pages 69 to 73 but has focused on those principal risks which alone or in conjunction could have a material impact on production, profitability, cash flows and liquidity over the assessment period:

Commodity prices: the Group's financial outlook is sensitive to commodity prices. A sustained low commodity price environment below market consensus would negatively impact the Group's profitability and cash flow.

Commissioning and new projects and business interruption: the Group's operations and growth projects may fail to ramp up or maintain operating parameters as planned.

Foreign exchange and inflation risk: a significant appreciation of the KZT/$ exchange rate from its current level or increased inflation in Kazakhstan could have a material impact on operating costs.

Liquidity risk: for borrowing facilities to remain committed, the Group is required to comply with various obligations, including compliance with financial covenants. A faster than expected increase in US interest rates would impact the Group's financial outlook. The Group will also need to enter into new financing arrangements to develop the Baimskaya copper project, as planned.

The Board has a reasonable expectation that there would not be an unforeseen event, outside of the Group's control, during the viability assessment period which would significantly restrict production or export of material from the Group's operations for a sustained period. Such events could include a natural phenomenon, a significant political or legislative change or regulatory challenge or significant civil disorder.

Process to assess the Group's prospects

The Board has performed its viability assessment based on the Group's Treasury forecast, which it reviews regularly. The forecast is prepared with input from the annual budgeting process, individual project plans and life of mine (LOM) plans, which reflect the expected production profile and cost of operations over their economic lives.

The Board has considered the key assumptions made in the viability statement and is satisfied that they are appropriate. These include assumptions based on externally sourced views on commodity pricing, exchange rate and inflation and interest rates, as well as an internal assessment of future production levels and project commissioning dates. Commodity price assumptions have been set with reference to market consensus estimates.

To reflect the principal risks which could have a material impact on the Group's viability over the three-year period, the base case model has been subjected to stress testing and sensitivity analysis. This considered severe scenarios, but not those the Board considered to be implausible, and included:

- A sustained low commodity price environment below market consensus throughout the viability period;
- A sustained low commodity price environment with lower than expected production from the Bozshakol and Aktogay operations, including a delay to the expected commissioning of the Aktogay expansion; and
- A sustained low commodity price environment and lower than expected production combined with an increase in Group operating costs due to adverse exchange rates and higher cost inflation.

In addition, reverse stress testing was performed, in particular in respect of the sensitivity of the forecasts to downward movements in the copper price. This indicated that no reasonably possible negative movement in the copper price would lead to non-compliance with financial covenants.

The Board has considered the Group's current existing debt facilities, which are fully drawn, the significant level of debt amortisation during the viability period of $1.5 billion, and the likely changes to debt and financing facilities required to deliver the Group's strategy, in particular the Aktogay expansion and study of Baimskaya. A new Aktogay financing facility, in the region of $600 million, is expected to be completed in the first half of 2019 and has been included in the Board's assessment of various scenarios below.

Board and director stewardship disclosures

Lloyds Banking Group Plc

Lloyds Banking Group Plc provided a clear statement of appliance of the Code's Main Principles.

National Grid plc

In National Grid plc's Annual Report and Accounts 2018-19 the Chair explains in his letter the work the board has done introducing the 2018 UK Corporate Governance Code and specific detail around how they are addressing workforce engagement.

Introduction and the new UK Corporate Governance Code 2018

This year has seen significant changes to the Corporate Governance landscape, which have remained high on the Board's agenda this year, reiterating the importance with which we treat Corporate Governance.

Following the introduction of the new UK Corporate Governance Code 2018 (the new Code), the Board took the opportunity to review stakeholder engagement (especially workforce engagement), succession planning, diversity and the role of the Remuneration Committee in more depth over the year. From the work we have completed in previous years, I am pleased to say that we are well placed to meet the new requirements. As you will see throughout this report, we are now doing more to ensure that the views of our stakeholders are being captured in the boardroom, and maintaining focus on creating the right culture for the Company. In next year's report, we will report in detail on our compliance against the new Code.

Other external influences on the Board agenda included the ongoing UK regulatory and political uncertainty and the legal separation of the Electricity System Operator, all of which will have a significant impact on the way we work and operate. The Board has also taken time to discuss topics such as our strategy, innovation, cyber security, RIIO-T2 and the Hinkley-Seabank Connection Project.

Stakeholder engagement and the Board's duty

The role and effectiveness of the Board are essential in a successfully run company. During the year, we discussed the Board's duty under section 172 of the Companies Act 2006, with a significant focus on reviewing and mapping out our key stakeholder groups and discussing the Board's current level of engagement and incorporation of its views into decision-making. Our discussions around RIIO-T2, the Massachusetts gas labour dispute and workforce contingency plan, the Hinkley-Seabank Connection Project and our Business Plan are examples of how the Board has had regard to its duty under section 172, including ensuring we had regard for the interests of key stakeholders and the likely consequences of any decisions in the long term. You can read more about who our key stakeholders are and how they have influenced key decision-making on pages 54 – 55.

Workforce engagement

In November 2018, the Board considered the provisions of the new Code and, in particular, reviewed the three FRC recommended methods of workforce engagement. Following a detailed review of the existing mechanisms for engagement by the Board, Executive Committee and senior management, the Board thought it was important that it builds on the extensive existing range of engagement activities that are already in place and continues to consider workforce views in relevant decision-making processes. The Board determined that the workforce was not limited to Company employees, but also included contractors and agency workers, in all locations. Current engagement mechanisms include reviewing and implementing actions from the employee survey results, site visits by myself and Non-executive Directors and separate Non-executive Director sessions with a cross section of the workforce. These mechanisms will be enhanced to include additional engagement sessions with the Non-executive Directors and our approach to leadership dinners will evolve to drive greater, more diverse, workforce representation and broader communications by inviting a representative from each employee resource group to a separate dinner. Focus will be on the Board's interactions with all employees, hearing their views on the outcome of the employee engagement survey and other topical issues, such as gender pay. We will continue to review and adapt our approach during the year.

External Board evaluation

This year, we appointed Dr Sabine Dembkowski of Better Boards Limited to undertake an independent, formal and rigorous evaluation of our Board and committees. During the evaluation process, Sabine provided the Board with insights about the different aspects of effective boards and how they can work together more effectively as a team. Each Board member received an individual evaluation and the Board had a combined action plan. The process and outcome can be found on page 56.

Culture

As Chairman, promoting a culture of openness and debate in the boardroom is one of my key responsibilities, and as a Board we play an important leadership role in promoting the desired culture throughout

Cobham plc

Cobham plc provided clear disclosure on how governance has contributed to the company's strategy and examples of tools and techniques the board uses to monitor culture.

How governance has supported our turnaround strategy

Strategy	The Board's actions	What we achieved in 2018
Returning the business to financial strength → Read more on page 7	– The Board challenged management proposals as part of its strategic review to focus on areas where the Group has strength in capability and customer base. – The Board has agreed a target for Net Debt: EBITDA of less than 1.5 times. – The Board has been debating its policy on capital allocation and agreed a target capital structure, including a future dividend policy. – The Audit Committee has monitored the utilisation of provisions and charges throughout 2018.	– The completion of the AvComm and Wireless test and measurement businesses divestment for US$455m in March 2018 has helped strengthen the balance sheet. – The Group is in a net cash position at 31 December 2018, down from a gearing ratio of 1.2x at 31 December 2017. This is significant progress, as Cobham had a gearing ratio of 3.0x 24 months ago. – The Board has approved a target capital structure and capital allocation policy. – The remaining unutilised balances relating to the 2016 exceptional charges total £206m at the year end which will continue to unwind as cash outflows.
Focusing the portfolio on markets we know → Read more on page 7	– The Board and management have worked together to identify and divest businesses which are not considered to be part of the Group's 'core business'. These divestments were approved by the Board, enabling management to concentrate on the retained businesses in the Group. – The restructuring of the business units enables better customer focus and a more clearly defined business identity, more closely aligned to end markets. In some parts of the business, a layer of management has been removed, which has simplified the structure and will deliver cost savings.	– The divestment of AvComm and Wireless test and measurement businesses supports the focus of the Group on its defence, aerospace and space markets. As mentioned above, this was completed in March 2018. – In May 2018, we divested the 'Opera' electromagnetic simulation software business for £7.8m, and a smaller Lightning Test and Consultancy business was divested in November 2018 for £1.9m. Both of these businesses were part of the Communications and Connectivity Sector. – We have restructured the Aviation Services Sector into two regional businesses (UK & EMEA and Australia). – The Communications and Connectivity Sector and the Advanced Electronic Solutions Sector management have also undertaken a re-structuring exercise, to reduce costs and refocus on market-facing businesses.
Resolving legacy issues → Read more on page 7	– Resolving legacy issues enables the Board to be more forward looking and to concentrate on the more strategic issues affecting the Group.	– We have continued to progress delivery on the contracts against which we took significant charges in 2016. – On the largest of these, the KC-46 tanker programme, we announced on 19 February 2019, a settlement regarding Boeing's damage assertions, bringing an immediate end to the Boeing withhold on Cobham invoices. – The Financial Conduct Authority's investigation in relation to the Company's compliance with the Listing Rules, Disclosure and Transparency Rules and the Market Abuse Regulations between April 2016 and February 2017 has been discontinued. – The Group is actively involved in attempting to resolve the tax treatment of interest deductions on one of the Group's financing arrangements; refer to note 30 for further details.
Improving operational execution and effecting cultural change → Read more on page 9	– Improvement of performance and delivery to customers leading to more business being awarded and thus enhancing order intake, and ultimately assisting in margin improvement. This can be demonstrated by KPIs 1, 2 and 5 on pages 18 and 19. – Improved employee working conditions and culture support achievement of strategic objectives and help resolve some legacy cultural issues. – Launched new purpose statement and values to support cultural change.	– We are continuing to invest in the infrastructure at a number of sites – including Wimborne, UK and San Diego in the US – to address some long-standing operational issues. – We are focusing on improving our operational performance to reduce the significant costs related to late delivery to customers and the re-work of product that has failed post-production quality tests. – The senior management team was brought together in various forums to ensure that a more customer focused, performance based culture with common values is adopted. – We are in the process of implementing a global Human Resources information system which will give the transparency to allocate resources more effectively, manage skill groups, assist in succession planning and develop talent across the Group.

Culture

Key Activities and discussions

- Undertook third culture assessment using Heidrick and Struggles Organisation Assessment Questionnaire.
- Started an exercise to identify and launch new purpose and values.
- Revised talent and senior management development programmes.

Key Priorities for 2019

- Support the cultural realignment, primarily focusing on bedding in the new purpose and values across the businesses.
- Develop KPIs to monitor cultural change

Succession and diversity disclosures

Rightmove plc

Rightmove plc provide an example of disclosure on engaging with the issue of a long-serving chair and how the business plans to respond.

The 2018 UK Corporate Governance Code (effective from 1 January 2019) has introduced a provision that the Chairman should not remain in post for more than nine years from the date of first appointment to the Board. It also states that to facilitate effective succession planning, the period may be extended for a limited time. As Scott Forbes has served as Chairman of the Board since 2005, the Board recognises that it will not be compliant with this provision during 2019. The Nomination Committee is planning for an orderly Board succession plan, following active consultation with shareholders representing a majority of the Company's shares in the second half of 2018. The Board believes that a consensus view has been established in favour of an orderly succession plan for the Board Chairman, including the recruitment and orientation of capable and experienced succession candidates. The Company remains committed to good governance, but recognises the need for any transition to be smooth to preserve Group knowledge, culture and shareholder confidence.

Pearson plc

Pearson plc provided disclosures on diversity, including objectives, targets and measurement of performance.

Diversity

The Board embraces the Code's underlying principles with regard to Board balance and diversity, including in respect of ethnicity, gender and age. The objectives set out in the Board's diversity and inclusion (D&I) policy and our progress towards these objectives are shown in the table below. The Committee ensures that the Directors of Pearson demonstrate a broad balance of skills, background and experience, to support Pearson's strategic development and reflect the global nature of our business. The Committee also ensures that appointments are made on merit and relevant experience, while taking into account the broadest definition of diversity. In the ongoing Non-Executive Director search process, emphasis is given to candidates who would enhance the overall diversity of the Board.

The gender diversity of the Board was 30% female representation as at 31 December 2018. However, as noted in the Board diversity and inclusion policy, we are committed to work towards the recommendations suggested by the Hampton-Alexander Review aimed at having at least 33% female representation on the Board by 2020.

During the year, the Board received an overview of the training on unconscious bias which is being delivered to employees and participated in elements of this programme. The Board received a detailed progress update in December on the Company's refreshed diversity and inclusion strategic approach, framework, governance and measurement models and 2019 priority areas. The Board also received an update on a new internal mentoring scheme, and agreed to join the programme whereby each Director is paired with a high-potential Senior Vice President female leader at Pearson. This launched at the end of 2018 and runs through 2019.

Board diversity & inclusion objectives

The Committee has agreed the following objectives to support the Board diversity & inclusion policy:

Objectives	Progress
We will strive to maintain a Board composition of: › At least 25% female Directors, with a target of at least 33% female Directors by 2020 › At least one Director of colour.	› 25% female Directors achieved. › Board includes one Director who identifies as Mixed – White & Black Caribbean.
All Board appointments will be made on merit, in the context of the skills and relevant experience that are needed for the Board to oversee Pearson's strategic development and that reflect the global nature of our business.	Achieved. Rigorous process used during recent search for Michael Lynton who has relevant experience and skills.
The Board will prioritise use of search firms which adhere to the Voluntary Code of Conduct for Executive Search Firms when seeking to make Board-level appointments.	Achieved.
The Board will continue to adopt best practice, as appropriate, in response to the Davies Review, the Hampton Alexander Review and the Parker Review.	The recommendations of the Davies Review, Hampton Alexander Review and Parker Review in respect of gender and ethnic diversity have been noted by the Board.
Where appropriate, we will assist with the development and support of initiatives that promote all forms of diversity and inclusion in the Board, Pearson Executive and our senior management.	Board mentoring scheme of senior leadership talent launched.

Diversity and talent in Executive pipeline

Our Code of Conduct sets out our global standards and responsibilities with regard to D&I at all employee levels, including the Pearson Executive, and covers many aspects, including gender, age, ethnicity, disability and sexual orientation. This is underpinned by a global statement on D&I along with country and business specific policies. A new Global Diversity and Inclusion Council is launching in early 2019 and will be chaired by Chief Executive, John Fallon. For more information on the Company's approach to diversity and inclusion, please see p38 in the Sustainability section.

We are a founder member of the 30% Club and the Chief Executive has also signed a personal commitment to set an aspirational target of at least 30% women in Pearson's senior management team by 2020. On our Executive team, there are currently two women out of ten members (20%) – this excludes the Chief Executive and Chief Financial Officer who are counted in the Board's metric. The senior leadership group, comprising the direct reports of the Pearson Executive, had 31% female representation as of 31 December 2018.

We believe that we have a multi-pronged plan in place to build our pipeline of women in leadership and senior management positions, and the Board and Committee will carefully monitor their development, and the development of all key talent. Pearson published its first gender pay gap report in Great Britain in March 2018 and has made a commitment to extend our gender pay reporting globally by 2020. Read more about our initiatives to address the gender pay gap on p38.

Kingfisher plc

Kingfisher plc included a case study regarding recruitment of a new non-executive director, including use of a recruitment agency, diversity in background in the long list of candidates, some information on appointment, expected individual contribution and the induction process.

Case study:

Selection, appointment and induction process of Sophie Gasperment, Non-Executive Director

Sophie Gasperment
Non-Executive Director

Appointed to the Board effective 1 December 2018.

Expertise and experience
Sophie brings to the Board expertise in strategy, brand and international retail markets as well as substantial experience in business transformation and digital capabilities, having held a number of senior leadership positions at L'Oréal, including executive chairman of The Body Shop International and managing director of L'Oréal UK & Ireland.

Sophie is a non-executive director of AccorHotels, where she chairs the appointments, compensation and CSR committee. She is also a non-executive director of the D'Ieteren group, and the lead independent director on the board of Cimpress, a NASDAQ-listed technology company. Sophie was appointed French Foreign Trade Advisor in 2005.

Selection and appointment
The Committee recommended Sophie's appointment to the Board following a full and comprehensive search, undertaken in conjunction with Egon Zehnder.

In line with the selection and appointment process, the Chairman and Group Company Secretary developed a comprehensive role brief for the Non-Executive position and compiled an initial longlist of candidates in conjunction with Egon Zehnder, including candidates from a broad range of backgrounds, from which the shortlist was prepared for Committee review.

During the interview and due diligence process, it became clear that Sophie's wide range of skills and experience of the international retail markets would be of great benefit to the Board as we support the company to deliver the ONE Kingfisher transformation.

Induction
A comprehensive and ongoing induction plan was developed for Sophie, which included one-to-one meetings with key senior management from within the business, including her fellow members of the Board and the Group Company Secretary. In addition, Sophie has been visiting stores and key head office locations across the business to gain a full understanding of the company's operations and challenges.

The induction programme also includes access to a Directors' briefing pack encompassing a wide range of key company information.

Accountability and internal control disclosures

Evraz plc

Evraz plc provided disclosure on significant financial reporting issues that included cross-referencing and detail on the global context. It highlighted one of the assumptions it has focused on in reaching its conclusions.

Areas of significant accounting judgement and management estimates

Impairment of goodwill and non-current assets
(Notes 5 and 6)

The Committee considered management's impairment assessment in the context of the current and future trading environment for the Group, including assumptions as to the continuation of tariffs and duties in North America and their impact on the recoverable amount of the affected assets. Testing was undertaken as at 30 September 2018 and reassessed at 31 December 2018 when no further impairment triggers were identified. The continued weakness of the rouble means that the carrying values of Russian cash-generating units remain low in US dollar terms and are largely not challenged by the value in use comparisons used to determine impairment, even if the pricing outlook were to deteriorate.

An impairment charge of US$30 million is recorded in the financial statements for 2018. This primarily relates to EVRAZ Stratcor Inc, where the full asset value of US$12 million has been impaired in anticipation that the entity will enter bankruptcy proceedings. There was a further impairment charge of US$6 million at Yuzhkuzbassugol to reflect an increase in site restoration provisions at one of the mothballed mines.

The Committee gave particular attention to the implications of trade barriers for the businesses in North America and management's assumption that these will end in 2023. Given the inherent uncertainty around these measures at the current time, the Committee accepted management's assumption on this occasion but will review it for the interim statements.

BT Group plc

BT Group plc included disclosure in the audit committee report on the performance evaluation of the audit committee.

Committee evaluation 2018/19

We carried out an internal evaluation of the committee led by the chairman and the company secretary. This entailed questionnaires completed by members, attendees and KPMG (our external auditors); the output of which was discussed and debated by the committee.

Key areas of focus	Suggested actions
Risk management	• Further review of the quality, reliability and resilience of key controls, especially financial and IT controls, and to verify our risks • Refresh and maintain knowledge levels; increase 'deep dive' reviews across our key risks and financial controls.
Meetings	• Further time for debate and challenge at meetings.
Composition	• Continue to keep the committee composition under review.

Barclays PLC

Barclays PLC included a case study about its consideration of the effectiveness of its internal and external auditors.

Governance in action – Audit quality

Although BIA, as the Barclays Group's internal auditor, and KPMG, as the Barclays Group's external auditor, have primary responsibility for the quality of their respective audits, the Committee plays an important role in promoting and supporting audit quality through its various responsibilities (as detailed in its terms of reference).

The Committee gains insight into the activities of BIA, and its effectiveness, in three ways. Firstly, BIA maintains a quality assurance and improvement programme that covers all aspects of BIA's activity across the Barclays Group and which is overseen by the Committee. In the event that any issues are identified in relation to BIA's work for Barclays Bank UK PLC and/or Barclays Bank PLC, such issues will be reported to the relevant audit committee. Secondly, the independent Internal Audit Quality Assurance team samples all of BIA's work on an annual basis and presents its findings to the Committee. Thirdly, the Committee commissions an external assessment of BIA at least once every five years with the last such review being undertaken during the second half of 2017. To the extent that the Committee is made aware of any development areas or issues, it endeavours to monitor the delivery of any remedial actions.

The Committee oversees the Group's relationship with its external auditor and is responsible for reviewing the performance, independence and objectivity of the external auditor in order to decide whether to recommend to the Barclays PLC Board a proposal for shareholders to reappoint the current external auditor. As part of that review, which is organised at a Barclays Group level, the views of the Barclays Bank UK PLC and Barclays Bank PLC audit committees are sought. In addition, this year, the Committee met with the nominated senior partner on the audit team who has responsibility for ensuring audit quality – without the Senior Statutory Auditor – in order to receive a report on his assessment of audit quality. KPMG provided the Committee with a report regarding the draft findings from the Public Company Accounting Oversight Board's review of KPMG's 2017 audit of Barclays, and the findings of the FRC's Audit Quality Review (AQR) team review of KPMG's 2017 audit of Barclays were also shared with the Committee. The AQR team monitors the quality of the audit work of statutory auditors and audit firms in the UK that audit certain entities, including banks such as Barclays. They conduct reviews of individual audits, and focus on the appropriateness of key audit judgements made in reaching the audit opinion and the sufficiency and appropriateness of the audit evidence obtained; reviews of firm-wide procedures are wide-ranging in nature and include an assessment of how the culture within firms impacts on audit quality.

The Committee believes that high quality audit is the primary mechanism for providing stakeholders with assurance that the financial statements give a true and fair view of their Company and, therefore, promotes market confidence in the Company's financial reports. For these reasons, the Committee continues to be an advocate of high-quality audit and keeps abreast of the debate as to whether audits, and auditors, are fit for purpose by regularly reviewing industry guidance from, for example, the FRC and the International Organization of Securities Commissions. The Committee provided information in response to the request from the Competition & Markets Authority for its review into competition in the UK audit market – which will examine three main areas: choice, resilience and incentives – and we look forward to reviewing the conclusions of that study.

Judgements and estimates, tax and pensions disclosures

The Weir Group PLC

The Weir Group PLC provided a statement on their policy with regards to 'tax transparency'.

Tax Transparency

Our approach to tax is governed by five key principles which are set and adopted by the Board and are stated as follows;

1. We are committed to compliance with all applicable tax laws and regulations, including timely submission of tax returns and tax payments;

2. We aim to develop and maintain effective, collaborative and co-operative working relationships with tax authorities in all territories where we operate based on both openness, honesty and transparency, and by providing all relevant information in a timely manner with a view to resolving any disputes early;

3. Our businesses make use of legitimate tax incentives, exemptions and statutory alternatives offered by governments. Tax planning is undertaken only where it is consistent with the substance of our business and with full regard to the aims of our stakeholders, our reputation and our broader commercial and economic goals;

4. We adhere to the standards for the disclosure of tax information in our published financial statements, in accordance with industry and generally accepted practice; and

5. We ensure compliance with our tax obligations by maintaining appropriate tax management arrangements including the roles and responsibilities taken on by our people.

These five principles are reflected and more information about our approach to tax are set out in our tax strategy which can be found on our website: https://www.global.weir/investors/corporate-governance/matters-reserved-to-the-board/.

Barclays plc

Barclays plc provided a clear statement explaining why they recognised a defined benefit surplus as an asset.

> Where a scheme's assets exceed its obligation, an asset is recognised to the extent that it does not exceed the present value of future contribution holidays or refunds of contributions (the asset ceiling). In the case of the UKRF the asset ceiling is not applied as, in certain specified circumstances such as wind-up, the Barclays Group expects to be able to recover any surplus. The Trustee does not have a substantive right to augment benefits, nor do they have the right to wind up the plan except in the dissolution of the Barclays Group or termination of contributions by the Barclays Group. The application of the asset ceiling to other plans is considered on an individual plan basis.

Other financial statements' disclosures

Stock Spirits Group PLC

Stock Spirits Group PLC provided an example of disclosing IFRS 9 impairment losses on the face of their income statement, in accordance with IAS 1.

	Notes	9 months to 30 September 2018 €000
Revenue	5	193,766
Cost of goods sold		(100,374)
Gross profit		93,392
Selling expenses		(42,541)
Other operating expenses		(21,968)
Impairment loss on trade and other receivables		(501)
Share of loss of equity-accounted investees, net of tax	22	(166)

Evraz PLC

Evraz PLC provided IAS 36 sensitivity disclosures, setting out the changes to key assumptions that would give rise to impairments.

Sensitivity Analysis

For the cash-generating units, which were not impaired in the reporting period and for which the reasonably possible changes could lead to impairment, the recoverable amounts would become equal to their carrying amounts if the assumptions used to measure the recoverable amounts changed by the following percentages:

	Discount rates	Sales prices	Sales volumes	Cost control measures	Terminal growth rate
EVRAZ Nikom	5.9%	(4.9)%	(6.0)%	1.3%	-
EVRAZ Inc NA – Large-diameter pipes	0.2%	(0.7)%	(1.6)%	0.2%	(0.6)%
EVRAZ Inc NA – Long products	8.7%	-	-	8.6%	-
EVRAZ Inc NA – Flat-rolled products	9.0%	-	-	4.9%	-

Appendix 4 – Regulatory overview

The big picture

The demands placed on companies in relation to their corporate reporting by regulators and investors continue to evolve, with significant changes coming into force across narrative, governance and financial reporting in December 2019 annual reports.

To assist companies in addressing changing demands, the FRC continues to issue helpful guidance as part of its long-standing 'Clear & Concise Reporting' initiative, as well as through the work of its Financial Reporting Lab ('the Lab').

Since we published our last annual report insights survey, the Lab has issued:

- Business model reporting; Risk and viability reporting – Where are we now? (October 2018) which explores how reporting has progressed since the Lab's earlier reports on the topics.
- Performance metrics – Principles and practice (November 2018) which provides guidance to companies and examples of how companies can apply the principles identified in the Lab's previous report on performance metrics.
- Artificial intelligence and corporate reporting – how does it measure up (January 2019), the third in the Lab's series of technology deep-dives, explores some of the potential use-cases that artificial intelligence has for corporate reporting.
- Disclosures on the sources and uses of cash (September 2018) considering how companies can answer investors' questions about how a company generates cash and how it intends to use that cash.

The following parts of our regulatory overview examine requirements and hot topics in respect of narrative reporting, corporate governance and financial reporting.

Narrative reporting

Over this past year there were no new disclosure requirements effective which impacted the strategic report. Instead, the past reporting season enabled companies to 'bed down' the UK implementation of the EU Directive on disclosure of non-financial and diversity information (NFR Directive)[1], now in its second year of implementation. The NFR Directive requires companies within scope to include a non-financial information statement in their strategic report. 87 companies in our survey were within scope by virtue of size. Our results indicate that while there has been improvement overall, many companies continue to find the new requirements a challenge (see section 6).

A significant development, which will take effect for periods beginning on or after 1 January 2019, is the publication of new reporting requirements stemming from the government's agenda for corporate governance reform. The new requirements aim to strengthen the link between section 172 of the Companies Act 2006 (s172), described below, and the strategic report to help the report provide greater insight into whether boardroom decisions have taken wider stakeholder interests into account[2]. The FRC has updated its Guidance on the Strategic Report to reflect these developments[3].

Existing requirements

The strategic report

Other than for small companies, which are exempt, the main component of the narrative section of an annual report is the strategic report, as required by section 414A of the Companies Act 2006. Companies are also required by section 415 of the Act to include a directors' report. Since the introduction of the strategic report this mainly contains basic compliance disclosures although recent corporate governance reform has seen some additional requirements added.

The Disclosure Guidelines and Transparency Rules (DTR) of the Financial Conduct Authority also require most listed companies to prepare an annual 'management report' to accompany their financial statements. However, with one small exception, these requirements duplicate existing requirements within the law concerning the content of the directors' report and strategic report.

The purpose of the strategic report is to provide information for shareholders and help them to assess how the directors have performed their duty, under s172, to promote the success of the company and, in so doing so, had regard to the matters set out in that section[4]. These matters include a number of non financial considerations:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

The content requirements for the strategic report differ depending on whether a company is a quoted company or a public interest entity (PIE), as defined below. This is due to the way that the NFR Directive was implemented into UK law as it resulted in two similar, but different, sets of requirements operating in parallel for quoted companies within scope, which leads to some complexity. The FRC, in its updated Strategic Report Guidance, has tried to help companies by producing one set of guidance for those entities which are PIEs (section 7B) and one set for those which are not (section 7A).

For all quoted companies, the strategic report is required to include[5]:

- a fair review of the company's business, including elements such as a description of the company's business model, its strategy and information about corporate social responsibility (see sections 5, 6 and 8 for more details);
- to the extent necessary for an understanding of the development, performance or position of the company, analysis using financial and, where appropriate, non-financial KPIs (see section 7 for more details); and
- a description of the principal risks and uncertainties facing the company. The UK Corporate Governance Code and associated guidance also contains requirements in this area (see section 9 for more details).

Also, many companies choose to present the longer term viability statement and going concern disclosures required by the 2016 Code as part of their strategic report (see section 10 for more details).

Non-financial information statement

For periods commencing on or after 1 January 2017, those entities that are PIEs need to include a separate non-financial information statement (NFI statement) in their strategic report[6]. A PIE is defined as:

a. a traded company (which means a company any of whose transferable securities (debt or equity) are admitted to trading on a regulated market in the EEA); a banking company; an authorised insurance company; or a company carrying on insurance market activity; and

b. parents of a group with more than 500 employees.

The content of the NFI statement is similar but not identical to the strategic report requirements above so companies will need to be careful that they include all the relevant elements that apply to them. For large quoted companies, the NFI statement builds on the existing requirements of the strategic report by introducing specific requirements to disclose information on anti-corruption and bribery matters (including related policies), to discuss due diligence over non-financial policies and to explain the impact of and risks relating to various non-financial reporting matters.

Disclosure does not need to be duplicated – there are exemptions from some of the existing strategic report requirements for companies which are required to include a NFI statement. However, the FRC's Guidance makes clear that a separate NFI statement will need to be made in the strategic report, but cross references can be made from that statement to the relevant content that is included elsewhere in the strategic report.

Our findings on how companies have addressed the requirements this year are discussed in section 6 (on stakeholders).

In June 2019, the European Commission published its Guidelines on non-financial reporting: Supplement on reporting climate-related information[7], which integrates the TCFD recommendations into the existing guidelines around fulfilling the disclosures in the NFI statement. These guidelines concluded that, given the systemic and pervasive impacts of climate change, most companies under the scope of the NFR Directive are likely to conclude that climate is a material issue and as such should be disclosing relevant information for investors.

The FRC's revised Guidance includes a lot of information for companies on how to present the content requirements of the strategic report most effectively. The updated version of the Guidance, which has been enhanced to recognise the increasing importance of non-financial reporting, reflects the requirements of the NFR Directive and enhances the link between the purpose of the strategic report and the matters directors should have regard to under s172.

The <IR> Framework also gives guidance on reporting requirements that will be helpful to UK companies. However, the <IR> Framework goes further than this, introducing the concept of 'Integrated Thinking' – challenging and enabling companies to 'live their story' rather than merely tell it. Integrated reporting (<IR>) is discussed in more detail throughout this report – look out for the <IR> boxes.

Alternative Performance Measures
The European Securities and Markets Authority's (ESMA's) Guidelines on Alternative Performance Measures (APMs)[8] apply to a variety of documents but, in particular, include within their scope the narrative sections of annual reports (but not the financial statements themselves) published by listed companies. Although they are described as 'Guidelines', ESMA has stated that they expect compliance with them to be enforced by national regulators.

In a UK context, the FRC has issued a number of publications explaining that they are assessing how companies are meeting the requirements of the ESMA Guidelines as part of the activities of their Conduct Committee, i.e. reviews of company annual reports. These include their annual review of corporate reporting[9] and their findings from their second thematic review[10] of the use of APMs. The FRC's Lab has published two reports on performance metrics, the first being an investor perspective on the principles of reporting performance metrics[11] and the second providing guidance to companies and examples of how companies can apply those principles[12].

Deloitte has produced a practical guide to the ESMA Guidelines[13] to assist preparers in complying with the requirements. Similarly, ESMA itself has issued a set of Q&As in relation to its Guidelines[14].

The Guidelines set out a framework for the presentation of APMs, also known as non-GAAP measures, aimed at promoting their usefulness and transparency. In particular, they require that:

- APMs should be defined and the basis of calculation set out;
- APMs should be reconciled to the most directly reconcilable line item, subtotal or total presented in the financial statements;
- APMs should not be displayed with more prominence, emphasis or authority than the most directly comparable measure defined by the entity's financial reporting framework;
- APMs should be accompanied by comparatives for the corresponding previous period; and
- APMs should be consistent over time, with changes in or the cessation of use of an APM explained.

Our findings on the presentation of APMs are discussed in section 7.

Statements outside the annual report
There are various reporting requirements for companies, aimed to increase transparency, which require publication on a website rather than as part of a company's annual report. These include:

- a slavery and human trafficking statement, as required by the Modern Slavery Act 2015[15]. (see section 6);
- disclosure of tax strategy[16];
- gender pay gap information, which is different to and more detailed than the existing requirements around gender reporting[17] in the annual report; and
- disclosure of payment practices and performance[18].

Publication of all the above is required to be on a website rather than as part of a company's annual report. However, where issues in these areas are material to the business, companies will need to consider whether disclosure should also be provided to meet the above requirements of the strategic report. We looked at the extent to which companies are deciding to include some of this information in their annual report (see sections 6 and 8).

New requirements for December 2019 year-ends

The government has published new reporting requirements for private and public companies in response to its consultation on corporate governance reform. The Companies (Miscellaneous reporting) Regulations 2018[19] introduce the following new reporting requirements for periods beginning on or after 1 January 2019:

- All large companies (private as well as public) must include a section 172(1) statement in their strategic report which describes how their directors have complied with their duty to promote the success of the company for the benefit of its members whilst having regard to the matters set out in section 172(1) (a) (f) (see above)

We looked for an indication that the s172 matters were considered by those companies in our survey. Most companies clearly considered employees, customers and the environment. See section 6.

- The directors' report of all large companies (private as well as public) must include more information on how 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 on the principal decisions taken by the company during the financial year. Requirements are also added in respect of how directors have engaged with employees, had regard to employee interests, and the effect of that regard on the principal decisions taken by the company during the financial year.

Section 6 of our survey discusses the trends we are seeing with respect to engagement with stakeholders.

- All companies of a "significant size" must disclose their corporate governance arrangements in their directors' report and on their website, including whether they follow any formal code (excluding companies such as listed companies which are already required to report on their corporate governance arrangements – see below).
- All quoted companies must also comply with new reporting requirements that have been introduced in respect of CEO pay ratios and long-term incentive outcomes.

Further details can be found in our Need to Know[20]. The FRC's updated Guidance on the Strategic Report includes guidance on how companies might approach the section 172(1) statement.

Areas of regulatory focus

Narrative reporting is under increasing scrutiny - the strategic report is the second most commonly raised issue in the FRC's corporate reporting reviews. The FRC is aware of concerns regarding a lack of trust in big business and that expectations of corporate reporting are rising, particularly in respect of:

1) recognising the importance for the long-term success of the company of engagement with employees, customers, suppliers and other stakeholders. The FRC is encouraging companies to be more transparent about how they are engaging various stakeholders and distributing the value they create amongst different groups of those stakeholders, such as in the form of dividends, pay and benefits, capital investments and tax; and

2) the need to communicate how a company generates and preserves value.

The FRC's updated Guidance on the Strategic Report has been enhanced to recognise the increasing importance of non-financial reporting and encourages companies to consider wider stakeholders and broader matters that impact performance over the longer term. Future changes to reporting requirements in this area are also described below.

The following areas of regulatory focus have been identified in relation to narrative reporting.

- The business review included within the strategic report should be **fair, balanced and comprehensive**. This includes balancing analyses that use non-GAAP measures with analyses that use unadjusted metrics and ensuring discussions of performance and position are suitably comprehensive and not omitting 'bad news'. Companies should also ensure that they provide a fair and balanced assessment of performance and prospects that covers both positive and negative aspects.

- Presentation of **alternative performance measures** is still a significant focus area given the requirements introduced by the ESMA Guidelines. In addition, the identification of items excluded from APMs (often described as 'exceptional items') is also likely to be an area of continued focus – see the financial statements section of this appendix for more detail.

- The **linkage and consistency** of the information included in the 'front half' and 'back half' of the annual report. Companies should ensure that there is cohesion between the information reported and effective linkage throughout the annual report. For example, consistency would be expected between the items identified as part of capital when discussing capital management in the front and back halves of the report. Similarly, the description of reconciling items in a company's tax note should be consistent with discussions in the strategic report. The FRC has also highlighted[21] that they want companies to pay attention to ensuring the links between the financial statements and discussions of strategy, performance including KPIs, financial position and cash flows are clear.

- Ensuring that information provided is **company-specific and material** to an understanding of the business, its performance and prospects.

- Identification of **principal risks and uncertainties**. Companies should ensure that the risks and uncertainties disclosed are genuinely *principal* and make sure they discuss how risks are identified, managed or mitigated. Linkage between risks and strategic objectives and KPIs has been specifically highlighted as needing to be clearly disclosed. There is a particular focus on those systemic risks such as climate risk, Brexit and cyber risk.

- The FRC expects reference to be made to the **impact of climate change** where relevant for an understanding of the company's activities. Omitting this would question whether the strategic report is comprehensive.

- A number of suggestions for improvement of **disclosure of business models** were made in the FRC's Financial Reporting Lab's report in 2016. Companies should, therefore, expect more scrutiny in this area, e.g. in respect of articulating the key drivers of the business.

- Where in scope, ensure that the requirements for the **non-financial information statement** are covered.

- **Identification of KPIs**. Companies should consider whether ratios that are discussed prominently in the strategic report should be identified as KPIs, and that where APMs are identified as KPIs the information required by the ESMA Guidelines is given. Where KPIs have changed year on year, changes should be explained.

- Disclosure of **dividend policy and practice** (i.e. how the policy is applied in taking decisions to declare dividends) as well as the level of distributable reserves will be an area of focus, especially after the FRC's latest Financial Reporting Lab report on this topic (published in October 2017) made a number of suggestions to improve disclosure.

- The **impact of the EU referendum** decision has been highlighted as an area where the FRC expects to see more detailed disclosure as the economic and political effects develop.

Looking further ahead

Following its consultation on a "streamlined and more effective energy and carbon reporting framework" for the UK, the Government took the decision to broaden the greenhouse gas reporting requirements for quoted companies and extend the reporting requirement to all large companies. In November 2018 the Energy and Carbon Regulations[22] were made. Quoted companies are already required to disclose information in their directors' report regarding their annual quantity of emissions in tonnes of carbon dioxide equivalent, as well as a ratio expressing the company's annual emissions in relation to a quantifiable factor associated with the company's activities.

The Energy and Carbon Regulations are effective for periods beginning on or after 1 April 2019 and require quoted companies to disclose information regarding their annual energy consumption, including the proportion of the carbon dioxide emissions and energy consumption figures relating to emissions in the United Kingdom and offshore area and a description of any measures taken for the purpose of increasing the company's energy efficiency.

Corporate governance

This past year there were no new disclosure requirements affecting corporate governance disclosures.

Much of the reporting focus for companies and the Financial Reporting Council (the FRC) has been on areas being explored for the purpose of improved communication between companies and investors, in particular viability statements (see section 10) and audit committee reporting (see section 13).

New legislative requirements arising from the Government's corporate governance reform agenda, together with the fundamental changes built into the 2018 version of the UK Corporate Governance Code (the 2018 Code), come into effect for periods commencing on or after 1 January 2019, with pressure from investors to adopt certain of the disclosure requirements early, particularly with regard to executive pay. There has been some focus on how companies disclose their activities as they prepare to implement the requirements of the 2018 Code and new legislation.

Existing requirements

Listed companies are required by the Listing Rules to make certain disclosures about corporate governance in their annual reports. Companies with a premium listing are required to state how they have applied the main principles set out in the UK Corporate Governance Code[23] (the Code) issued by the FRC. Their disclosure should be sufficient to enable shareholders to evaluate how the principles have been applied. They are also required to make a statement of compliance throughout the year with all relevant Code provisions, identifying provisions that have not been complied with and explaining their reasons for this non-compliance. The FRC has issued guidance[24] on what constitutes a meaningful explanation. The Listing Rules also require disclosures regarding certain provisions of the Code, including those on the preparation of financial statements on a going concern basis and the preparation of a longer term viability statement.

During the period covered by this year's survey, companies had to report on their compliance with the 2016 Code, which is supported by the FRC's Guidance on Board Effectiveness[25], Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[26], and by the Guidance on Audit Committees[27]. The FRC's guidance documents include recommendations regarding disclosure in the annual report. Alongside the 2016 Code, a new FRC Ethical Standard for Auditors also became effective for periods commencing on or after 17 June 2016, which places additional restrictions on the non-audit services that can be provided by the external auditor. Disclosure recommendations regarding non-audit services are incorporated into the Guidance on Audit Committees.[28]

The main components of a company's corporate governance report are:

- a statement on how the company has applied the main principles of the Code and a statement of compliance with the detailed provisions of the Code (see section 11), often with an introduction from the Chairman of the board focusing on the principles of accountability and effectiveness;

- statements on the robust assessment of principal risks and the longer term viability statement (see section 10), which some companies include as part of their corporate governance report, although the majority have presented these as part of their strategic report;

- a report on the work of the audit committee, in particular its role in oversight of effectiveness of risk management and internal control systems, in assuring the integrity of the company's financial reporting, such as its detailed consideration and challenge of management regarding the significant issues affecting the financial statements, and in its oversight of relationships with both internal audit and the external auditor, covering effectiveness and scope and (for the external auditor) tendering and non-audit services (see section 13 for more details); and

- reports from the other significant board committees, in particular the nomination committee regarding succession and diversity (see section 12 for more details), the remuneration committee and, where constituted, the risk committee.

Quoted companies reporting under the Act are required to include a directors' remuneration report. This report must contain a statement by the chair of the remuneration committee telling the story of the year in respect of remuneration. The report is split into a policy report, which is not subject to audit and is not required to be presented in full in years where there will not be a vote on the company's remuneration policy, and an annual report on remuneration, some elements of which are subject to audit. The policy report is subject to a binding shareholder vote every three years, or whenever the policy is to change. The annual report on remuneration is subject to an annual advisory vote and includes a "single figure" directors' remuneration table. The GC100 and Investor Group has published guidance on these requirements, which was most recently updated in July 2019[29] to reflect changes arising from the Shareholder Rights Directive II (SRDII) which came into effect from 10 June 2019.

Updates to the DTR, reflecting the diversity requirements of the EU Non-Financial Reporting Directive, came into effect for periods commencing on or after 1 January 2017.

These require companies within scope – public interest entities that are not small or medium sized – to describe their diversity policy in relation to the board, including aspects such as age, gender, geographical diversity and educational and professional background, in the corporate governance statement. As well as describing the policy, or providing a clear explanation if no such policy exists, they must explain the objectives of the policy, how it has been implemented and the results of the policy in the reporting period. Where this information is incorporated into existing disclosures outside the corporate governance statement, a suitable cross-reference should be provided.

For companies on the Alternative Investment Market (AIM), corporate governance disclosure requirements mean that companies must report on the application of a recognised corporate governance code, such as the UK Corporate Governance Code or the QCA Corporate Governance Code.[30]

New requirements for December 2019 year-ends

2018 UK Corporate Governance Code

Under the Government's corporate governance reform initiatives, elements of reform are being brought in through the 2018 UK Corporate Governance Code (the Code), issued by the FRC in final form on 16 July 2018 and accompanied by new Guidance on Board Effectiveness, effective for periods commencing on or after 1 January 2019. The FRC took the opportunity to perform a fundamental review and has also covered recent hot topics including corporate purpose, s172 of the Companies Act 2006 (described above), succession planning, corporate culture and diversity.

The changes to the Code are wide-ranging and principles-based. They are aimed squarely at companies achieving long-term, sustainable success. Reporting under the Code and the associated guidance is expected to demonstrate "how the governance of the company contributes to its long-term sustainable success and achieves wider objectives".[31]

In this context, the key new elements of reporting requirements under the new Code are below.

On board leadership and company purpose, much of which is likely to be covered in the strategic report:

- The board should describe how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how its governance contributes to the delivery of its strategy.

- The board should assess and monitor culture and ensure corrective action is taken where required. Disclosure should explain the board's activities, any action taken, and an explanation of the company's approach to investing in and rewarding its workforce.

- Where there has been a 20 per cent or greater vote against a resolution, the board should seek feedback and provide a final summary on what impact this has had on the decisions the board has taken and any actions or resolutions now proposed.

- The board should describe how the views of the company's key stakeholders and the other matters set out in s172 of the Companies Act 2006 have been considered in board discussions and decision-making. Whilst this is similar to the legislative requirement explained in the narrative reporting section of this regulatory overview, as it falls within the Code it applies to all premium listed companies, not only those that are UK registered.

- If the board does not use one of the three methods of workforce engagement described in provision 5 of the Code, it should explain what alternative arrangements are in place and why it considers that they are effective.

On division of responsibilities:

- The board should provide a clear explanation where it considers a non-executive director is independent regardless of any of the circumstances outlined in the Code which may impair independence, or other relevant circumstances which may suggest that a non-executive director's independence is impaired.

- The reasons for permitting directors to undertake other significant external appointments should be explained.

On composition, succession and evaluation, including nomination committee reporting:

- The papers accompanying the resolutions to elect each director should set out the specific reasons why their contribution is, and continues to be, important to the company's long-term sustainable success. (In practice, we expect this disclosure will generally be in the annual report which accompanies the resolutions.) Also see section 12.

- A clear explanation should be provided where the chair remains in post beyond nine years from the date of their first appointment to the board (for succession planning purposes).

- Enhancement of disclosures regarding board evaluation, including the nature and extent of the external evaluator's contact with the board and individual directors, the outcomes and actions taken, and how it has or will influence board composition.

- Diversity disclosures, including how succession planning supports developing a diverse board, and the gender balance of those in the senior management and their direct reports.[32]

On audit, risk and internal control, including audit committee or risk committee reporting:

- Where there is no internal audit function, in addition to explaining why this is the case, there should be an explanation of how internal assurance is achieved, and how this affects the work of external audit.

- In addition to the existing disclosures regarding principal risks, the board should carry out a robust assessment of the company's emerging risks and explain what procedures are in place to identify emerging risks.

On remuneration, most disclosure requirements have historically not been included in the Code. However, the new Code requires a description of the work of the remuneration committee, including:

- the strategic rationale for executive directors' remuneration policies, structures and any performance metrics;

- reasons why the remuneration is appropriate using internal and external measures, including pay ratios and pay gaps;

- a description, with examples, of how the remuneration committee has addressed the factors affecting policy and practices: clarity, simplicity, risk, predictability, proportionality and alignment to culture;

- whether the remuneration policy operated as intended and, if not, what changes are necessary;

- what engagement has taken place with shareholders and the impact this has had;

- what engagement with the workforce has taken place; and

- to what extent discretion has been applied to remuneration outcomes and the reasons why.

These changes will come into effect for periods commencing on or after 1 January 2019.

Changes for large private companies
As mentioned above, the Secretary of State made The Companies (Miscellaneous reporting) Regulations 2018[33] on 17 July 2018 in response to the Government's corporate governance reform agenda.

This includes the requirement for all companies with either 2,000 or more global employees, or a turnover over £200m globally and a balance sheet over £2bn globally, to disclose their corporate governance arrangements in their directors' report and on their website, including whether they follow any formal code.[34]

This applies for periods commencing on or after 1 January 2019 and falls on individual companies that are not otherwise required to make corporate governance disclosures in the annual report, including AIM companies and subsidiaries of listed businesses that meet the size criteria.

Although companies are not required to use any particular code, the Wates Corporate Governance Principles for Large Private Companies[35] were issued in December 2018 in order to provide a set of principles for companies to apply and explain against should they so wish.

Areas of regulatory focus
Corporate governance is currently an area of substantial focus for Government, regulators such as the FRC, and investors along with their representative organisations. Much of the focus over the past year has been on the corporate governance reform changes implemented in July 2018 through legislative change and a new 2018 UK Corporate Governance Code, all of which will come into effect for periods commencing on or after 1 January 2019.

The FRC has encouraged companies to consider and bring some of the related disclosures in the strategic report into effect early, through its revised Guidance on the Strategic Report and guidance on implementing non-financial reporting (see above).

Some of the other areas that the FRC is focusing on include:

- Further improvements to **viability statements**, which the FRC highlights is a priority for investors.[36] One of the key focus areas for the FRC and for investors is the disclosure of prospects as well as viability. The FRC has explained that it envisages a two stage process to meet the Code provision with clearly differentiated reporting on each stage – the first being about the assessment of the prospects of the company, including the resilience of the business model, and the second being about the directors' reasonable expectation of viability for the period of their assessment. The FRC anticipates that the period over which directors assess the prospects of the company will be longer than the period for the viability assessment. This is also consistent with the Investment Association's Guidelines on Viability Statements[37] and with the findings of the FRC's Financial Reporting Lab's report on Risk and Viability Reporting.[38]

- **Succession planning** and **corporate culture** disclosures have each been the subject of recent FRC projects and feature in the new 2018 UK Corporate Governance Code (see 'Looking further ahead' below).

- The FRC is encouraging companies to review their **Brexit** disclosures regularly. In particular, it calls for companies to make their disclosures on the uncertainties arising as a result of Brexit more specific, identifying the nature of the likely risks and ensuring the disclosure reflects their latest analysis of the potential impact on the business.

The FRC has launched a new Lab along the lines of the Financial Reporting Lab in order to foster dialogue between audit committees, investors and auditors. The Audit & Assurance Lab published its first report, Audit Committee Reporting, in December 2017. This report "focuses on the good practice elements of existing audit committee reporting, and encourages audit committees to consider adopting them."[39]

The report's key recommendations on audit committee reporting included:

- It is useful to bring out **key messages**, for instance in an introductory statement from the chair.

- More **concise reporting** is more likely to be read, enabling key information to be identified by investors

- Explain in the audit committee report why the **significant issues** relating to the financial statements were deemed to be significant, what challenges the audit committee raised on those issues and what the conclusion was. The disclosure on significant issues should be easily identified and understood.

- Sufficient emphasis should be placed on **audit quality** and **auditor independence**, in particular disclosure is useful when there is a planned external audit tender.

- Make it clear what the audit committee's role is in relation to **internal control, risk management**, and internal audit, in particular where there are other committees such as a risk committee that may share responsibility in this area.

Looking further ahead
Although there are new requirements for disclosure regarding board evaluation in the 2018 UK Corporate Governance Code, these could be enhanced further. At the request of the Department for Business, Energy and Industrial Strategy, ICSA published a consultation in May 2019 regarding the effectiveness of independent board evaluation in the UK listed sector.[40]

Part of this included new proposals for disclosure guidance to assist listed companies in providing shareholders with annual report disclosure that they would find useful in assessing how diligently the board is seeking to improve its effectiveness. The proposals cover both internal and external board evaluations with some additional disclosures recommended for externally facilitated reviews.

Audit committee report disclosures regarding non-audit services are likely to gain more prominence and perhaps more detail, as the 70% cap on non-audit services takes effect for the financial year commencing on or after 17 June 2019 for those companies that have had the same auditor for at least three years. The FRC consulted in July 2019 regarding changes to the Ethical Standard for auditors which again we anticipate will lead to disclosure as audit committees revisit their non-audit services policies.

Financial statements

Listed groups are required to prepare consolidated accounts under IFRS Standards as adopted by the EU, although whether and for how long the EU endorsement aspect will remain unaltered once the UK leaves the EU is at present unclear. Listed entities that are not parent companies, such as many investment trusts, can also choose to prepare financial statements using FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102).

The separate financial statements of a 'qualifying entity' can be prepared under FRS 101 Reduced Disclosure Framework (FRS 101), which closely reflects IFRS accounting but with reduced disclosures. If eligible, this may be an attractive option for many parent companies' separate financial statements and for their subsidiaries. Another option is to apply FRS 102 with reduced disclosure.

The most significant change of the past year saw most companies in our survey adopting IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers for the first time. The impact of these new IFRSs is discussed in section 15.

New requirements for forthcoming year-ends

Below is a list of the new IFRS requirements coming into force for financial years ending between September 2019 and August 2020. Hyperlinks to further information are included in the table.

Title	As issued by the IASB mandatory for accounting periods starting on or after	Per the EU adopting regulation, mandatory for accounting periods beginning on or after
IFRS 9 – Financial Instruments	1 January 2018	1 January 2018
IFRS 15 – Revenue from Contracts with Customers (including clarifications)	1 January 2018	1 January 2018
IFRIC 22 – Foreign Currency Transactions and Advance Consideration	1 January 2018	1 January 2018
Amendments to IFRS 2 (Jun 2016) – Classification and Measurement of Share-based Payment Transactions	1 January 2018	1 January 2018
Amendments to IFRS 4 (Sept 2016) – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	1 January 2018	1 January 2018
Amendments to IAS 40 (Dec 2016) – Transfers of Investment Property	1 January 2018	1 January 2018
Annual Improvements to IFRSs: 2014-16 Cycle (Dec 2016) – IFRS 1 and IAS 28 Amendments	1 January 2018	1 January 2018
IFRS 16 – Leases	1 January 2019	1 January 2019
IFRIC 23 - Uncertainty over Income Tax Treatments	1 January 2019	1 January 2019

Title	As issued by the IASB mandatory for accounting periods starting on or after	Per the EU adopting regulation, mandatory for accounting periods beginning on or after
Amendments to IFRS 9 (Oct 2017) - Prepayment Features with Negative Compensation	1 January 2019	1 January 2019
Amendments to IAS 28 (Oct 2017) - Long-term Interests in Associates and Joint Ventures	1 January 2019	1 January 2019
Annual Improvements to IFRS Standards 2015–2017 Cycle (Dec 2017)	1 January 2019	1 January 2019
Amendments to IAS 19 (Feb 2018) - Plan Amendment, Curtailment or Settlement	1 January 2019	1 January 2019

Companies reporting under FRS 102 should note that the triennial review[41] made a number of amendments to various sections, effective for periods commencing on or after 1 January 2019.

Areas of regulatory focus

The Financial Reporting Council (FRC) announced that during 2019/20 it would undertake thematic reviews on:

- impairment of non-financial assets;
- disclosures relating to the implementation of IFRS 16 Leases within 2019 interim accounts; and
- the effects of the decision to leave the EU on companies' disclosures.

The findings from these reviews, once published, will no doubt prove helpful for preparers as the 2019 year-end reporting season approaches.

In respect of the impairment thematic review, the FRC is looking to encourage more transparent reporting of the events and circumstances that led to the recognition or reversal of an impairment loss and the basis on which the directors concluded that the carrying amounts of non-financial assets are recoverable.

Acknowledging that disclosures in full year accounts prepared under IFRS are more comprehensive than those provided in condensed financial statements prepared under IAS 34 *Interim Financial Reporting*, it is worth noting that the FRC's stated expectations in respect of IFRS 16 transition included:

- quantitative disclosure to be accompanied by informative and detailed explanation of the changes, tailored to the company's specific circumstances;
- clear explanations of the effect of transition, including comparison of previous accounting policies with new policies;
- appropriate commentary on comparative amounts, where transitional arrangements may mean these are not directly comparable with current period amounts;
- any key judgments made by management in applying IFRS 16 to be clearly explained, such as including clarification of the exemptions they intend applying and the policy choices that they have made; and
- an explanation of how the transition has been implemented, after careful consideration of the transitional disclosure requirements under IFRS 16 and the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Priority sectors announced by the FRC for reviews in 2019/20 are as follows:

- financial services, with emphasis on banks, other lenders and insurers;
- oil and gas;
- general retailers;
- retail property;
- business support services; and
- construction and materials.

Per their Annual Review of Corporate Governance and Reporting 2017/18[42], published in October 2018, the FRC's most commonly raised substantive queries, in order, related to:

1) judgements and estimates (see section 14 of this publication);

2) APMs (see section 7);

3) strategic report (discussed in various sections);

4) income taxes (see section 14);

5) revenue (see section 15);

6) business combinations (see section 15);

7) impairment of assets (see section 15);

8) pensions (see section 14);

9) statement of cash flows (see section 15);

10) provisions and contingencies; and

11) accounting policies.

More generally in relation to financial statements, and in addition to the items above, significant areas of regulatory focus at the moment include the following:

- Disclosure and accounting for complex supplier arrangements, including supplier financing and presentation of payables in the balance sheet and associated cash flows in the statement of cash flows (see section 15).
- The impact of a low interest rate environment, uncertainties around the macro-economic environment, Brexit (see section 3) and climate change (see section 2) mean that scrutiny can be expected on issues such as impairments, sensitivity disclosures, recognition of deferred tax assets and fair value measurements.
- Investor calls also continue for insight into the level of distributable profits that a company has available and capital allocation and distribution policies (see section 8 for current practice per our survey). Further guidance is available in separate guidance published by Deloitte.[43]

Looking further ahead

The table below shows other new standards and amendments published by the IASB, along with their effective dates and EU endorsement status.

Title	As issued by the IASB mandatory for accounting periods starting on or after	Per the EU adopting regulation, mandatory for accounting periods beginning on or after
Amendments to IFRS 3 Business Combinations – Definition of a Business	1 January 2020	TBC
Amendments to IAS 1 and IAS 8 – Definition of Material	1 January 2020	TBC
IFRS 17 – Insurance Contracts	1 January 2021	TBC
Amendments to IFRS 10 and IAS 28 (Sept 2014) - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Postponed	TBC

Regulatory overview endnotes

1. https://www.iasplus.com/en-gb/news/2016/12/regulations-implementing-eu-non-financial-reporting-directive-published
2. https://www.iasplus.com/en-gb/news/2018/08/new-company-reporting-requirements-for-private-and-public-companies-approved-by-parliament
3. https://www.frc.org.uk/accountants/accounting-and-reporting-policy/clear-and-concise-and-wider-corporate-reporting/narrative-reporting/guidance-on-the-strategic-report
4. Companies Act 2006 s414C(1)
5. Companies Act 2006 s414C
6. Companies Act 2006 s414CA
7. https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf
8. https://www.iasplus.com/en-gb/news/2017/10-1/frc-thematic-reviews-pensions-judgements-and-estimates-apms
9. https://www.frc.org.uk/getattachment/f70e56b9-7daf-4248-a1ae-a46bad67c85e/Annual-Review-of-CG-R-241018.pdf
10. https://www.frc.org.uk/getattachment/ff987c01-416f-4635-8dba-fdda5530f4b5/091117-APMs-CRR-thematic-review.pdf
11. https://www.frc.org.uk/getattachment/e94631d1-69c1-4349-8ce5-780d4eca455f/LAB_Reporting-of-performance-metrics_June-2018.PDF
12. https://www.frc.org.uk/getattachment/cd978ef7-72ad-4785-81ee-e08bb7b7f152/LAB-Performance-metrics-FINAL.pdf
13. https://www.iasplus.com/en-gb/publications/uk/need-to-know/2016/ntk-apms
14. https://www.esma.europa.eu/sites/default/files/library/esma32-51-370_qas_on_esma_guidelines_on_apms.pdf
15. https://www.iasplus.com/en-gb/publications/corporate-governance/governance-in-brief/gib-modern-slavery-act
16. https://www.iasplus.com/en-gb/news/2016/06/hmrc-tax-strategy-guidance
17. https://www.iasplus.com/en-gb/news/2016/12/gender-pay-gap-reporting-regulations
18. https://www.iasplus.com/en-gb/publications/corporate-governance/governance-in-brief/gib-payment-practices
19. http://www.legislation.gov.uk/ukdsi/2018/9780111170298/contents
20. https://www.iasplus.com/en-gb/publications/uk/need-to-know/2018/ntk-s172-1
21. https://www.frc.org.uk/getattachment/f70e56b9-7daf-4248-a1ae-a46bad67c85e/Annual-Review-of-CG-R-241018.pdf
22. https://www.iasplus.com/en-gb/publications/uk/need-to-know/2018/energy-and-carbon-reporting-requirements-enacted
23. https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code
24. https://www.frc.org.uk/getattachment/a39aa822-ae3c-4ddf-b869-db8f2ffe1b61/what-constitutes-an-explanation-under-comply-or-exlpain.pdf
25. https://www.frc.org.uk/getattachment/11f9659a-686e-48f0-bd83-36adab5fe930/Guidance-on-board-effectiveness-2011.pdf
26. https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf
27. https://www.frc.org.uk/getattachment/6b0ace1d-1d70-4678-9c41-0b44a62f0a0d/Guidance-on-Audit-Committees-April-2016.pdf
28. https://www.frc.org.uk/getattachment/6b0ace1d-1d70-4678-9c41-0b44a62f0a0d/Guidance-on-Audit-Committees-April-2016.pdf
29. https://uk.practicallaw.thomsonreuters.com/Link/Document/Blob/I53efc83fac8211e9adfea82903531a62.pdf?targetType=PLC-multimedia&originationContext=document&transitionType=DocumentImage&uniqueId=96a97804-4ea4-4e7e-a5a7-045d70c38770&contextData=%28sc.Default%29&navId=3BED55AFBBCB7F1FE5FCA70839304FB2&comp=pluk
30. Governance in brief: The QCA updates its Corporate Governance Code as AIM tightens rules – May 2018 https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-gib-aim-rule-qca-code-may-2018.pdf
31. https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF
32. This is intended to be the same measure as in the Hampton-Alexander review, which calls for the gender balance of the executive committee and its direct reports
33. http://www.legislation.gov.uk/ukdsi/2018/9780111170298/contents
34. Governance in brief – BEIS issues legislation to deliver key corporate governance reforms – June 2018 https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-gib-beis-regulations-june-2018.pdf
35. https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf
36. FRC's advice for preparing 2017/18 Annual Reports, published October 2017, https://www.frc.org.uk/news/october-2017/advice-for-preparing-2017-18-annual-reports
37. https://www.ivis.co.uk/media/12490/Guidance-viability-statements-final2.pdf
38. FRC's Financial Reporting Lab project report, Risk and Viability Reporting https://www.frc.org.uk/getattachment/76e21dee-2be2-415f-b326-932e8a3fc1e6/Risk-and-Viability-Reporting.pdf
39. Audit & Assurance Lab Project, Audit Committee Reporting https://www.frc.org.uk/getattachment/7f97f065-d912-4ca0-a96b-1f2fd4b0a565/LAB_Final.pdf
40. https://www.icsa.org.uk/assets/files/pdfs/guidance/consultations-2019/icsa_board_evaluation_-consultation_document_-may2019.pdf
41. https://www.iasplus.com/en-gb/publications/uk/need-to-know/2018/ntk-frs-102-triennial-review-2017
42. https://www.frc.org.uk/getattachment/f70e56b9-7daf-4248-a1ae-a46bad67c85e/Annual-Review-of-CG-R-241018.pdf
43. https://www.iasplus.com/en-gb/publications/uk/closer-look/2019/a-closer-look-capital-maintenance-and-distributions-under-the-spotlight

Contacts

For more information visit www.deloitte.co.uk/annualreportingsights. If you would like advice on specific application of principles set out in this publication, or would like to meet with us to discuss your reporting issues, please contact your local Deloitte partner or:

Veronica Poole
Global IFRS Leader and
UK Head of Corporate Reporting
+44 20 7007 0844
vepoole@deloitte.co.uk

Peter Westaway
Director
+44 20 7007 9024
pwestaway@deloitte.co.uk

Amanda Swaffield
Director
+44 20 7303 5330
aswaffield@deloitte.co.uk

Endnotes

1. https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter
2. https://www.frc.org.uk/getattachment/3851b9c5-92d3-4695-aeb2-87c9052dc8c1/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations.pdf
3. https://www.ipcc.ch/2018/10/08/summary-for-policymakers-of-ipcc-special-report-on-global-warming-of-1-5c-approved-by-governments/
4. https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf
5. As at July 2019; see https://www.fsb-tcfd.org/tcfd-supporters/
6. https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf
7. The Global Risks Report 2019, 14th Edition, World Economic Forum
8. http://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf
9. https://www.frc.org.uk/getattachment/4b73803d-1604-42cc-ab37-968d29f9814c/FRC-Lab-Business-model-reporting-v2.pdf
10. https://www.iasplus.com/en-gb/publications/uk/need-to-know/2018/ntk-s172-1
11. https://www.gov.uk/government/publications/corporate-governance-new-reporting-regulations
12. https://www.iasplus.com/en-gb/news/2019/01/iosco-esg
13. https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-gib-brexit-and-viability-disclosures-february-2019.pdf
14. Annual Review of Corporate Governance and Reporting 2017/2018, published October 2018, https://www.frc.org.uk/getattachment/f70e56b9-7daf-4248-a1ae-a46bad67c85e/Annual-Review-of-CG-R-241018.pdf
15. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf
16. https://www.frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf
17. https://www.iasplus.com/en-gb/news/2019/06/icsa-the-governance-institute-consults-on-the-effectiveness-of-independent-board-evaluation
18. https://www.frc.org.uk/getattachment/7f97f065-d912-4ca0-a96b-1f2fd4b0a565/LAB_Final.pdf
19. We determined the ratio either by taking the ratio as reported by the audit committee or, if no ratio was provided, calculating it ourselves from information in the audit committee report or financial statement notes.

Notes

Deloitte.

Designed by CoRe Creative Services. RITM0323780