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Governance in focus

On the board agenda – the 2019 reporting season

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Welcome to our 2018/19 reporting season review

Foreword from William Touche

Dear Board Member,

This time last year we referenced growth, geopolitical concerns, business model disruption, and technology transformation as key features on the day to day board agenda. Of course, these matters remain ever present and perhaps even more challenging today.

This year, however, it would be strange if we did not focus on the opportunity to enhance reputation and trust in business. We highlight the ever-increasing reporting requirements about the wide range of activities undertaken by companies as they go about their daily affairs.

Although the regulatory and legislative vehicles may not be as joined up as they could be, taken together, and if addressed thoughtfully, they do represent a powerful combination with the potential for an exciting and very real step change in communication and transparency, the cornerstones of trust.

The purpose of companies is being redefined – and each company will articulate theirs in their own way, based around a common premise that companies create wealth for shareholders by serving customers with essential products and services in an ever more innovative, efficient and responsible manner, with the goal of creating higher living standards for all.

In addition to articulating their purpose, companies are required to report their own environmental impacts as well as the risks to their business from climate change. Not a week goes by now without an investment house or a regulator calling for more transparency in this area as the compelling case for the human race to address our impact on our environment is made around us on a daily basis. The UN's Sustainable Development Goals are increasingly being adopted as core principles.

Business conduct is also becoming more transparent – building on the UK's ABC legislation, the EU now demands not only disclosure of a company's policies on anti-bribery and corruption, but Boards have to tell the world what due diligence they have done in relation to the effectiveness of those policies and the outcomes of their diligence.

Early in 2020, in their first annual reports under the 2018 UK Corporate Governance Code, directors of UK listed companies will be reporting on how the interests of key stakeholders and the other matters set out in section 172 have been considered in board discussions and decision-making. In the annual report there will be a new section 172 statement explaining the issues, factors and stakeholders considered relevant in fulfilling their duties as directors, the engagement methods used, and the resulting impact on decisions and strategies during the financial year. The GC100 has recently issued useful but far-reaching guidance for companies on this topic.

With these developments in mind, we are structuring this year's 'On the board agenda' differently and presenting articles under the following key themes:

- Responsible business
- Risk & viability
- Remuneration
- Year-end reporting & assurance

Responsible business
In this section we examine the famous section 172 of the 2006 Companies Act, the practical implications for boards and their management teams. We emphasise that boards must be careful to go beyond intent and describe the true experience of stakeholders. We also examine the potential reputational risks from social media and other public platforms for voicing stakeholder concerns.

Risk & viability
As we head into the reporting season, one of the most significant risks facing many companies is the continued uncertainty around Brexit. This means that forecasting, which underpins so much decision making, is more challenging than usual. The FRC and investors continue to call for the narrative in the annual report to distinguish between the prospects of your business over the longer term, and shorter term planning and viability periods. This will be a useful framework given the near term departure from the EU. We examine these challenges, and other topical risks, such as cyber and data risks, and how Red Team attacks should be embraced by the corporate world.

Remuneration
We review the 2018 AGM season and those remuneration trends and areas of focus for remuneration committees in the coming year, including holding periods, annual bonus trends and the extension of the remuneration committee remit.

Year-end reporting & assurance
The FRC's Corporate Reporting Review Team has set out its areas of focus for the 2018/19 reporting season. We summarise these and draw out some of the key changes from the updated Guidance on the Strategic Report.

With the increased focus on stakeholder information in annual reports, we ask if boards are confident that this information is produced within a robust control environment and how boards can be assured that this is the case. What enquiries should boards be making?

Once again, this review is a full read, as there is much to consider. To help pull it all together we have included, as an appendix, a checklist of some of the key questions you might ask as an active and engaged board member. Any questions for us, please do get in touch with your Deloitte partner or our governance team.

Yours faithfully,

William Touche
Vice-Chairman
Leader of Deloitte UK Centre for Corporate Governance

Deloitte opinion pieces

Who will be the Chair of the Future?

What skills, capabilities and experiences will be required to be a successful Chair in ten years? How will boards operate and what will be their priorities?

Much has been written about the development of the role and responsibilities of the CEO and their executive team. However, there has been far less debate around one of the other most influential roles driving the impact and future success of businesses: the Chair of the board.

Through a series of interviews with some of the most experienced Chairs within British business, we have explored how the role will evolve to address the new demands and complexities of this most important role in our new paper – Chair of the Future.

From those conversations, it's clear that navigating an increasingly greater pace of change and uncertainty is at the heart of the Chair's role; we see the emergence of five key themes which are influencing the board agenda:

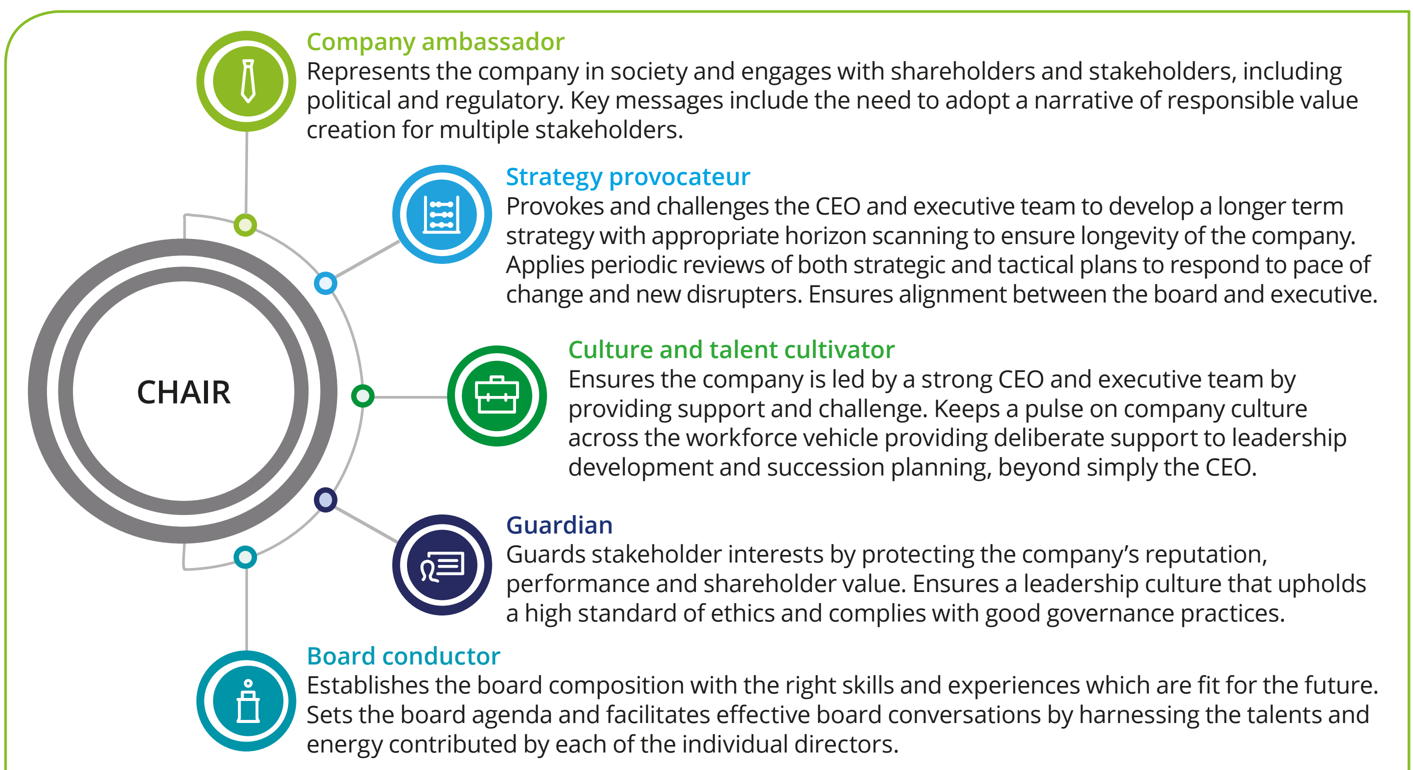
1. The rise of inclusive capitalism and the need to become a purpose-led organisation
2. New technologies and new ideas: managing disruption
3. An upsurge in stakeholder management and balancing conflicting dynamics
4. The mounting burden of regulation
5. Capital shifts from West to East and, increasingly, from public to private

These themes are challenging traditional thinking around how the board operates, and consequently the role of the Chair. On the face of it, some Chairs may now appear less formal and more accessible. In reality, operationally there has been a fundamental shift towards the professionalism of boards, led by the Chair. Chairs of today find themselves in a significantly more demanding role.

Who will a future Chair need to be?

As our conversations turned towards the future, some of our interviewees reflected that the frame of reference for Chairs has changed. The more traditional descriptions of the role and responsibilities of the Chair considerably underestimate the actual demands and complexities of the job day to day. With the evolution and professionalisation of boards, there is strong recognition that the role of the Chair has changed over the years.

Based on the comments of the participating Chairs, we have designed a new framework for thinking about the role of the Chair of the future.



While the terms of reference reflect elements of the role as it stands today, the areas outlined in the framework will significantly grow in importance over the next five to ten years.

It shows a profound shift underway in the boardroom mirroring the changing role of the corporation in society. Underpinning this is the overarching concept of the Chair, the ultimate guide and guardian of the direction and fortune of the company, described by one interviewee as 'The Chief Reputation Officer'.

With all these demands to orchestrate an effective board, Chairs of the future will need to be increasingly willing to flex their behaviours and personal style. There are a number of vital skills, characteristics and success factors that will continue to be relevant, regardless of circumstances: Strong emotional intelligence, being innately curious, humility and an understanding of the business and competitive landscape in which the organisation operates – these elements will always be central to being an effective Chair.

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"Deloitte's leaders are constantly speaking with senior business leaders, board members and Chairs, and a recurring topic that we have heard again and again has been the opportunities and challenges for business brought about by the rapidly increasing pace of change in the world.

This has led to a poignant question, what will be the future implications of this disruption for the Chair and the boardroom? How will they need to evolve and adapt in the coming years to be able to lead, operate and govern in this new evolving business landscape?"

Nick Owen, Deloitte Chairman

Spotlight on audit

As Senior Partner and chief executive of Deloitte, the recent spate of inquiries and reviews into the British audit market has caused me to reflect on whether as a profession we have done enough to strengthen trust in our capital markets. If we have not, what do we need to do now to rectify that? This is not just a concern for auditors – many board chairs and members will have a keen interest, and be considering what the implications are for their business and shareholders.

We expect the report from Sir John Kingman into the overall regulatory structure for listed companies and for the accounting profession in the coming weeks. In addition, the Competition and Markets Authority has launched a separate review into competition in the UK audit market and how to prevent conflicts of interest in the sector, and most recently the BEIS Select Committee has announced an inquiry on the audit market which will begin in early 2019. In 2019, we also expect an independent review into the future of audit to examine how it should be adapted to be fit for the future. In our responses, Deloitte has and will apply a principle that any change must enhance audit quality, therefore improving trust and confidence in the UK's capital markets.

We propose banning all non-audit related services to FTSE 350 and large public interest entity audit clients to address perceptions around conflicts definitively. As part of this, we need a clear definition of what audit related services are required by companies. All other services, with no exceptions, would then be banned. We therefore welcome the FRC's review of the Ethical Standard which will cover this area.

We have also called for market share caps for the listed market - either taken as a whole or for particular subsets of the FTSE 350 to encourage greater market participation. This will not be universally popular and won't provide immediate results. But over time and with additional supporting measures such as shared audits, it would address choice and competition issues and reduce barriers to entry. Strengthening independent governance for audit practices to monitor and report publicly on any potential conflicts and how they have been dealt with is also desirable.

But changes are required more broadly across financial reporting. We support a UK equivalent of America's Sarbanes-Oxley act (2002), which sought to improve the accuracy and reliability of corporate reporting in the wake of the Enron scandal. Aimed at the UK's largest listed companies, this would place appropriate accountability on company boards and management to ensure the quality of financial reporting. Compelling management and directors to take greater responsibility for the quality of their companies' internal controls - coupled with the results of the Kingman review into the Financial Reporting Council launched in June - should lead to improvements in the quality of corporate financial reporting. Our soundings with investors and audit committee members lead us to believe that a thoughtful approach here would be welcomed.

I believe these remedies can deliver significant and lasting positive change. They will be challenging for us and boards, but change is needed if we are to rebuild the trust so fundamental to business and the economy.

There have been calls to break up the Big Four accounting firms and for them to shed their non-audit businesses. But this is not the answer. Direct access to non-audit specialists is critical for businesses like ours. In the past financial year alone, over 55 per cent of all key matters included in Deloitte's audit reports of FTSE 350 companies required input from specialists. At Deloitte over 2,100 specialists from outside audit in areas from cyber risk and blockchain to property and pensions valuations, to specialists in banking regulation challenge management and enhance audit quality, supporting our 4,000 audit professionals.

This debate should not be conducted in a vacuum. The UK professional services sector is the envy of the world, a big exporter and one of the crown jewels of the UK economy. The debate over its future in the UK is being watched closely around the world. It's critical that whatever the remedies chosen, they do not damage our international competitiveness. As we approach Brexit, maintaining the UK's attractiveness as a place to invest, its financial services and deep, liquid capital market, and position in the global economy is crucial to our nation. The strengths of Britain's audit market is fundamental to all and we need to keep our financial services structures looking reasonably similar to our nearest capital markets competitor – the USA. Breaking up the big four would be seriously detrimental to the UK, making the US capital markets much more attractive for international companies. We believe that all Boards should be giving attention to the audit debate and ensuring their views are heard – failure to do so could lead to unintended consequences we should all be concerned with.

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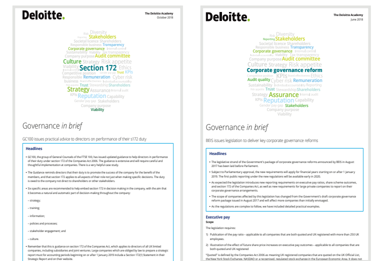
Responsible business

Section 172 in practice and on paper

In this article we remind boards about the requirements of the new Section 172(1) statement and highlight some practical guidance which has been issued to support them in discharging this duty effectively.



Practical steps to help discharge the section 172 duty

The GC100, the group of General Counsels of the FTSE 100, has issued updated guidance (Guidance on Directors' Duties – Section 172 and Stakeholder Considerations) to help directors in the performance of their duty under section 172 of the Companies Act 2006. The guidance is useful and extensive, requiring careful and thoughtful implementation at companies.

The Guidance focusses on practical steps which will help embed consideration of section 172 factors so that they are more likely to be a natural and automatic part of decision-making throughout the company. It is acknowledged that many business decisions are not made at board level but are delegated to all levels throughout the organisation. This means it is important to create a culture in the business where the broader implications of decisions are always considered.

Section 172 - Duty to promote the success of the company
(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —

a. the likely consequences of any decision in the long term,

b. the interests of the company's employees,

c. the need to foster the company's business relationships with suppliers, customers and others,

d. the impact of the company's operations on the community and the environment,

e. the desirability of the company maintaining a reputation for high standards of business conduct, and

f. the need to act fairly as between members of the company.

The Guidance also makes the point that it is not the directors' duty to balance the interests of the company and those of other stakeholders. Instead, after weighing up all the relevant factors, directors must ask themselves which course of action they consider best leads to the success of the company, having regard to the long term. This can sometimes mean that certain stakeholders will be adversely affected, but this does not invalidate the decision made as long as adequate and appropriate consideration of all the relevant factors has taken place.

"In short, your duty under section 172 involves both judgement and process: you should aim to have suitable processes in place for your company so that in taking decisions to promote the success of the company, you have considered one way or another the long-term consequences and the wider stakeholder considerations."

There are a number of recommendations and practical steps suggested to help directors discharge their section 172 duty effectively:

Strategy	• Consider the relationship between corporate vision and goals and stakeholder interests. There should be a clear understanding of your company's dependencies. • Matters which are critical to the long term success of the business should be given sufficient time and focus by the board and management.
Training	• Provide suitable induction training to all new directors (including subsidiary directors) and refresher courses from time to time. • Make sure that management are also aware of the directors' duties in the Companies Act as this may enhance their effectiveness in achieving the company's goals in line with the board's stakeholder and other duties.

Information	• Make sure the board is getting the information it needs to make informed judgements about the stakeholder interests and factors which are relevant for the company. • The metrics and reports the board receives should be broad enough to address the section 172 duty and not always focused on financial reports, current operational issues and market data. They should not obscure the things that really matter for the long-term success of the company. • The information available to others, below board level, should be consistent in approach and message such that it supports the achievement of the company's goals and the board's responsibilities under section 172.
Policies and processes	• Recognise the section 172 duty in the terms of reference of the board and each committee. • Ensure the company secretary attends all board meetings to advise directors as necessary on matters related to their duties and responsibilities under section 172. • Remuneration policies and incentives should reflect the section 172 factors where relevant, for example by including appropriate metrics and performance measures. • Stakeholder factors should be addressed in board papers where judged relevant. The impact of a decision should be proportionately, clearly and appropriately explained to the directors and the papers should include appropriate inputs to assess them. • There should be a consistent approach to minute taking, whether brief or detailed, and as to when section 172 factors are minuted. • Implement specific company policies and processes on section 172 topics relevant to your company, allocating responsibility to the appropriate management functions.
Stakeholder engagement	• Consider how stakeholder groups experience the company, its board and management through day to day business interactions, as well as through specific processes, structures or channels established for engagement. • Consider whether your company does what it says it does to and for stakeholders, and whether it is perceived as doing so by those stakeholders.
Culture	• Focus on the development of your company's culture so it is automatic that relevant stakeholder factors are built into the conduct of the company's business.

When considering each of these steps, a key point to remember is that there is no one-size fits all: directors need to identify and re-assess over time the factors which are most important to the organisation and the activities being undertaken.

The Guidance includes a useful case study which takes readers through the various stages of the considerations around a decision to scale back a product line and sets out how the section 172 duty was exercised.

Hearing the stakeholder voice

Fostering genuine and meaningful dialogue with stakeholders, which is embedded within organisational strategy and governance structures, cannot be delivered by companies overnight.

Succesful relationships with a company's workforce, suppliers, customers and the wider community rely on honest communication, trust, mutual respect and the ability to compromise. It is well-known that these values are of great importance to the millennial generation. Companies which demonstrate a genuine desire to listen to stakeholders and consider their interests, are likely to benefit in the long run.

The key areas of work, which companies will need to address in order to achieve effective engagement when engaging with stakeholders, are outlined below:

Report on engagement activities
The new reporting requirements mean that boards will need to demonstrate to shareholders that directors have performed their duty under section 172. There will be a much greater focus on reporting the specific outcomes from engagement activities, as well as any impact on the decisions taken by the board.

Establish a robust framework
A robust governance framework will be necessary to link engagement activities to board processes. This should include terms of reference, as well as policies and procedures to document the links with engagement activities.

Build capacity for effective engagement
Companies will need to build the knowledge and capacity necessary to conduct effective engagement activities. This will apply to the board, staff involved in planning and conducting engagement activities, as well as stakeholders themselves.

Analyse and act on feedback
Rigorous analysis of the feedback collected will be necessary in order to distil a wide range of views into clear findings for the board. Companies will need to develop realistic, practical actions which genuinely respond to feedback received.

Plan and conduct engagement events
Companies may need to conduct engagement events using a range of channels in order to receive a reliable range of feedback, as well as to maximise the reach of engagement activities. When planning events, companies could adopt digital solutions for gathering views.

For further detail on these areas and questions for companies to consider, please see our publication "Hearing the stakeholder voice".

The Section 172(1) Statement

Scope

The legislation requires, for periods commencing on or after 1 January 2019, a statement in the **Strategic Report** of how directors have complied with their duty to have regard to the matters in 172 (1) (a)-(f) – all companies (listed and unlisted) qualifying as large under the Companies Act 2006, in addition to other complex scoping requirements.

As a reminder, companies qualifying as large under the Companies Act 2006 meet at least two of the following criteria:

- Turnover of more than £36m;
- Balance sheet total of more than £18m;
- More than 250 employees.

Reporting requirements

In their Strategic Report, all companies qualifying as large under the Companies Act 2006 will be required to include a separately identifiable "Section 172(1) statement" describing how directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006 when fulfilling their duties as a director.

BEIS has suggested that companies will probably want to include information on some or all of the following:

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

The supporting FAQs issued by BEIS suggests the following points to note in relation to the Section 172(1) statement:

Tailoring	• The disclosures should be tailored to the individual circumstances of each company. The focus should be on matters that are of strategic importance to the company and should be consistent with the size and complexity of the business.
Subsidiaries	• All qualifying companies, **including subsidiaries**, will need to meet the new reporting requirements. This is because, under the Companies Act, the duty of directors is owed to their company. • This approach to reporting by groups and their subsidiaries is not new. Qualifying subsidiaries already have to prepare their own strategic report, even where the parent company is required to prepare a "group strategic report" under s414A(3).
Website publication	• The legislation states that this statement should be made available on a website. • For quoted companies, that are required to make their annual report available on a website, this requirement will be met through the annual report. Unquoted companies, that are not required to publish their annual report on a website, will need to make arrangements to ensure that the Section 172(1) statement is available on a website. This can be a website maintained by or on behalf of the company (such as the website of a parent company) provided it identifies the company in question.

Guidance from the FRC

The FRC has included guidance to help companies meet these new reporting requirements in the updated Strategic Report Guidance. That guidance makes the following points:

- There will be linkages and overlaps between information contained in the strategic report and that required to be included in the section 172(1) statement. Companies are encouraged to avoid repetition, maintain the cohesion of the narrative contained within the strategic report and incorporate information into the section 172(1) statement by cross-reference where appropriate.
- The section 172(1) statement should focus on matters that are of strategic importance to the company. The level of information disclosed should be consistent with the size and complexity of the business.
- The interests of one group of stakeholders may not always be aligned with the interests of other stakeholders or with the interests of shareholders. Where there are conflicts, or where the interests of one group have been prioritised over another, the section 172(1) statement could explain how the directors have considered the different interests and the factors taken into account in making that decision.
- There should be consistency between the principal decisions discussed in the section 172(1) statement and the review of the business contained in the strategic report.

Section 172 in practice and on paper – aide memoire

1. Consider the areas drawn out in the GC100 Guidance and how well they are addressed at the organisations you are involved in – is there a clear plan of how these matters are being actioned?
2. Do you have a clear view on the key stakeholders for your organisation and the effectiveness of the engagement mechanisms being used – is there sufficient board visibility of this?
3. Has an exercise been done to confirm which entities within the group will be required to prepare the Section 172 Statement – is there a clear process for development and review of these statements across the group which incorporates sufficient time for full consideration by the board and reflects the fact that the statement will be covering board activities for the full year commencing on or after 1 January 2019?

Purpose and the Sustainable Development Goals

In this article we focus on how the Sustainable Development Goals can be used as a framework for businesses to articulate their purpose and their role in society, as required under the 2018 UK Corporate Governance Code.

The focus on purpose in the UK Corporate Governance Code 2018 is a welcome development and reflects the increased expectations of companies to clarify their intended relationship with the wider world and make a positive impact through their core business.

For some, purpose is any reason to get out of bed in the morning. But for companies looking for long term success, an enduring and valuable purpose needs to articulate the intended role in society and its connection to the non-negotiable elements of their business model.

Making this link enables businesses to set clear guiderails for their choices across strategy and culture and allows them to benefit from the interdependency of a commitment to societal impact and enduring commercial success (see diagram).

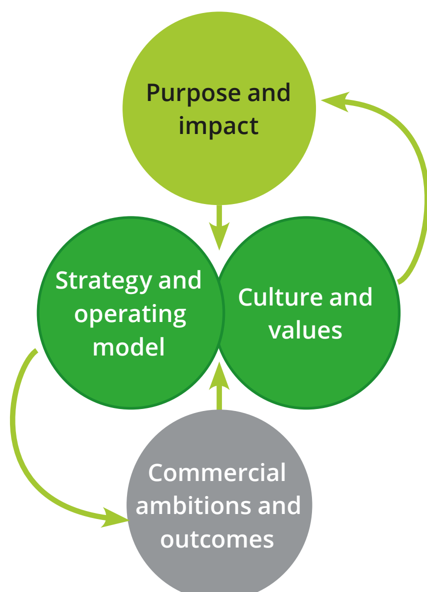
Every day, we see stories that highlight demands on companies to be purpose-led, reflecting the wide spread changes in our collective consciousness. Social impact is an increasing consideration for consumers, investors, regulators and senior **business leaders** as all types of stakeholders increasingly expect businesses to make an authentic commitment to society.

The response to this growing demand has been crystallised by the Code's requirement on businesses to articulate their purpose. But it is a significant challenge for companies to call out their role in society in a way that highlights the interdependence of a commitment to the wider world and long term commercial outcomes. In a complex, interconnected world with multiple interwoven challenges, companies can struggle to demonstrate the mutually reinforcing benefit from addressing social needs through their core business.

We are fortunate that in the Sustainable Development Goals, we have a commonly accepted, broadly recognised and supported means of describing what we mean by social impact that cuts through the noise.

The Sustainable Development Goals (or SDGs, or Global Goals) were ratified by all countries of the UN in 2015. With 17 Goals, 169 targets and 232 indicators, the SDGs offer a common language for nations and businesses to define what impact they intend to make.

Further, as a proxy for society's future expectations, the SDGs provide a strategic framework for helping business to future proof their business model.



Where businesses choose to signal their intent to contribute to the SDGs they join a community of commitment amongst global businesses – indeed, more and more companies are recognising the benefits of doing so. But making such a commitment and placing it at the top of the organisation in corporate purpose is not the end of the story, but the beginning.

For businesses to truly make an impact, and to benefit from doing so, they need to live and breathe their purpose. To do so, there are lots of sources of support. Amongst these, the World Benchmarking Alliance is due to provide a means for companies to be properly recognised for their impact.

Here in the UK, we are widely recognised around the world as pioneers in responsible business. The new requirement in the UK Corporate Governance Code to report on purpose and section 172 will help us to go even further and catalyse more companies to make a deeper commitment to the wider world, as framed through the SDGs. We expect the contribution of business to feature significantly when the UK Government presents our progress on the SDGs through voluntary submission to the UN in July 2019.

As more companies use the SDGs as a tool to describe their role in society we are approaching a tipping point, where companies become increasingly expected to both recognise the obligation to act and to call out and drive towards the opportunities associated with being purpose-led.

Purpose and the Sustainable Development Goals – aide memoire

1. Do you have a clearly articulated company purpose?
2. Have the Sustainable Development Goals been examined in the context of your organisation's role in society?
3. Are company purpose and societal impact evident in your strategy and business model?

Contacts – SDGs and Strategy

Monitor Deloitte, our strategy consulting practice, works side by side with our clients to make the choices that will help stretch and sharpen their ambition. With purpose becoming an increasingly critical component of a sucessful business model, we help organisations discover their purpose, embed it across their decision making, measure the progress and demonstrate the benefits of a commitment to wider society.

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Stepping up on climate change

In this article we detail the existing disclosure requirements for annual reports on climate change risk. We explore the developing pressures on companies from the PRA, FCA and investors to move towards incorporating the voluntary recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) in the annual report.

Introduction

Climate change has never been a more topical issue. In October the Intergovernmental Panel on Climate Change (IPCC) concluded that the existing target for global warming to be limited to 2% is insufficient and needs to be changed to 1.5% – which will require prompt and decisive action from governments, businesses and individuals alike. The alternative is a series of devastating environmental impacts. The BEIS Select Committee is now encouraging more precise and challenging ambitions for a low carbon future.

In these publications we have highlighted several times now the importance placed by investors, investor bodies, proxy agencies, regulators and other stakeholders on attention to climate change and related annual report disclosures.

In this article we go through the existing disclosure requirements, possible future requirements – notably TCFD – and explain some of the pressures on companies to start making these disclosures now.

"For companies most directly impacted by climate change, we expect the whole board to have demonstrable fluency in how climate risk affects the business. The company should explain the board's oversight of management's approach to managing and mitigating the risk. Over the next few years, we expect that companies will enhance their disclosure related to climate change as awareness and understanding of the TCFD's recommendations spreads." BlackRock Investment Stewardship

Existing disclosure requirements

For companies with material impacts on the environment and for whom the environmental factors represent principal risks, the reporting requirements are as follows:

Area (References are to sections of the Companies Act 2006)	**Requirement**	**Applicable for**
Strategic report – trends and factors s414C(7)	To the extent necessary for an understanding of the development, performance or position of the entity's business, the strategic report must include the main **trends and factors** likely to affect the future development, performance and position of the entity's business.	Quoted companies
Principal risks and uncertainties s414CB(2)(d)	The strategic report must include a description of the **principal risks** arising in connection with the entity's operations and, where relevant and proportionate – a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk, and a description of how it **manages and mitigates** the principal risks.	All companies preparing a strategic report. For quoted companies, the UK Corporate Governance Code also requires this disclosure (2018 Code, provision 28)

Area	Requirement	Applicable for
Non-financial reporting s414C(7)(b)(iii) s414CB(1), (2) (b) and(c), (4)	To the extent necessary for an understanding of the development, performance or position and impact of an entity's activity, the strategic report must include information relating to, as a minimum: a. environmental matters (including the impact of the entity's business on the environment); b. the entity's employees; c. social matters; d. respect for human rights; and e. anti-corruption and anti-bribery matters. To the extent necessary for an understanding of the development, performance or position of the entity's business, the strategic report must include information about community issues. The strategic report must include a description of the policies pursued by the entity in relation to the matters and any due diligence processes implemented by the entity in pursuance of those policies. It must also include a description of the outcome of those policies. If the entity does not pursue policies in relation to one or more of these matters, the strategic report must contain a clear and reasoned explanation for the entity not doing so.	The scoping requirements are complex, however all public interest entities with 500 or more employees in the group must comply

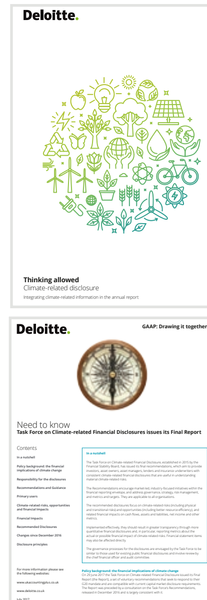
Area	Requirement	Applicable for
s172(1) statement – The Companies (Miscellaneous reporting) Regulations 2018	All large companies (private as well as public) must include a section 172(1) statement in their strategic report which describes how their directors have complied with their duty to promote the success of the company for the benefit of its members whilst having regard to the matters set out in section 172(1) (a)-(f). (The matters in s172(1) include the impact of the company's operations on the community and the environment.)	Applicable to all large companies and to medium companies that do not have exemptions available Applicable for periods commencing on or after 1 January 2019

A reminder of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)

- The organisation's governance around climate-related risks and opportunities.
- The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.
- How the organisation identifies, assesses, and manages climate-related risks.
- The metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Disclosure moves on – PRA/FCA discussion paper on climate change disclosure

> "Climate change, and society's response to it, presents financial risks… And while the financial risks from climate change may crystallise in full over longer time horizons, they are also becoming apparent now."
> PRA consultation paper 23/18, October 2018



During October, the FCA published a discussion paper, Climate Change and Green Finance, on how these matters might impact financial markets and whether reporting of climate change related matters by listed companies may be in the public interest.

It highlights the relatively low take up of the encouraged disclosure of climate-related financial information flagged by the Financial Stability Board's Task Force in its September 2018 status report. Few companies disclosed the financial impact of climate change and provided only limited disclosure on the impact of climate change on company strategy in various scenarios.

In the light of this limited voluntary disclosure, the FCA's discussion paper asks what can be done to ensure that sufficient disclosure is provided by companies and that investors are receiving what they need in the area of climate change.

The FCA identifies four areas which it believes requires specific regulatory focus:

1. Climate change and the effect on pension investments, looking at the responsibilities of independent governance committees of pension funds and also of private pension funds. The long term nature of pension investments means the impact of climate change related risks is much more likely. The FCA will consult on changes in this area.
2. Innovation in specialist green products, ensuring these markets work well. The FCA is keen to enable further innovation in green finance and ethical investment. It has also set an Innovate FinTech Challenge for industry, calling for the market to develop innovative financial products and services to assist in the UK's transition to a low carbon economy.
3. Disclosures regarding climate change by quoted companies. The FCA will consult on issuing guidance regarding the ways the current regulatory regime might be interpreted to apply to climate change-related risks. The FCA highlights and asks questions on how companies interpret the current regime and whether the materiality judgement is clear enough on climate-related matters. It also asks whether companies should be required to provide a statement to investors explaining whether or not they have followed the TCFD recommendations.
4. Finally, the FCA asks the following questions about public reporting of financial services firms in the context of applying the TCFD framework:
    a. Do you think that a requirement for firms to report on climate risks would be a valuable measure?
    b. Do you have any suggestions for what information could be included in a climate risks report?
    c. Do you have any views on which regulated firms should be required to compile a climate risks report?

The FCA seeks responses to its discussion paper by 31 January 2019.

The PRA has published an accompanying discussion paper, setting out its high expectations of banks and insurers regarding how the approach managing the financial risks from climate change. Responses to the PRA discussion paper should be submitted by 15 January 2019.

Example TCFD disclosure

HSBC summarised their response to climate change risk using the framework recommended by the TCFD in the 2017 annual report:

Task Force on Climate-related Financial Disclosures ('TCFD')

Initial response to the Financial Stability Board

Reducing global carbon dioxide emissions is a critical challenge for everyone. We recognise its importance and seek to be a leader in managing climate change risk while developing opportunities with – and for – our customers. We welcome the new disclosure recommendations from the FSB taskforce, which assist the understanding of climate-related risks, and we were a signatory to the June 2017 TCFD report. This represents our first disclosure under the framework. We recognise this will evolve and expand over time.

Governance	Sustainability is a key concern of the HSBC Group Management Board, with five presentations taking place during 2017. HSBC's 2016 Statement on Climate Change may be found on our website at www.hsbc.com/our-approach/measuring-our-impact. The site gives information on our approach to low/high carbon transition, managing our direct impact and partnerships. Our Climate Business Council ('CBC'), established in 2010, is an internal strategic committee whose role is to coordinate across the bank, identifying and developing products and services to meet customers' sustainable finance needs. There is also a group-wide ESG steering group, chaired by the Group Finance Director, leading our approach to ESG issues, including external disclosure and materiality considerations.
Strategy	HSBC's strategy is to connect customers to opportunities across a diversified range of products and services. This, along with our geographical presence in developing markets, gives us a unique opportunity to engage with our customers and support their transition strategies. HSBC has committed to directing $100bn of financing and investment to the low-carbon economy by 2025. In order to facilitate the transition to the low-carbon economy for us and our clients, during 2017 we created a 'Global Head of Sustainable Finance' and an 'HSBC Centre of Sustainable Finance'. Additionally, via training, we have expanded our in-house sustainability expertise to approximately 1,300 employees across the Group. We are committed to strengthening our role as a thought leader in the financial services industry. During 2017, HSBC's Global Research Climate Change Centre was ranked number one by Extel and HSBC was the second-ranked bookrunner by Dealogic for green, social and sustainability bonds. We will work with our customers in all our businesses to develop sustainable products and support innovation.
Risk Management	Climate risk, both physical and transition, is an increasing risk. During 2017 the Executive Risk Management Committee approved a framework for measuring transition risks across our loan portfolio. We have identified the higher transition risk sectors as oil and gas, metals and mining, power and utilities, automobiles, building and construction, and chemicals. We actively engage with clients in these sectors to support their transition strategies. We monitor and report our exposure internally, and will do so externally in 2018. Over time we expect a reduction in the carbon intensity of our portfolio. Our Sustainability risk policies cover all our lending to sensitive sectors and we apply the Equator Principles to project finance. Details are available at www.hsbc.com/our-approach/measuring-our-impact. We also manage the physical risks to our global network relating to climate change by undertaking regular operational stress testing and contingency planning.

Next steps

The HSBC Centre of Sustainable Finance, Risk Management and Finance will work with external experts to develop climate-related scenario analysis and related disclosures.

Financial Reporting Lab project

"The changing climate will impact our lives and the societies we live in. There are many calls to action for all parts of society to respond, and do so quickly. The Financial Reporting Council's ('FRC') Financial Reporting Lab ('the Lab') is playing its part in calling for companies to be more transparent on how they are addressing climate risk." Phil Fitz-Gerald, Director of the Lab, blog post, October 2018

The FRC's Financial Reporting Lab has launched a new project on climate change reporting, alongside workforce engagement reporting. The scope is not yet final, however it is likely to:

- Explore how companies understand, measure and report on climate change and workforce issues, especially in the context of new reporting requirements.
- Examine how investors use this information in their decision-making process and consider whether the emerging reporting meets investor needs.
- Identify where best practice reporting of material information overlaps with relevant frameworks under which companies may develop their reporting, for example, the TCFD recommendations.
- Discuss which areas of reporting are most challenging for companies.
- Consider the extent to which lessons can be learnt from emerging international reporting practice.
- Highlight best practice in company reporting.
- The Lab encourages companies that are interested to participate to contact them by emailing FinancialReportingLab@frc.org.uk.

Stepping up on climate change – aide memoire

1. Do you have a good understanding of how climate-related risks (extreme weather event, longer term physical changes, regulation, technology change) may impact your business?
2. Have you considered how these risks may differentially impact your supply chain, customers and competitors? Have you identified relative opportunity and relative threats?
3. Can your Board articulate the management and mitigation strategies your organisation is applying to the different areas of climate change risk?
4. Have you considered whether and how to incorporate the recommendations of the TCFD in the annual report and discussed with management whether any readiness activities need to be conducted?
5. Is there anything material you are aware of in relation to climate change that may impact your company's longer term prospects and therefore should be addressed and disclosed to investors?
6. Are you sufficiently aware of the carbon footprint of your company's operations, direct and indirect, so you have a feel for the potential areas of impact were a carbon tax to be introduced as a driver of change?

Contacts – Climate change

Deloitte's Sustainability team provides a comprehensive compliance framework with tools to assist companies in developing medium term strategies and action plans, training and maturity assessments.

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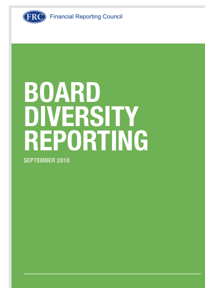
Talking about diversity

In this article we explore recent findings on board diversity from the FRC and others, together with gender pay gap reporting – now entering its second year – a new call for ethnicity pay gap reporting and the supporting actions organisations will need to take around self-reporting mechanisms.

Board diversity reporting



In recent years there have been numerous government initiatives around board diversity. The Davies Review on gender diversity has passed the baton to the Hampton-Alexander Review. The Parker Review focused on ethnic diversity at board level, supported by the McGregor Smith Review on broader BAME diversity in business.

The reporting regime changed, of course, with the introduction of non-financial reporting regulations last year, with listed companies now required to report under the DTR on the board diversity policy with regard to aspects such as age, gender, educational and professional backgrounds, the objectives of the policy, how it was implemented and the results in the reporting period.

Our annual reporting survey of 100 listed companies, Annual Report Insights 2018, indicated that although 80% of annual reports referred to aspects of board diversity other than gender, only 29% of companies met these new DTR requirements (53% of FTSE 100 companies). In general, boards are not as clear as they could be about measurable objectives on board diversity (disclosed by 22% of companies this year, up from 16% in 2017).

This has now become an area of significant attention for the regulator, which sees diversity as key to an effective boardroom dynamic, helping to avoid groupthink and complacency.

In the 2018 UK Corporate Governance Code, diversity underlines Principle J, which calls for appointments and succession plans to "promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths." Principle L calls for diversity to be featured in the board evaluation.

This is explored in several of the more detailed provisions, including Provision 23 asking for companies to describe the linkage between the diversity and inclusion policy and company strategy. This goes well beyond lip service and companies will need to put some thought to how they will apply the new Principles in practice.

In September the FRC published a new report outlining its findings in respect of board diversity reporting in the FTSE 350. Given the context of the new Code and the increased focus on board diversity, it is no surprise that the findings give plenty of room for improvement, although they do show substantial movement since the 2012 Code first introduced a requirement for boards to discuss diversity.

The FRC flags the disappointing finding that, whilst some boards treat diversity as an opportunity and an issue of strategic importance, for many it appears to be a compliance exercise. We feel this reflects the findings of our annual reporting survey.

Some interesting statistics and findings from the FRC's report include:

- 98% of FTSE 100 and 88% of FTSE 250 companies disclosed a policy on board diversity, a considerable improvement since 2012 when this disclosure requirement was first included in the UK Corporate Governance Code.
- 15% of FTSE 100 companies reported against all four measures stated within provision B.2.4 of the current UK Corporate Governance Code which include describing their policy on diversity, the process for board appointments, their objectives in implementing the diversity policy and the progress on achieving these objectives.

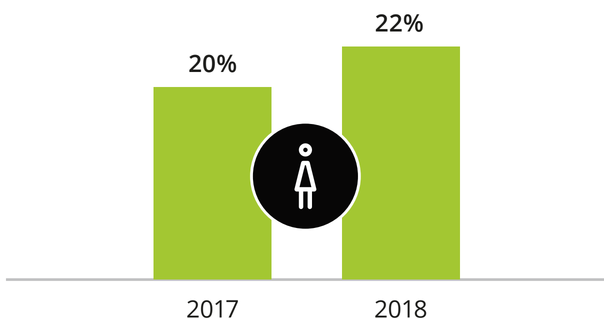
"There have been many actions to move the dial on gender diversity in the workplace over many years but these have failed to deliver significant movement. We need to try harder and tackle more fundamental issues to gain the traction required." **Amanda Blanc, Chair of the ABI**

Gender diversity – the Hampton-Alexander Review
The Hampton-Alexander Review has published its 2018 report, which is released annually in November.

The Review focuses not only on gender diversity on boards, but also gender diversity of the chair, of executive directors and of the executive committee, including the pipeline that helps to promote suitable candidates to those positions.

Our Annual Report Insights 2018 shows that the comparatively easy ask of reporting on the gender diversity on the executive committee and their direct reports has been met by only 15% of companies in our full sample of 100 listed companies, and only 25% of the FTSE 350 companies that have been the focus of the Hampton-Alexander Review.

In our survey sample we saw a small improvement in the proportion of the board that were women, from 20% in 2017 to 22% this year. This was driven by increases in the FTSE 250 and smaller companies, offset by a small decline in women board members in the FTSE 100.



Gender pay gap – a reminder
All employers with more than 250 or more relevant employees will need to publish their second gender pay gap report by 4 April 2019, based on data as at 5 April 2018. Last year over 10,000 reports were published.

So far this year, six months on from the date on which the report is based, just over 300 reports have been published.

In August, the BEIS Select Committee published a report, Closing the Gender Pay Gap. This highlights that median pay across the economy is 18% in favour of men, with 13% of employers having gender pay gaps in favour of men of over 30%.

The report also has some useful observations on improving gender pay gap reporting, and indeed help towards longer term efforts to reduce the gender pay gap itself. These include:

- Including details in the report of an action plan set by the organisation to close the gender pay gap and steps taken during the year.
- Boards introducing KPIs for reducing and eliminating their pay gaps.
- Remuneration committees, in reporting on pay policy, explaining how their commitment to reducing the pay gap is being reflected in their decisions.

Ethnicity pay gap

In the wake of the attention and interest around gender pay gap reporting this year and some businesses choosing to voluntarily publish an ethnicity pay gap, the Department for Business, Energy and Industrial Strategy (BEIS) is consulting on views on ethnicity pay reporting.

The objective of the consultation is to 'enable government and employers to move forward in a consistent and transparent way', and to inform future Government policy on ethnicity pay reporting. It asks questions regarding what ethnicity pay information should be reported by employers to allow for meaningful action, who should be expected to report, and next steps.

Questions include what type of ethnicity information should be reported that would not place undue burdens on businesses. For example:

- one pay gap figure comparing average hourly earnings of ethnic minority employees as a percentage of white employees; or
- several pay gap figures comparing average hourly earnings of different groups of ethnic minority employees as a percentage of white employees; or
- ethnicity pay information by pay band or quartile, showing the proportion of employees from different ethnic groups by £20,000 pay bands or by pay quartiles.

The consultation document notes that the Government is mindful of the existing requirements in place for gender pay gap reporting, and welcomes views on the extent to which employers would find it helpful to mirror parts of the gender pay gap methodology. It draws out that the recent McGregor Smith report suggests that ethnicity data should be reported for companies with more than 50 employees, whereas gender pay gap reporting is in effect for companies with more than 250 employees.

Views are also invited on the most effective approaches for employers to improve employee self-reporting, which is recognised as a key area of challenge for companies in this area.

The consultation closes on 11 January 2019.

The challenge of self-reporting

An area of real challenge for companies aiming to increase diversity is self-reporting – the need to ask employees to inform the company about their protected characteristics in order to analyse diversity, improve policies and publish information. This has been highlighted by the BEIS consultation regarding ethnicity pay.

Employers tend to ask about protected characteristics – and in the case of public sector employees, are required to do so – but employees are not required to answer. There is a significant difference in level of reporting of different characteristics. This then becomes a barrier to tracking diversity and progress towards eliminating discrimination – sometimes called the "data deficit".

According to a report published in August by the Equality and Human Rights Commission (EHRC), 51% of employers report barriers to collecting data on the ethnicity of employees, and 52% to collecting data on disability. 13% of employers thought that nothing would overcome those barriers.

The EHRC's report suggests several good practice actions that can be implemented by companies and help towards reducing self-reporting barriers. These include:

- Internal communications campaigns to highlight to staff how data collected will be used to support equality.
- Collecting data at regular intervals and on a rolling basis.
- Publishing equality reports that show workforce breakdowns of employees by protected characteristics.
- Monitoring recruitment bias.
- Establishing working groups or action plans to address ethnicity and disability pay gaps, for example leadership workshops targeted at staff from ethnic minority groups.

It is worth bearing in mind that increasing levels of self-reporting will not necessarily result in finding a higher proportion of individuals with protected characteristics, but it will provide the vital data needed by companies to promote change and equality.

Talking about diversity – aide memoire

1. Are you familiar with the board's policy on diversity, how that relates to succession planning and whether it meets the new demands of the 2018 UK Corporate Governance Code? Is the policy clearly reported in the annual report, together with objectives and outcomes?
2. Does your board treat diversity both at board level and throughout the organisation as an opportunity and a matter of strategic importance? Is it given sufficient time at board level?
3. Do you have a clear view on the diversity challenges throughout your organisation, the actions being taken to increase diversity where necessary, and this year's gender pay gap results? Do you have an understanding of your ethnicity pay gap?

Contacts – Diversity

Deloitte's Sustainability team works with companies to identify any issues around diversity pay and equality, collect and consider relevant data, help them through the design and implementation of action plans to address any gaps and assist in developing reporting plans and the disclosures required for internal and external purposes.

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Your reputation in the hands of social media

In this article we consider how board members can be in the best position to help the organisations that they steward to understand the impact of social media and how to use it effectively to relieve reputational damage in a crisis.

This year has seen no let up in the number of organisations hit by a broad range of crises.

These have stemmed from a variety of sources. Some have been fast-moving 'incident-driven' crises relating to safety failures or security breaches. Others have developed more slowly as organisations have been drawn into the spotlight because aspects of their *performance* have been subject to criticism or because their policies are at odds with public expectation.

Whatever the cause, crises invariably lead to reputational damage for the organisations involved. And, in conversations about reputation damage, board members are quick to come to the topic of social media.

An opportunity as well as a challenge

Social media has, of course, dramatically changed the media environment and the way people engage with 'news'. Timescales have been radically altered and the current expectation is that organisations are open, transparent and 'always on'. Social media has enabled everyone, regardless of their position, to share their experiences far beyond their immediate friends and family network. This empowers individuals and allows them to shape the wider news agenda.

But, fundamentally, social media for a company is just another communication channel which can support a wider crisis communication response. The tactics and context may have changed, but the principles of effective reputation management remain the same.

In any crisis, an organisation will need to communicate to maintain trust and protect its reputation. It will need to find ways to explain what has happened, what it is doing in response to the situation and, frequently, how it feels about what has happened. The organisation must prioritise those affected – the victims - demonstrating that they will be supported in the long-term. Often this demands humility and contrition. And, as a working principle, the organisation should attempt to communicate these matters with the right tone before it is forced to do so and therefore ensure that its voice is heard.

Social media, for all its challenges, can be a powerful tool to achieve all this. It allows an organisation to communicate directly with its stakeholders, bypassing traditional media and speaking straight to the people who really matter. Twitter, for example, allows an organisation to show it is listening, to provide helpful information about the crisis and to demonstrate what it is doing to resolve the situation. It can also be used to correct any inaccuracies, swiftly and effectively.

But none of this will happen without careful planning and consideration. A fast-moving crisis is not the time to start thinking about how social media should be used. In addition to building up a strong social media presence during day-to-day business, so it is important to put social media front and centre of any wider crisis preparedness programme.

Below are a set of questions for board members to ask, to help the organisations that they steward use social media effectively to relieve reputational damage in a crisis.

1. **Does the organisation have a clear policy for how it will use social media in a crisis?**
    - A major crisis will generate interest and scrutiny in an organisation that is far beyond its usual stakeholder groups. Social media can quickly become vast and feel unmanageable. Consequently, the way that businesses aim to use social media in a crisis may need to differ significantly from business as usual.
    - This increase in volume may mean it is simply not possible to respond to each Tweet individually, which might be the approach the organisation usually takes. Rather, it may use Twitter to sign-post and direct people to its main website. Similarly, the organisation must answer a number of questions: *Who is responsible for drafting and approving content in a crisis? Which channels will be used and for what purpose? How will offensive posts will be handled?*
    - This policy (or stated purpose) should be clearly summarised in wider crisis plans so that there is clarity throughout the organisation.

2. **Does the organisation have access to the necessary social media expertise and resources it will need in a crisis?**
   - Policies and processes don't manage crises; people do. It is likely that additional people will need to be brought into the communication team to manage the anticipated volume of social media activity. These people will need to be identified in advance (from inside or outside the business), trained and given opportunities to practice and rehearse their roles.
3. **Does the organisation have the right listening tools in place to fully utilise social media?**
   - At its essence, social media is a series of conversations conducted in public. This allows communication professionals to listen in real-time to what previously closed groups are saying about your organisation: What do they think about you? What do they know about the incident or issue? What do they expect you to do in response?
   - The right listening tools can allow an organisation to identify a potential crisis early, allowing the business to take mitigating actions or to inform its response in the middle of a major incident. We recommend organisations use a combination of software solutions coupled with human analysis - a comprehensive listening and monitoring process giving a thorough analysis of online presence, assessing consumers, campaigns, influencers and ultimately reputation. This is the full service package which is desirable, either run in house or bought in as a service.
4. **Are board members (and senior management) taking steps to make sure they are not inadvertently escalating any crisis situation?**
   - In a crisis, journalists and other commentators will look to continue a story. LinkedIn accounts, Twitter feeds, Facebook and other channels will be pored over looking for a new angle. Board members need to take care that their own social media accounts do not inadvertently add to the situation. They should also be mindful of what they post - photos and opinions - and how they might look against the backdrop of a crisis with clear victims. This extends to family members too.

In summary

Board members can certainly help drive an organisation to become better prepared to use social media effectively. But when the crisis strikes and it feels as though the business is being overwhelmed by criticism on social media and traditional media, board members can also offer a supportive and sensible voice. They can remind an organisation not to overreact and not to make the mistake of equating online sentiment with the wider offline world.

The rise and rise of social media:

1. The number of social media users in 2018 is 3.2 billion, up 13 percent year-on-year
2. 44 million active social media users in UK (66% population)
3. 33m in the UK use Facebook on a regular basis
4. 47% of online adults in the UK use Twitter on a regular basis

Sources: We Are Social: Digital in 2018 report

Unprepared: no capability to use social media

1. 78% of companies consider that social networks will be extremely important in the next 3 years
2. But 38% say they have no capability at all to use (normalise and enrich) information found on social media

Sources:
1) Harvard Business Review. Study of 628 companies, of which 57% have earnings over $5 billion, 32% between $1 -$5 billion and 11% between $50 million and $1 billion.
2) Unified report, "The New Age of Transparency" 2017

Your reputation in the hands of social media – aide memoire

1. Does the organisation have the right listening tools in place to fully utilise social media?
2. Does the organisation have a clear policy for how it will use social media in a crisis?
3. Does the organisation have access to the necessary social media expertise and resources it will need in a crisis?

Contacts – Reputation

Deloitte Crisis and Resilience helps our clients not just through the good times, but also in the toughest moments of crisis, providing clients with the clarity and confidence for when it really matters. Our specialists can help you identify, assess, prevent, prepare, respond and recover from crises. Many of our clients have emerged from great challenges even stronger than before.

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Governance in focus | On the board agenda – the 2019 reporting season

Risk & viability

Identifying and addressing emerging risks

In this article we put forward some suggestions to help boards meet the new Code provision to perform a robust assessment of emerging risks in addition to the principal risks.

As innovation, technology, and regulation evolve, so the risk landscape also evolves to disrupt strategies, business models, markets, and customer behaviour. To protect and enhance long-term value, companies need to have a dynamic and active approach to risk.

With a proactive approach to risk, leaders find themselves better positioned to navigate this disruptive environment, and leaders often discover new opportunities to create value for stakeholders, boost performance, and grow their businesses.

It is natural for management to focus narrowly on the "risk-of-the-day" being pushed from the outside by the media or by regulators, or on the most pressing current risk to the organisation, identified from within. Yet this approach can obscure other risks and skew investments in risk management, as well as the organisation's responses to risks.

Senior leaders need a panoramic view of risk—an integrated perspective that can lead to an understanding of the full risk landscape and its potential impact on the organisation. This is reflected in the FRC's late addition to the 2018 UK Corporate Governance Code which calls for boards to carry out a robust assessment of the company's emerging risks as well as the principal risks. Boards must now also describe what procedures are in place to identify emerging risks.

A recent research paper by the Institute of Risk Management provided the following helpful definition of emerging risks:

"Those risks that have not yet occurred but are at an early stage of becoming known and/or coming into being and expected to grow greatly in significance. They do not have the 'track record' of other better known, non-emergent, risks and usually arise in the longer term."

We put forward some questions that boards could usefully be asking to help identify emerging risks:

- In which areas is the **business model** vulnerable to disruption?
- What is our exposure to **technology** disruption?
- How could material **environmental & social risks** affect the company's short and long term value?
- What planning is the board doing around the **implications of Brexit – both short and longer term** (in whatever form it may take)?
- What are the exposures to **cyber & data security risks** both directly and for key suppliers?
- What are the drivers of **productivity** in the business and how are these managed?

To be effective at this type of horizon scanning, the board must ensure that there is an integrated risk management system that clearly ties the risk strategy to corporate strategy and *delivers actionable risk intelligence* to the people who need it, when they need it, to make and implement decisions.

Here are two examples of tools which can be used to assist in this process:

Peek into the future: Leverage technology to sense risk

Challenge

Economic crises, market movements, regulatory changes, social media backlash, and new technologies can present major risks in our interconnected world. While typically "unforeseen," in hindsight the signs were there and the risks (if not the events) could have potentially been anticipated.

Approach

Risk sensing platforms scan the external landscape for early signs of emerging risks. By combining human insight with data mining and cognitive technologies, risk sensing synthesises and analyses massive volumes of online and social media information on geopolitical, economic, regulatory, operational, and financial events to deliver predictive intelligence on relevant emerging issues worldwide.

Benefits

Risk sensing enables the enterprise to identify trends, anticipate risks, and seize opportunities based on the best information available. It supports strategic decision making, provides outside-in views of risks, and positions the organisation for first or second-mover strategies or preemptive tactics. It also assists in transforming emerging risks into opportunities.

Practice makes perfect: Scenario planning and war-gaming

Challenge

Strategic risks can undermine the organisation's drivers of value and threaten its competitive position and ability to achieve goals and sustain performance. These disruptive risks create the need for rapid response and, potentially, rapid evolution.

Approach

Scenario planning gauges the impact of social, political, technological, and other trends on the organisation. It positions management to respond by adjusting strategies, capabilities, and risk management options. War-gaming enables the enterprise to rehearse, test, refine, and adjust strategies and enhance decision making amid uncertainty, and to consider second- and third-order effects of decisions.

Benefits

Scenario planning and war-gaming exercises are designed to enhance risk intelligence by broadening management's view not only of risks and its impacts, but also of the ways in which the enterprise experiences risks. This positions management to broaden the organisation's choice-set of responses while better understanding the potential knock-on effects of specific responses.

The aim is to develop a more resilient and confident business with:

- Strategic assumptions regularly stress tested.
- Relentless focus on operational discipline and cultural soft spots in critical areas.
- Continuous consideration of weak signals and unchallenged beliefs.
- Prompt identification of, and rapid response to, emerging risks and disruption – internal and external.

Identifying and addressing emerging risks – aide memoire

1. Do we monitor our entire business ecosystem and the broader risk landscape for emerging threats to our strategy, operations, and reputation?
2. Do we have a process for monitoring the assumptions underlying our strategy and investment decisions and for enhancing those decisions accordingly?
3. Do we have a good understanding of our integrated risk management programme and are we able to provide comprehensive oversight?
4. Have we harnessed data and analytics to create an enterprise-wide view of risk and to deliver timely risk information to decision makers at all levels?

Contacts – Risk Advisory

If you would like to discuss your organisation's approach to identifying and assessing emerging risks, or other aspects of risk management, please reach out to the contacts set out below.

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Brexit, viability statements and capital allocation decisions

In this article we explore the challenges directors face preparing their viability statements, including the assessment of future prospects, in the light of an upcoming Brexit. We also look at recent FRC guidance regarding capital allocation and dividends and FRC Lab analysis regarding business model, principal risks, and viability statement disclosures.

Brexit and the viability statement

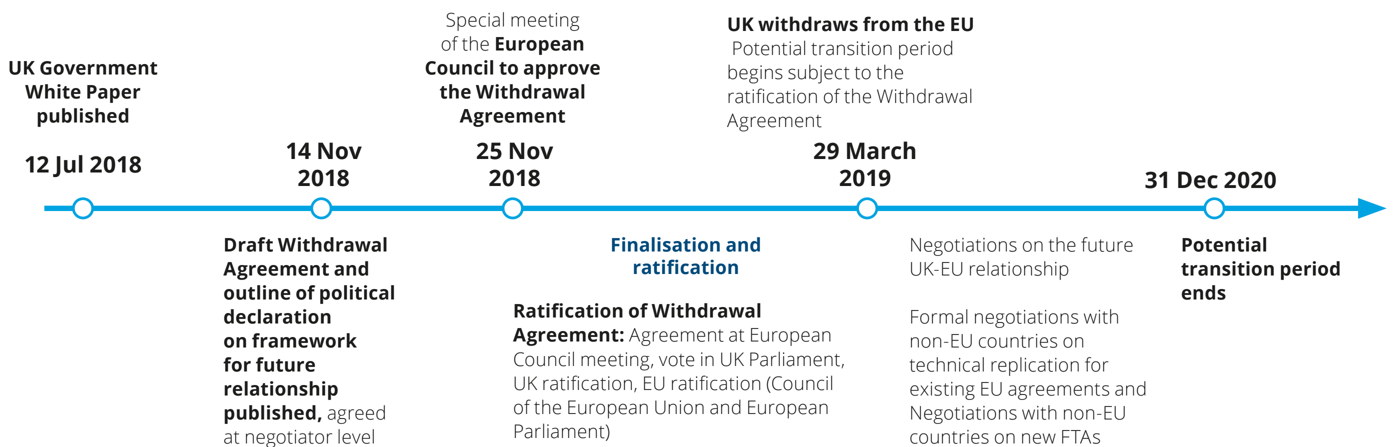
Article 50, the mechanism for leaving the European Union, was triggered on 29 March 2017, meaning that by operation of law, the UK will leave on 29 March 2019.

The range of possible scenarios means that companies have struggled to know the best way to prepare for potential challenges. However, many have now established the nature of the most significant challenges. In some cases, contingency plans sit ready to be implemented.

This is the backdrop against which companies are preparing annual reports, including their description of longer term prospects and the separate viability statement which normally looks out over 3-5 years.

For December year ends, there may be no definitive answer on whether the EU and the UK have an agreed deal prior to the year end. However, there may well be more clarity before the annual report is signed – or if delays arise, even in the few days following the signature of the annual report.

Brexit timeline



What are the requirements?

Under the 2016 UK Corporate Governance Code, provision C.2.2. covers the viability statement:

Taking account of the company's current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have 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.

Our research shows that comparatively few companies have so far mentioned Brexit in their viability statement, either as part of the scenarios they have tested or as an assumption underlying their supporting analysis. Based on public disclosures alone, therefore, there is little evidence that companies have built the multiple uncertainties of a wide-ranging Brexit impact into their forward-looking forecasts.

With critical decisions and implementations so close at hand, directors will in all likelihood need to be mentioning Brexit this reporting season and explaining what assumptions have been built into their forecasts, especially when it comes to liquidity and cash flow issues.

This is not merely a matter for management, but something that auditors will also need to consider, given their responsibility under auditing standards to confirm in their audit report whether they have anything material to add or draw attention to with respect to the directors' reporting on risk and the longer term viability statement.

What should the board do?
The board should make sure that forecasting incorporates clear scenarios around the potential impacts of Brexit on their business. Management should be asked to run several scenarios which can be refined and finalised as critical milestones change or pass, and the audit committee chair should ensure that sufficient time has been allocated to challenge the forecasts and the sensitivities.

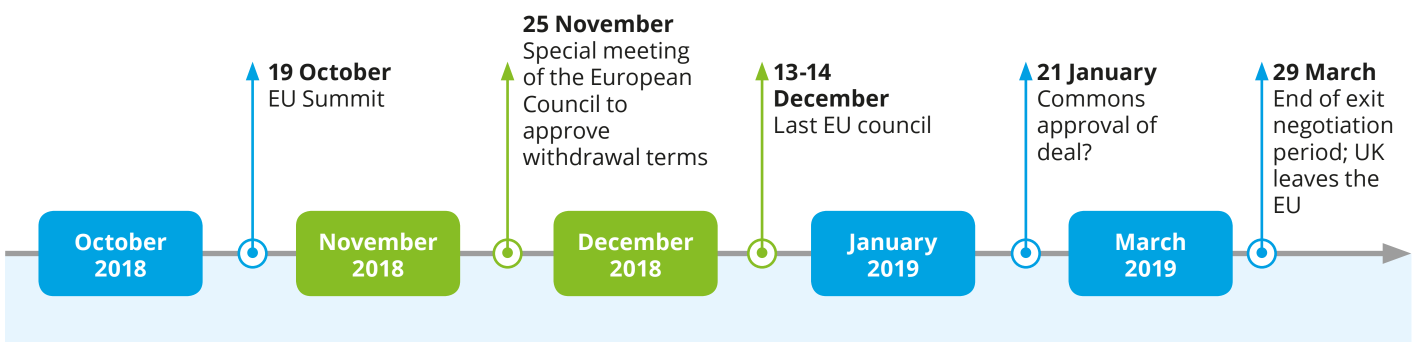
Where sensitised forecasts show a short term impact on liquidity and cash flows, not only the longer term viability statement but also going concern should be examined with rigour.

The audit committee should also pay close attention to the quality and clarity of reporting on the impact of Brexit, which is receiving special focus from the FRC.

Brexit and the viability statement – aide memoire

- Do we truly understand the impact Brexit could have on our business – its strategy, business model and future viability?
- Has the board articulated the nature of the company's Brexit risk and set its risk appetite in order to plan effectively?
- Have we built into that assessment the broader risks to the economy and availability of workforce?
- If Brexit has not been classified as a principal risk before, should it be classified as such this year? Are we satisfied that any contingency plans are sufficiently robust?
- Has management modelled the impact of Brexit in a consistent manner to how other longer term viability statement scenarios are assessed? Does this include modelling Brexit impacts to materialise in combination with other principal risks?
- Is the board satisfied that the modelling scenarios used by management for the impact of Brexit on the company are complete and that their impact upon the business is considered to be realistic?
- Have the assumptions underlying our assessment of the impact of Brexit been both validated and stress tested?

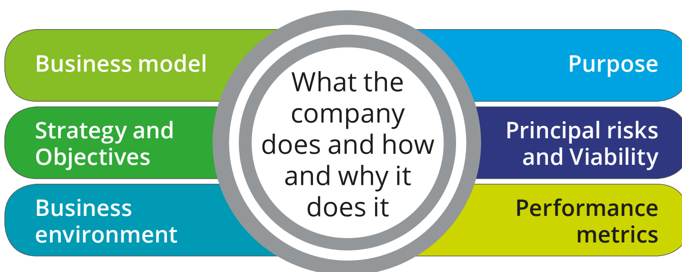
Key political signposts indicating direction of travel



Business model, principal risks and viability statements

In October 2018, the FRC's Financial Reporting Lab published an implementation study regarding company reporting on business model, principal risks and viability statements, following its reports on those topics during 2017.

The Lab found that, whilst there have been improvements, investors consider that these disclosures could be more valuable still. There continues to be emphasis on the need for reporting to be more consistent in the following areas – what the company does and how and why it does it – and for linkage throughout the annual report to be improved



(Lab report, October 2018)

The Lab has shared a series of findings and questions for boards on all three areas refined through its recent reviews of annual reports and its interactions with investors.

Business model

Investors have consistently highlighted that they are looking for particular information within a business model: how the company makes money, key sources of value and drivers of that value.

The Lab flags in this new report that investors appreciate the need for companies to structure their communications efficiently and do not necessarily require this information to be within the business model disclosure. Cross-referencing and good linkage would, however, be useful.

The Lab found in its review that linkage was still lacking and changes to the business model had not necessarily helped add broad understanding nor company specific detail.

Business model disclosure – aide memoire

- Does your business model clearly communicate how you create value (both in terms of cash generation and non-financial value) over the longer-term?
- Is it clear for the reader as to what this longer-term period is?
- Is your business model disclosure comprehensive, covering all elements investors find useful that are relevant to your business, either in a single disclosure or through clear and meaningful cross-referencing?
- Does your disclosure include the business models of all your significant businesses, or refer to where that information is, and the value of combining them within one group?
- Are the key drivers of your business model(s) clear?
- Does your disclosure demonstrate how your business is unique?
- Does the business model graphic improve the ability to understand the business model for those outside your organisation?

Principal risks

The Lab recognises that risk reporting is already well developed but continues to recommend more detail on risk tolerance, responsibilities and mitigating actions. Lack of linkage to the business model continues to be an issue.

The Lab flags in this new report that investors are particularly focused on disclosures regarding the UK's withdrawal from the EU. They seek detail on how prepared companies are, the stage of implementation of mitigating activities and enough numerical data to help them assess the impact.

Principal risks – aide memoire

- Does the description of principal risks identify how they are specific to the company?
- Are the risk disclosures detailed and specific enough to understand why the risk is material and over what time period?
- Is it clear to the reader how the company categorises and prioritises principal risks?
- Are movements in principal risks, including movements into and out of the principal classifications, explained?
- Do the mitigating activities include specific information that allows the reader to understand the company's response and current stage of mitigation?

Companies cited by the Lab as examples of reporting where companies had enhanced the value of their disclosures were SSE, Vodafone and Essentra.

Viability reporting

The Lab has previously reported on concerns that viability statement reporting was tending towards boilerplate and warned about this trend.

In 2017 the FRC called for greater application of the two stage process of reporting on long term prospects and then the board's statement of viability. This call to action was heeded and applied by some companies. The Lab flags that, because there is a lack of consistency in applying the process, viability statements are not always seen as useful to investors, so companies are encouraged to have another go at this.

The viability statement – aide memoire

- Does the disclosure differentiate between the directors' assessment of long term prospects and their statement on the company's viability, and clarify why different time horizons are used?
- When disclosing long-term prospects has the board considered their stewardship responsibilities, previous statements they have made (especially in raising capital), the nature of the business and its stage of development, and its investment and planning periods?
- Does the viability statement disclose any relevant qualifications and assumptions when explaining the directors' reasonable expectation of the viability of the company?
- Is the link between the viability statement and principal risks clear to the reader, particularly in relation to the scenario analyses?
- Are the stress and scenario analyses disclosed in sufficient detail (and quantification) to provide investors with an understanding of the nature and potential impact of those scenarios, and the extent and likelihood of mitigating activities?

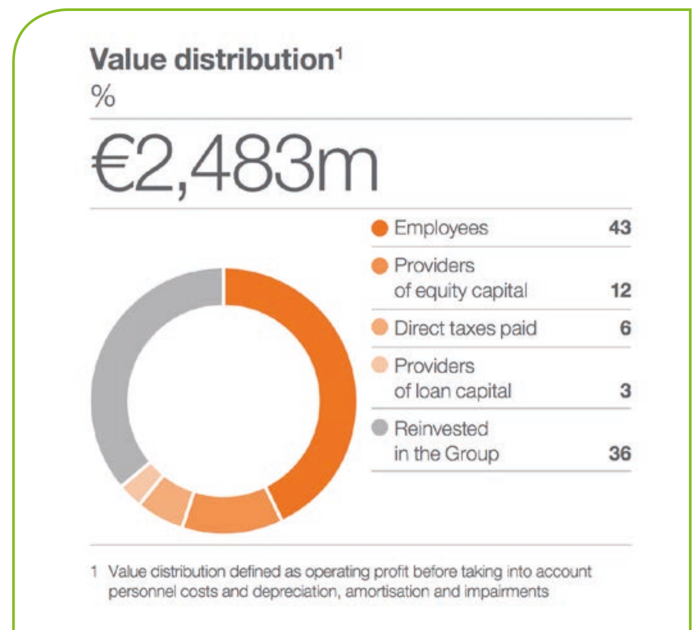
Companies cited by the Lab as examples of reporting where companies had enhanced the value of their disclosures were Informa, Tyman, Croda International, Burberry, Hastings Group Holdings, Nationwide and Superdry.

Capital allocation and dividends – the FRC's updated Guidance on the Strategic Report

In preparing its updated Guidance on the Strategic Report, published at the end of July, the FRC recognises concerns regarding a lack of trust in business. It also recognises that expectations of corporate reporting by investors are rising.

In its Guidance, the FRC encourages companies to be more transparent about capital allocation decisions. This includes how companies are engaging with various stakeholders and how they distribute the value they create amongst different groups of those stakeholders, such as in the form of capital expenditure, investment in skills and training, research and development, and tax. The link should be made to how the allocation of resources supports the strategy of the business.

Some companies have helpfully created diagrams such as pie charts so that users of the annual report can visualise their explanations of capital allocation decisions (examples include Centrica, Lonmin, Mondi).



Mondi Group Integrated report and financial statements 2017

The FRC highlights that dividends are also a key part of the capital allocation decision and of course one that is critical to investors' decision making. This is closely linked to the decision making process the directors must apply under s172 and will involve balancing the short and long term interests of shareholders. When companies come to apply the requirements of the new s172(1) statement, applicable for periods commencing on or after 1 January 2019, the important decision making processes around capital allocation in general, and dividends in particular, may be one area where companies could include useful detail. Clarity of reporting regarding dividends is also an area flagged for attention and potential future legislation by the Government.

The FRC also reminds companies that the narrative reporting and the financial statements must be cohesive and linked effectively 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.

Preparing for the red dawn in cyber regulation

In this article we explore how the business world is moving towards “red team” testing for cyber preparedness and resilience to cyber attacks – and what your organisation can and should be doing.

TIBER-EU is a new framework from the European Central Bank (ECB), as a guide for adoption by national authorities and oversight bodies, intended to drive cyber preparedness and resilience to systemic cyber attacks, and consequently reinforce economic stability of their jurisdiction. Typically, what is seen as standard practice in financial and other systemically important institutions soon becomes standard practice elsewhere.

TIBER stands for **T**hreat **I**ntelligence-**B**ased **E**thical **R**ed Teaming, essentially a cyber stress test for how robustly the firm’s prevention, detection and response capabilities perform during a cyber attack against a critical function and its supporting people and processes. This framework targets the harmonisation of such testing requirements, and follows successful schemes targeting top tier financial services organisations in the UK (CBEST), the Netherlands (TIBER-NL) and Hong Kong (iCAST). It is the result of consultation with industry, national authorities and relevant service providers for threat intelligence and red teaming.

The red team test not only practically assesses the feasibility of a successful attack, and your ability to prevent, detect and respond, but also uses after-the-fact analysis with the organisation’s internal security teams. The terminology originates from the NATO practice of having friendly troops emulate the enemy during wargames for realistic training exercises, providing a live, intelligent adversary for combat.

Threat intelligence is used to create realistic and credible cyber attack scenarios against your critical assets. These seek to emulate how real-world adversaries might attack your critical systems. The red team simulates the scenarios using controlled techniques and tactics replicating those used by threat actors. They are ethical in that the red team is not typically ex-hackers with the potential to do harm, but comprises qualified professionals under contract, who will act with integrity and discipline, and are experienced in simulating a real attack whilst effectively managing the associated risks.

The implications

The red team tests must be performed by external specialists, with minimal knowledge of internal resources. They are carried out against live production systems in order to most accurately replicate real-world attacks and assess real-life capabilities. This does introduce operational risk, however it eradicates any doubt over the relevance of deficiencies identified, increasing the assurance provided. TIBER-EU provides a standard methodology for delivery and defined qualifications for both the individuals and service providers. So accredited consultancies will be accustomed to operating within, and mitigating such risks accordingly.

Although currently voluntary, if your organisation operates a systemically important payment, clearing and settlement systems in the euro area, it is likely the ECB will now be expecting you to be able demonstrate you take cyber resilience seriously by undertaking intelligence-led red teaming on a regular basis.

This framework now marks a clearly defined standard for how entities can demonstrate the level of cyber resilience expected. This is in combination with additional ECB cyber security requirements such as breach reporting, and a focus on cyber risk management. We believe this signifies a new era of transparency of board attention to cyber resilience. Regulators can more readily assess an individual firm’s relative investment, and level of proactivity, in the remediation of deficiencies identified.

This arises from an ability to provide effective challenge to cyber security management, which in turn requires understanding of key cyber risk issues, cyber threats, and how to deal with them appropriately. This requires significant expertise, typically not found in the boardroom.

We are already seeing that where entities are found to be non-compliant, deficient or otherwise under-invested in cyber resilience, they can expect to see enhanced supervision or enforcement actions (such as external reviews or significant financial sanctions).

All of this means no more excuses, if you are an entity the competent authority considers to be responsible for safeguarding critical functions. The ability to withstand cyber attacks, with the potential to impact the local and wider economies, is now considered a crucial capability.

How should you prepare?
This approach of undertaking practical assessments to obtain empirical evidence that evidences your organisation's cyber capabilities is being widely adopted by supervisors and oversight bodies across other sectors of nationally critical importance. In the UK, we have seen the original CBEST scheme be successful at raising the profile of cyber risk at the board. Regulators have taken the same approach in the telecommunications (TBEST), Nuclear (NBEST) and Government (GBEST) sectors, with many more set to follow. Coupled with the spread throughout Europe and the rest of the globe, it appears that regulators believe this to be an effective way of knowing exactly how resilient their constituents are to a cyber attack.

With this focus on resilience in mind, we suggest ask yourselves the following:

1. Do you have an independent view of realistic cyber threats to your organisation?
2. Do you know how effectively your security systems and processes would perform under such attacks?
3. Have you recently tested this in a robust way and learnt the lessons from doing so?

Finally, embrace the spirit of these exercises, and use them to get an honest assessment of your firm's cyber security. Do this by getting credible threat intelligence to define realistic cyber attack scenarios, seeing how well your defences cope in a practical test (also an effective way to challenge operational teams), and cutting through the noise around internal cyber posture. After all, it's better to be found wanting during a rehearsal, than in front of the world's press in a real-life crisis situation

Preparing for the red dawn in cyber regulation – aide memoire

1. Do you have an independent view of realistic cyber threats to your organisation?
2. Do you know how effectively your security systems and processes would perform under real world cyber attacks?
3. Have you recently tested this in a robust way and learnt the lessons from doing so?

Contacts – Cyber
Deloitte's Attack team helps our clients to challenge their status quo and explore the potential implications of a cyber attack, without the real-world business consequences. We enable them to proactively learn critical lessons and implement vital preventative measures. This allows clients to prepare to detect, respond and recover from attacks, while minimising the potential for escalation to a crisis. It also reinforces their ability to withstand the adversarial pressures they face continually, while defending our critical national infrastructure.

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Brexit: Assessing the impact on personal data flow

In this article we explore the impact of Brexit on personal data and highlight the importance of organisations understanding what personal data is moved between jurisdictions as part of everyday activities.

Information flow between an organisation and its suppliers is a fundamental part of any business operation. It enables daily activities such as managing staff, providing services to customers and meeting regulatory requirements.

In the EU, free flow of personal information is taken for granted. For many decades, organisations have been building, shaping, growing and expanding their business, supported by the freedom to flow personal information across Member States. It was not been envisaged that this freedom would be disrupted.

Since the introduction of the 1995 Directive on data protection, organisations in the UK have been using EU mechanisms to send personal information to locations outside the UK, to take advantage of low-cost locations and as part of the globalisation of their operations.

Today, given the Brexit situation, it is time to consider how organisations can:

- Adopt their strategy to flow personal information from the UK to locations outside the EU; and
- Continue to freely flow personal information between the EU and the UK.

Methods of flowing personal information to locations outside the EU (including UK post-Brexit) include:*
As a member of the EU, the UK was able to freely flow personal information to locations outside the EU using mechanisms, such as:

- EU Model Clauses
- Binding Corporate Rules (BCR)
- Privacy Shield
- Adequacy

These mechanisms do not generally equal the level of freedom to flow and share personal information that UK- and EU-based businesses have had to date. Most of these mechanisms come with additional operational, compliance, and financial implications.

Adequacy comes close to providing the current level of freedom enjoyed by businesses in the EU. However, it takes several years for the European Commission to conclude that a location is adequate. Whilst adequacy allows for free flow of personal information, it comes with conditions and limitations. Maintaining adequacy is an ongoing obligation on the UK's part, and this means ensuring that privacy protections and rights of individuals are maintained to a standard that is acceptable to the EU Commission. If the UK fails to meet this standard, there is a risk that adequacy status can be revoked.

Facilitating personal data flow after Brexit
The UK Government recognises the importance of undisrupted flow of data between the EU and the UK post-Brexit. In May 2018, they put forward an ambitious request to the EU to grant the UK an 'enhanced adequacy status'. This would distinguish the UK from other locations where the Commission has made adequacy findings. This unique status was sought on the basis of the historically close UK-EU alignment on privacy and data protection.

The UK Information Commissioner's Office (ICO) has been the most influential privacy regulator in the EU, and the UK Data Protection Act 2018 is almost identical to the General Data Protection Regulation (GDPR), thus allowing the UK Government to assert that it provides equal or on-par protection to EU citizens in the UK. However, this is only half of the equation, as obtaining an adequacy status requires the European Commission's acceptance that UK provides an equal or on-par protection to EU citizens in the UK.

Likelihood of an adequacy finding by March 2019
The UK Government and regulators remain quietly optimistic about the possibility of an adequacy status for the UK. The reality may be somewhat different. This is because EU has concerns over the UK's bulk data collection laws, such as the Investigatory Powers Act 2016, and are likely to consider them incompatible with the protections offered by GDPR.

The outline of the political declaration on the framework for the future relationship between the UK and EU, published on 14 November 2018, indicates that both parties will commit to a high level of personal data protection, with the Commission commencing its assessment on the UK's adequacy, 'endeavouring to adopt decisions' by the end of 2020 (the end of the proposed transition period), with the UK also

taking steps to ensure comparable facilitation of personal data flows to the EU. However, if the UK were to leave the EU without a delay, it is unlikely that such a decision will be reached by March 2019.

What happens if the UK is not granted an adequacy status?

The Commission has published a statement that the UK will be deemed a Third Country (non-EU member state) from 29 March 2019. This means that personal information flow between the EU and the UK will need to be conducted on some other basis, such as EU Model Clauses, BCR, or other permitted grounds. Such arrangements will require careful planning and can be costly. In some circumstances, this may lead to relocation of data processing activities.

What about personal information flow from the UK to countries outside the EU?

UK business that currently flow personal data to non-EU countries (based on the EU framework), will need to consider whether they are able to continue on those bases. For example, contracts incorporating EU Model Clauses may require reviewing and updating, and data transfers on the basis of Privacy Shield as well as EU adequacy findings may need to be revisited. As the UK leaves the EU, UK organisations will have a limited ability to rely on these arrangements.

To date, the UK regulator and the UK Government have not offered guidance on the post-Brexit impact of data flows from the UK non-EU countries. This leaves organisations of all sizes in a difficult predicament.

What should your organisation do next?

It is vital to understand the impact of Brexit on personal data flow and prepare to take the necessary steps to mitigate this risk. The degree to which your organisation is impacted will depend on whether existing data flow arrangements can be maintained.

Brexit: Assessing the impact on personal data flow – aide memoire

1. Has your organisation mapped critical personal data flows to your entities and suppliers from the UK to locations outside the EU?
2. Has your organisation considered if existing data flow arrangements can be leveraged to continue the current data flows?
3. Do you know what if any additional steps are required to send and receive personal information in the UK?

*** Glossary of terms**

- **EU Model Clauses:** Standard data protection contractual terms adopted by the Commission.
- **Binding Corporate Rules (BCR):** An internal code of conduct operating within a multinational group, which allows transfers of personal data from the group's EEA entities to non-EEA group entities.
- **Privacy Shield:** A binding legal framework under European law which can be used to transfer personal data to the US (conditions apply).
- **Adequacy:** This is a decision by the Commission that the law and how it is applied in that country provide sufficient protection for individuals' rights and freedoms for their personal data.

Contacts – Data protection

Deloitte has been supporting clients to navigate privacy changes for over two decades. Our expertise is drawn from our team's experience both within the industry and consulting across a range of sectors, around the world. We help our clients identify and understand privacy and data protection regulatory requirements. We define and produce practical, pragmatic and workable solutions to ensure compliance and risk management as well as support senior leaderships and board directors define organisational privacy strategy.

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The board: Making a positive difference when an organisation is in crisis

The board is responsible for assuring business viability. A crisis calls that into question. Andrew Griffin, a partner in our Crisis and Resilience practice, spoke with Admiral Sir James Burnell-Nugent, formerly Commander-in-Chief Fleet of the Royal Navy and now a non-executive director.

Admiral Sir James Burnell-Nugent, formerly Commander-in-Chief Fleet of the Royal Navy, now advises organisations on leadership. He is also chair, non-executive director and adviser to a range of small and large organisations including QinetiQ , Evercore and Risk Intelligence.

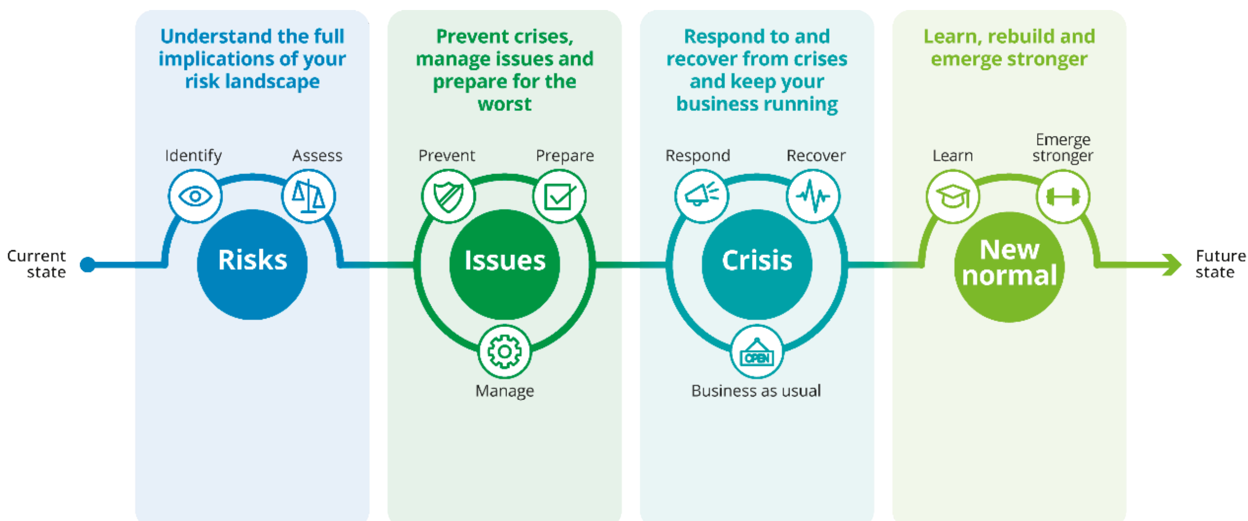
Q: Sir James, what is your view of the role of the board and of individual non-executive directors in crisis management?
The role of a board in peacetime is well understood – to oversee, assure and challenge the executive team. A board must scrutinise a wide dashboard of vital signs: market demand, innovation, regulation, leadership, sustainability, ethics and risk. Implicit is the ability of an organisation to withstand a crisis. But the role of the board in a crisis can be ambiguous.

The Companies Act 2006 identifies the board's "duty to promote the success of the company". This isn't just the success of a recent product launch, or even shareholder return. Success in this context is longer term – it's about being a viable business in the future – with the capacity to respond to opportunities and risks.

Crisis management should be an active concern for every board, whose ultimate responsibility is to state its confidence in the executive level.

In addition to this mandate, the personal reputation exposure of board members is growing. Legal action and pressure from shareholders to remove board members, if they are deemed to have neglected a core or fiduciary duty, is on the rise.

Q: In Deloitte's Crisis and Resilience practice, we think of the way crises evolve as having a "lifecycle", with organisations going through the different phases of understanding the business and its risk landscape, which you mentioned earlier, the prevention and preparedness stage, then once a crisis is underway, the response stage and finally, recovery.



Clearly, non-executive board members will have a role in each of these stages.

Perhaps we could start by discussing your views of the role of the non-executive director in crisis prevention?
In my experience, the critical factor is the board's remit to look at difficult issues and risks and to challenge the executive on how they are being managed, with the goal to prevent a crisis.

Almost all potential crises have happened before in some way or another, whether to the organisation itself or a peer. Identifying them and putting mitigation strategies in place, is a must, and should have the close attention of the board.

Boards can also ask the executive if they have spent time assessing crises suffered by their peers and if they have considered their potential exposure to the same issues.

Q: We see plenty of articles in the press about the impact of crises, such as cyber attacks. How can non-executive directors help companies be better prepared for crises?
Crisis management is about being ready for anything. Crisis management plans should set out the structure, objectives, teams and information flows. At board-level there must be clarity on who will lead, how decisions will be made, who will talk to media and investors, and who will address the concerns of suppliers, customers and regulators.

Plans should be rehearsed, tested and improved to ensure they will survive a crisis. Most organisations do test on a regular basis. In my opinion, too few boards are involved, or ask questions about these exercises, feeling this is an executive function.

Q: After an organisation has started to suffer the effects of a crisis, how should non-executive directors be involved in the response?
That careers can be made and broken under the pressure of a crisis is played out regularly on our TVs and in our newsfeeds: getting it right is a shared goal. The role of the board is crucial when the crisis has at its heart criticism of the performance of the executive. In corporate scandal crises, for example, the board is particularly likely to be needed.

In other circumstances, the board should encourage the executive team to get out early and address an escalating issue, however it should not be active in 'putting the fire out'. Of course there may be some specialist expertise that a particular board member can bring to bear, but as a general rule, the board can better meet its responsibility by keeping a strategic focus and not having a tactical role in the management of a crisis.

In supporting the executive, the board can keep focus on what is right, and in the longer term interest of the company, shareholders, other stakeholders and the wider public. This may be as important as determining whether there is still confidence in the executive team to discharge its duty.

Leading a crisis response can be a lonely place. The need for a sounding board and honest point of view is where the chair and board can add value also. This team can stand back, offer a considered point of view, spot stakeholders who are not being kept in the picture, or see an ethical dimension that might otherwise be missed. In an intensely busy period, make sure there is time for short, quality debriefs to happen.

Q: And finally, is there a role for non-executives in the recovery phase?
Once a crisis has passed, the executive needs to return to a 'new normal'. A crisis is often hard to look back on with depth and scrutiny because of the personal and organisational difficulties that are inextricably wound up in it.

In this aftermath, the board can play an important role. With the independence that it has, it is well placed to carry out a review of the crisis, how it was managed and how it can be prevented or managed better.

Contacts – Crisis and Resilience

Deloitte Crisis and Resilience helps our clients not just through the good times, but also in the toughest moments of crisis, providing clients with the clarity and confidence for when it really matters. Our specialists can help you identify, assess, prevent, prepare, respond and recover from crises. Many of our clients have emerged from great challenges even stronger than before.

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Remuneration

Executive pay – in the spotlight

In this article we look at the 2018 AGM season and remuneration trends, recent Corporate Governance reforms in executive pay, and areas of focus for remuneration committees in the coming year.

It has been over a year since the Government announced its intention to implement a package of corporate governance reforms including a number of proposals around executive pay, and we have now seen details of how these will be effected. The 2018 AGM season has shown that executive remuneration remains very much in the spotlight, and in an uncertain political climate, it is certainly an area where there appears to be cross-party consensus.

In addition to a requirement to publish CEO to employee pay ratios, the new UK Corporate Governance Code[1] includes a number of changes which are set to expand the remuneration committee agenda in the coming year. These include a widened remit around workforce remuneration, as well as a greater focus on how judgment is used to ensure that pay outcomes are justified and supported by performance.

2018 AGM season

Following a quieter AGM season in the FTSE 100 last year, in 2018 we saw a much more challenging voting environment in particular for the top 30 companies. 15% of FTSE 100 companies received 'low votes' (less than 80% in favour) on remuneration, compared to 8% las year, reflecting a tougher stance taken from proxy agencies, as well as a focus on companies receiving low votes in previous years.

A similar picture emerged in the FTSE 250 as investors and proxy agencies continued to demonstrate that they now expect the same standard of engagement and disclosure as in larger FTSE 100 companies. Despite a slight fall in the median CEO 'single figure' total pay compared to last year, around 10% of FTSE 250 companies received 'low votes' on the remuneration report, and three companies lost a shareholder vote on remuneration (annual remuneration report or policy), compared to just one the previous year. Around one-half of FTSE 250 companies receiving low votes did so for a second consecutive year, and the Investment Association has indicated that it is looking to develop proposals to address the issue of 'repeat offenders'.

Notwithstanding this, overall levels of shareholder support remained high, with a median vote of circa 96% in favour of annual remuneration reports, and this high level of support is often overlooked by commentators.

Key issues raised

In terms of key issues raised, these included specific high-profile cases involving exceptionally high pay-outs under one-off incentive plans. We also saw a number of low votes relating to pay arrangements for new hires, in particular where fixed pay and/or incentive opportunities were set at a level higher than the predecessor. In more recent months, we have seen shareholders oppose the provision of any compensation in lieu of reduced pensions – in particular, where there is an increase in salary alongside a reduced pension provision for a new hire. With a relatively high level of recruitment activity in the listed market, this is likely to remain an area of focus for investors.

We also saw investors take a tough stance on where there is a lack of clarity around how bonus arrangements operate. These issues are often exacerbated by targets which are not considered to be sufficiently stretching, or where overall awards are excessive or misaligned with the shareholder experience.

Remuneration trends?

Executive alignment and long-term features

In terms of remuneration trends, a key theme continued to be long-term accountability and executive alignment, in particular in the FTSE 250. Executive directors will now receive no shares until at least five years from the initial award in 74% of FTSE 250 long-term incentive plans, compared to just 29% of plans two years ago, when the typical time horizon was three years. This practice is now aligned with the FTSE 100 market, and is a trend that we expect to move further with the introduction of new requirements under the UK Corporate Governance Code.

1. To apply to all companies with a premium listing in the UK, in respect of accounting periods beginning on or after 1 January 2019.

Innovation – end of 'one size fits all'?

Despite the continued prevalence of a 'one size fits all' approach, we have seen early signs that shareholders can be supportive of more innovative incentive arrangements, when tailored in the right way and supported by a business rationale. Two FTSE 250 companies received the support of their shareholders in adopting restricted share plans. The new UK Corporate Governance Code Guidance on Board Effectiveness states that 'remuneration committees are encouraged to be innovative and to work with shareholders to simplify the structure of the remuneration policy'.

While we do not expect to see a significant shift in incentive market practice in the near term, companies may now have greater scope to engage with shareholders on how incentives can better support the diverse nature of businesses, provided there is coherence with the strategy and protection against rewards for failure.

Reduced executive pensions

Nearly one-quarter of FTSE 100 companies reduced executive pension provisions in the last year, primarily for new hires, and we saw an emergence of this trend in the FTSE 250. The new Code requires that 'the pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce', and we expect to see further reductions made in the coming year. Investor views and expectations in this area continue to evolve, and companies should focus on implementation in their specific circumstances, in order to avoid any unintended consequences.

The coming year – areas of focus

Widening the remit of the remuneration committee

The new UK Corporate Governance Code will expand the remit of the remuneration committee, with a view to ensuring that executive pay decisions are made through a broader lens, and outcomes are clearly explained to wider stakeholders. During the year we have seen that politicians, investors and the public expect remuneration committees to understand their workforce – how it is comprised, rewarded, and incentivised.

Remuneration committees will now be looking at how best to adapt to an expanded remit in reviewing workforce remuneration and policies, as well as how they can effectively engage with employees on executive pay.

Pay ratios

While a relatively small number of companies published a CEO to employee pay ratio in 2018, we expect to see a significant number of companies voluntarily 'go early' in publishing their pay ratios in the coming year, now that the final methodology has been published. This is in line with guidance from the Investment Association in this area.

Judgment and discretion

In 2018 we saw an increasing number of remuneration committees exercising discretion to reduce formulaic outcomes, typically to take account of specific corporate events or poor underlying performance. Around one in six FTSE 100 remuneration committees reduced formulaic out-turns under incentive plans in 2018, and we expect this to increase with changes to the Code.

Exercising discretion when determining incentive payouts can be fraught with difficulty, and using a methodical approach or framework to assess whether the formulaic outcome is fair is vital in order to reach a position which is robust from the perspective of both executives and shareholders. Now more than ever, executive pay must stand up to external scrutiny and, in particular, not be excessive where performance does not justify it.

Executive pay in the spotlight – aide memoire

1. Are you at risk of challenge in relation to the current investor hot topics, e.g. high pay-outs under one-off incentive plans or new hire packages coming in at a level higher than the predecessor?
2. Are you taking the opportunity to engage with shareholders on more innovative incentive arrangements?
3. Has there been a review of your executive pension arrangements in relation to the changes to the UK Corporate Governance Code and evolving investor guidance?
4. Is there a plan in place to address the other key remuneration changes in the Code for periods commencing on or after 1 January 2019, e.g. widening the remit of the Remuneration Committee and the ability to use judgment and discretion?

Contacts – Executive compensation

Deloitte's executive remuneration practice helps clients develop executive remuneration strategies in line with corporate objectives and advises remuneration committees on the corporate governance and regulatory framework that applies to executive remuneration in the UK.

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Year-end reporting & assurance

The Non-Financial Information Statement – clarifying the requirements

In this article we set out a reminder of the requirements of the Non-Financial Reporting Regulations and also set the record straight on the need for there to be a separate Non-Financial Information Statement within the Strategic Report.

It is fair to say that the implementation of the Non-Financial Reporting Regulations (NFRR) in the UK (mandatory for companies within scope (see below) for periods commencing on or after 1 January 2017) has caused some confusion around the exact nature and content of the disclosure.

Initially the FRC had stated that the disclosures required by the NFRR did not have to be either a discrete element within the strategic report or a separate statement. Instead, companies were encouraged to consider how this information relates to other information in the strategic report and to weave it together.

This view was revised in July 2018 when the FRC issued an update to its Strategic Report Guidance which clarified the position and confirmed that there **must be a separate statement** within the strategic report, but that this can include cross-references to where the required information can be found in the main body of the strategic report.

So now that we have a clear position from the FRC, for the 2018/19 annual reports within scope (see below), preparers should ensure that they are meeting this requirement. For the avoidance of doubt, the non-financial information statement should contain the following information **or** include cross-references to where such information can be found in the main body of the strategic report:

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

A reminder on the scope of the NFRR

The NFRR scopes in all public interest entities (PIEs) that have over 500 employees, on average, in the financial year. Where a company is a parent company at any time in the financial year, a non-financial information statement is required where the aggregate number of employees for the group headed by that company was more than 500, on average, in the financial year.

A PIE is defined as:

- a traded company (which means a company any of whose transferable securities 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.

This means that the scope of the Regulations is both narrower than all quoted companies (for example, because smaller quoted companies are excluded) and wider (in that large unquoted banking and insurance companies are included).

The FRC Guidance states that entities are encouraged to meet the requirements of the non-financial information statement through a title and a series of cross-references, so as to maintain the coherence of the strategic report. Entities are discouraged from replicating information located elsewhere in the strategic report in the non-financial information statement. An example of such an approach was seen in the 2017 Lloyds Banking Group Annual Report and Accounts:

Non-financial information statement

We aim to comply with the new Non-Financial Reporting requirements contained in sections 414CA and 414CB of the Companies Act 2006. The below table, and information it refers to, is intended to help stakeholders understand our position on key non-financial matters. This builds on existing reporting that we already do under the following frameworks: CDP, Global Reporting Initiative, Guidance on the Strategic Report (UK Financial Reporting Council), UN Global Compact, UN Sustainable Development Goals and UN Guiding Principles.

Reporting requirement	Policies and standards which govern our approach	Risk management and additional information	
Environmental matters	Environmental statement	Environment, pages 26–27	Environmental risk management, page 133
Employees	Ethics and Responsible Business Policy[1] Ethical Policy Statement Colleague Policy[1] Code of Responsibility Health and Safety Policy[1]	Equality, inclusion and diversity, page 21 Health, safety and wellbeing, page 22 Learning and development, page 22 Responsible conduct and culture, page 24 Diversity, skills and composition, page 58	Board Diversity Policy, page 72 People risk, page 136 Governance risk, page 150
Human rights	Human Rights Policy statement Colleague Policy[1] Pre-Employment vetting standards[1] Data Privacy Policy[1] Anti-Slavery and Trafficking Statement Information and Cyber Security Policy	Human rights, page 22 Responsible and ethical lending, page 24 Working with suppliers, page 25	
Social matters	Volunteering standards[1] Matched giving guidelines[1]	Helping communities, page 19	Communities, page 25
Anti-corruption and anti-bribery	Anti-bribery Policy[1] Anti-bribery policy statement Anti-money laundering and counter terrorist financing Policy[1] Fraud Risk Management Policy[1]	Customer privacy and data security, page 23 Responsible conduct and culture, page 24 Operational risk, pages 135–136	
Policy embedding[2], due diligence and outcomes		Risk overview, pages 32–33	Risk management, pages 107–156
Description of principal risks and impact of business activity		External environment, pages 8–9 Creating value for our stakeholders, page 11 Addressing the issues that matter most, page 21	Direct and indirect economic contribution, page 24 Risk overview, pages 32–33 Principal risks, pages 34–37
Description of the business model		Our business model, pages 10–11	Our next chapter, page 14
Non-financial key performance indicators		Key performance indicators, page 7 What we have achieved over the past three years, page 12 Doing business responsibly, page 18 Helping Britain Prosper, pages 19–20	Running a responsible business, pages 21–25 Environment, pages 26–27

1 Certain Group Policies and internal standards and guidelines are not published externally.

2 The policies mentioned above form part of the Group's Policy Framework which is founded on key risk management principles. The policies which underpin the principles define mandatory requirements for risk management. Robust processes and controls to identify and report policy outcomes are in place and were followed in 2017.

The Non-Financial Information Statement – aide memoire

1. Are all the elements of the Non-Financial Information Statement covered in your Strategic Report, including due diligence activities on key policies and the outcomes of those policies?
2. Is there a clear statement, or a plan to include a clear statement, which sets out (through cross-referencing) where all the elements of the Non-Financial Information Statement can be found in the Strategic Report?

Key messages from the FRC's Corporate Reporting Review Team

In this article we highlight the key themes from the FRC's Annual Review of Corporate Reporting and annual letter to finance directors and audit committee chairs for 2018/19 annual reports.

New accounting standards

The first area covered by the FRC, separated from other financial statement disclosure matters, is the importance of disclosing the impact of the two new accounting standards on the financial statements in this first year of full implementation.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. With a focus on identification of performance obligations, there is new guidance on whether revenue should be recognised at a point in time or over time, which replaces the previous distinction between goods and services.

Companies are encouraged to invest sufficient time during their year-end preparation to ensure that:

- Explanations of the impact of transition are comprehensive and linked to other relevant information in the annual report and accounts.
- Changes to revenue policies are clearly described and explained, reflecting company specific information – as are any associated management judgements.
- Performance obligations, a new concept introduced by IFRS 15, are identified and explained, with a focus on how they have been determined and the timing of delivery to the customer.
- The impact of the standard on the balance sheet is also addressed, including accounting policies for contract assets and liabilities.

IFRS 9 Financial Instruments

IFRS 9 includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. The main impact here will be on financial reporting by banks but for other companies it is also important that they:

- Have updated their hedging documentation and assessed the effectiveness of existing hedges on application of the new requirements.
- Explain and, where possible, quantify material differences between IAS 39 and IFRS 9, including key assumptions adopted on implementation.
- Remember that the scope of the impairment requirements has been extended to include, for example, IFRS 15 contract assets, lease receivables, and will also apply to loans to subsidiaries and other undertakings in individual parent company accounts.
- Take particular care when considering the application of the standard to embedded derivatives and the different treatment required where the host contract is a financial asset compared to where it is a financial liability.
- Reconsider the accounting for previous debt modifications, such as refinancing, that did not result in derecognition.
- Reflect the additional disclosure requirements of IFRS 7.
- If relevant, explain why the impact is not material, particularly where significant financial instruments are recognised in the accounts.

IFRS 16 Leases

IFRS 16 sets out a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. IFRS 16 applies a control model for the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. As the standard is mandatory for periods beginning on or after 1 January 2019, in their December 2018 annual reports companies are expected to:

- Provide meaningful information about the application of the standard with a focus on their specific facts and circumstances.
- Disclose qualitative and quantitative information, identifying any lease portfolios that are significantly impacted by the new requirements.
- Explain the specific judgements and policy changes prompted by the new model and provided detail about the structure of their implementation projects.
- Identify the exemptions that companies intend to apply.

Other topical areas of reporting for attention

Area of focus	Description
Critical judgements and estimates	• A clear distinction needs to be made between judgements and estimates as different disclosure requirements apply. • Clear disclosure of the sensitivity of carrying amounts to the assumptions and estimates underlying a measurement calculation, or, if more meaningful, disclosure of the range of reasonably possible outcomes within the next year in respect of the carrying amounts of the relevant assets and liabilities. • Identification of any voluntary additional disclosures provided in respect of estimation uncertainty, for example, where the impact of any possible material change in estimate is not anticipated to have effect until a period outside the twelve-month window required by the standard.
Risks associated with Brexit	• Provide disclosure which distinguishes the specific and direct challenges to the business model and operations from the broader economic uncertainties which may still attach to the UK's position at the time you report. • Particular threats should be clearly identified and management should describe any actions they are taking, or have taken, to manage the potential impact (this may include recognising or re-measuring certain items in the balance sheet). • Consider and explain a wider range of reasonably possible outcomes when performing sensitivity analysis on their cash flow projections. • Decide whether Brexit uncertainties impact your statements on viability and even your ability to continue as a going concern. • Incorporate a comprehensive post balance sheet events review in the year-end reporting plan, in order to identify both adjusting and non-adjusting events and to make the necessary disclosures.
Complex supplier arrangements	• The strategic report and the disclosures of financial instruments should describe the nature and amount of any material funding arrangement and the impact that it has on the company's liquidity.
Risk and viability reporting	• Provide a clear description of how the company has assessed its prospects and viability. • Apply a two-stage process to the viability statement: first, assessing the future prospects of the company; and, second, stating whether directors have a reasonable expectation that the company will be able to continue to operate and meet its liabilities as they fall due (potentially over a shorter period).

Area of focus	Description
Alternative performance measures	• All companies that report alternative performance measures should apply the Guidelines produced by ESMA, i.e.: – definitions for all APMs used; – good explanations for their use; – reconciliations to IFRS amounts appearing in the financial statements; – no greater prominence for APMs than measures directly stemming from the financial statements; and – explanations for changes in APMs to be provided, which may include how they are defined or calculated.
Non-Financial Information Statement – required by the EU Non-Financial Reporting Directive	• The Strategic Report should include a Non-Financial information Statement covering information (or references to where that information is disclosed in the strategic report) relating to environmental matters, employees, social matters, respect for human rights and anti-corruption and anti-bribery matters. • For companies within the scope of the new requirements, disclosures should focus on the impact of its activities in respect of these matters, the policies it has in place, any due diligence processes introduced through which it assesses and tracks their effectiveness and the related outcomes.

Key messages from the FRC's Corporate Reporting Review Team – aide memoire

1. Are the FRC areas of focus for the 2018/19 reporting season clearly on the agenda for consideration by the audit committee?
2. Is the audit committee satisfied that the control environment for compliance with financial reporting requirements is robust and fit for purpose?

Articulating the board's monitoring and assessment of corporate culture

In this article we consider how boards should be preparing to implement the new UK Corporate Governance Code provision requiring them to monitor and assess corporate culture.

Corporate culture has been an area of focus for the FRC in recent years with the report on 'Corporate Culture and the Role of Boards' released in July 2016. The emphasis is on the importance of board focus on this topic in order to hold management to account. This has been further reinforced by the new provision in the 2018 UK Corporate Governance Code (applicable for periods commencing on or after 1 January 2019) calling for boards to "assess and monitor culture" and "where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action".

In our recent **Annual Report Insights Survey**, we found that as well as an encouraging 86% of companies discussing culture or values in their strategic report, 74% discussed board activities around culture in their corporate governance statements.

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. Almost a quarter of companies surveyed included some detail on the tools and techniques the board uses to monitor culture with 8% disclosing action taken by the board to address issues during the year around culture - for example, introducing new training on values, work on a fundamental cultural transformation in the business, or action to address concerning findings regarding culture arising from an employee engagement survey.

Disclosure focusing on the tools and techniques the board uses to monitor the quality of 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.

Croda International Plc provided insight on the board decision making process around culture and values, including the development of a culture plan, link to business strategy and a mechanism for monitoring culture throughout the business.

Culture and values
The Board spends a considerable amount of time meeting with employees and visiting our offices and manufacturing sites around the world. This ensures that our Non Executive Directors develop and maintain greater insight and understanding of the Business, which enhance the quality of decision making and debate. That diversity of thought allows the Board to consider the broader long term impact of its decisions on our employees, suppliers and customers and the communities in which we operate. On page 43 we set out more details of the Board's programme of activities outside the boardroom. We recognise the value of culture, and these visits also create opportunities for a cultural tone to be cascaded from the boardroom. Directors are able to promote the values-based conduct and behaviours expected from every part of the Company. The Board has spent time working on the development of our Culture Plan, linking our culture to our Business strategy in order to deliver business results. Central to this plan is the Global Employee Culture Survey, conducted in 2017 and designed in-house specifically to examine our culture and ensure that it is consistent with our values across the Business. More information about the survey can be found on page 02.

How the front half is compiled

The table below highlights some of the main sections of the front half of an annual report and the types of information normally presented, along with who typically has responsibility within an organisation for compiling the information:

Anglo American plc included an illustrative case study on values and culture, a technique to communicate culture that has been recommended by the FRC.

Material issues

Developing a capable and engaged workforce that behaves in a manner consistent with Anglo American's values and Code of Conduct:

- Training more than 3,400 leaders to help employees understand the new Code of Conduct
- Providing a toolkit of innovative materials to create simple and creative messaging that can be understood by all of our employees, regardless of cultural, educational or literacy background.

Employees at Anglo American's headquarters in London were part of our extensive employee engagement programme to cascade and embed our new Code of Conduct successfully. The Code provides employees with a single point of reference to guide them in making the right choices, and drives the behaviours that will support our high performance culture.

During 2017, more than 3,400 leaders were trained to facilitate Anglo American's new Code of Conduct engagement sessions with employees at all levels in the organisation. Helping employees to understand what it means to act ethically in Anglo American, and supporting them in this process, is all the more critical in challenging market conditions where there are strong tensions between the pressure to deliver targets and choosing to do the right thing.

The engagement programme for the Code of Conduct has encompassed all of our employees across a range of different cultural, educational and literacy backgrounds. The approach has been to train team leaders to facilitate discussions on ethical dilemmas and personal action commitments with their employees. The dilemmas have been based on everyday challenging situations that employees may encounter, such as what to do when they feel that safety or integrity may be compromised. During the discussions, employees were encouraged to refer to the new Code of Conduct as guidance in making the right choice or in knowing where to go to ask for more support.

The toolkit supporting leaders in the 'cascade' campaign included a range of innovative materials from animations to interactive documents. Anglo American was proud to win the 'Best employee engagement programme' award in relation to its efforts in this regard at the 2017 'CorpComms' Corporate Communications Awards.

Various initiatives are under way to measure the success of the engagement programme. In Anglo American's 2017 'Have your say' employee engagement survey, 94% of respondents agreed that the new Code of Conduct was guiding the right behaviours.

The FRC's Guidance on Board Effectiveness makes it clear that the focus on culture needs to be continuous. Periodic reflection on whether the culture continues to be relevant in a changing environment can help the company adapt its culture to ensure it continues to support the company's success.

Monitoring culture involves regular analysis and interpretation of evidence and information gathered from a range of sources. Drawing insight from multiple quantitative and qualitative sources helps guard against forming views based on incomplete or limited information.

Articulating the board's monitoring and assessment of corporate culture – aide memoire

1. How can we use technology to analyse, interpret and present information?
2. Do we need to invest in human resources or internal audit, develop skills and capabilities or encourage the use of multi-disciplinary teams?
3. Does internal audit have the degree of independence needed and a clear mandate to look at culture?
4. Is management using root cause analysis where cultural issues are found, examining not just what went wrong but why?

There is a particular focus on risk culture within prudential regulation and to help firms meet this challenge, Deloitte has developed Culture Conscious, an automated culture database that enables rapid client driven risk culture survey assessments with customised dashboard reporting, including benchmarking. It has been developed using our extensive industry experience and subject matter expertise. It includes human capital and risk management perspectives to give a 'richer' approach for assessing an organisation's culture and risk intelligence of its people. For further information please contact Stephen Gould, stgould@deloitte.co.uk or 020 7303 6409

Do you get enough assurance over the front half of your annual report?

In this article we challenge whether boards have sufficient understanding of how information provided by the company in the front half has been compiled and whether it meets today's complex regulatory reporting requirements.

Today even just the front half of a premium listed UK company annual report can exceed 100 pages. It has to address extensive regulatory reporting requirements and deliver important messages about the long term strategy as well as its performance and financial position of the business. Of course recently there has been much focus on an assessment of its future prospects in disclosures such as the viability statement.

However, although this may be addressed by reforms arising from the various reviews currently underway, the auditor continues to have a very limited remit in respect of information contained in the front half.

The auditor's main responsibility is to read the statements made by the directors in the annual report and consider whether anything they read is 'materially inconsistent' with financial statement disclosures or knowledge gained during the audit process. Judgement clearly has to apply here and it is not visible to readers of the audit report what that might be. As a result, the auditor provides very little *meaningful* assurance on the information contained in the front half. It is the directors who are responsible for the full annual report, including any 'other information' accompanying the financial statements.

Many stakeholders have observed that the 'audit expectation gap' between what stakeholders believe an audit covers and what it actually covers is widening. The FRC highlighted this in its *Developments in Audit 2018* publication as did the Competition and Markets Authority's *Invitation to Comment* on the audit market.

For directors, it is therefore important to understand clearly how information provided by the company in the front half has been compiled and whether it meets the necessary regulatory reporting requirements. Directors also need to determine whether they are happy the statements they are making can be fully supported – now more than ever this has importance given the ongoing media and public scrutiny faced by large companies.

This article focuses on key considerations for company directors in assessing:

- How the front half is compiled.
- Establishing the key information that different stakeholders focus on.
- What levels of assurance are currently obtained around information disclosed in the front half.
- What additional assurance you might seek to obtain.

From 2019, there will be further reporting requirements relating to company purpose, societal impact, and engagement with stakeholders other than shareholders, with companies encouraged to disclose early.

The Financial Reporting Council, in its October 2018 open letter to Audit Committee Chairs and Finance Directors, highlighted that they had identified an increase in the number of basic errors in the reports and accounts reviewed. They noted that the control environment around the report and accounts needs to be sufficiently robust to ensure the reporting remains free of basic errors which can detract from both the integrity of the company's report and accounts and trust in management.

Analysis shows that the wide variety of key corporate information presented in the front half is often managed by different functions, drawing on information from a multitude of sources. A strong internal governance process with appropriate levels of checks and balances, and perhaps some form of assurance over critical areas, is important to prevent errors and inconsistencies from creeping in.

How the front half is compiled
The table below highlights some of the main sections of the front half of an annual report and the types of information normally presented, along with who typically has responsibility within an organisation for compiling the information:

Area	Information presented	Function responsible
At a glance section	KPIs; and summary operational and financial results	Investor relations / Finance
Chairman/CEO statements	Operational analysis; KPIs; APMs; and financial highlights	Investor relations
Business model	Strategic priorities; operational statistics; and financial data	Investor relations / Strategy / FP&A
Key performance indicators	Financial and operational measures	Investor relations / Finance
CFO review	KPIs; APMs; and financial analysis	Finance
Divisional summaries	Strategic priorities; operational statistics; and financial data	Investor relations / Finance
Sustainability/corporate social responsibility (CSR)	Focus areas; strategic priorities; diversity statistics; policies; carbon emissions; pay ratios; and charitable activities	CSR team / Investor relations
Non-financial reporting information	Policy, due diligence and outcomes for: environmental matters; employees; social and community; human rights; anti-bribery and corruption	CSR team / Investor relations / General Counsel / Company Secretariat / Human Resources
Principal risks and uncertainties	Key risks and mitigating actions	Head of risk / General Counsel / Finance
Corporate governance statement (including committee reports)	Financial and other operational data	Company Secretariat
Remuneration report	Key remuneration data; KPIs and APMs	Company Secretariat / Human Resources / Finance

Establishing the key information that different stakeholders focus on
Directors of a listed company have a good understanding of the information their institutional investors and analysts focus on to analyse financial performance and position, including key performance indicators.

With increased focus on large companies from different stakeholder groups, we believe it is worth performing a structured exercise to refresh your views on which aspects of your front half might attract the most attention. This might include those disclosures most likely to get public scrutiny, such as directors' remuneration, corporate social responsibility matters and the viability statement.

We recommend a five step process:

1. identify all current stakeholders for your business (a "stakeholder map");
2. determine what information in the annual report they might focus on;
3. assess the importance of that information to the various stakeholders;
4. consider 'what could go wrong' if that information was incorrect or misleading; and
5. rank that information using a 'tiering' system.

This exercise will provide the core information to assist in determining both whether current systems and processes in place are appropriate for the compilation of the necessary information for the annual report, and also whether you have the right oversight and challenge, or independent assurance on that information, or where you might want to see things done differently.

As stated above, it is worth remembering that the majority of the other information in the front half is only considered by the auditor in the context of knowledge already obtained through their audit and whether the information presented is materially consistent with that knowledge. The auditor's responsibilities generally **do not constitute an assurance engagement** on other information or impose an obligation on the auditor to obtain assurance about the other information.

A reminder of the scope of the auditor's responsibilities regarding other information presented with the financial statements
Some of the auditor's key responsibilities in this area include:

- Read the other information and in doing so:
  a. Consider whether there is a material inconsistency between the other information and the financial statements; and
  b. Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit.
- Consider whether, based on the work undertaken in the course of the audit, the information given in the directors' report and strategic report appears to be materially misstated in the context of the auditors' understanding of the applicable legal and regulatory requirements.

For companies applying the UK Corporate Governance Code:

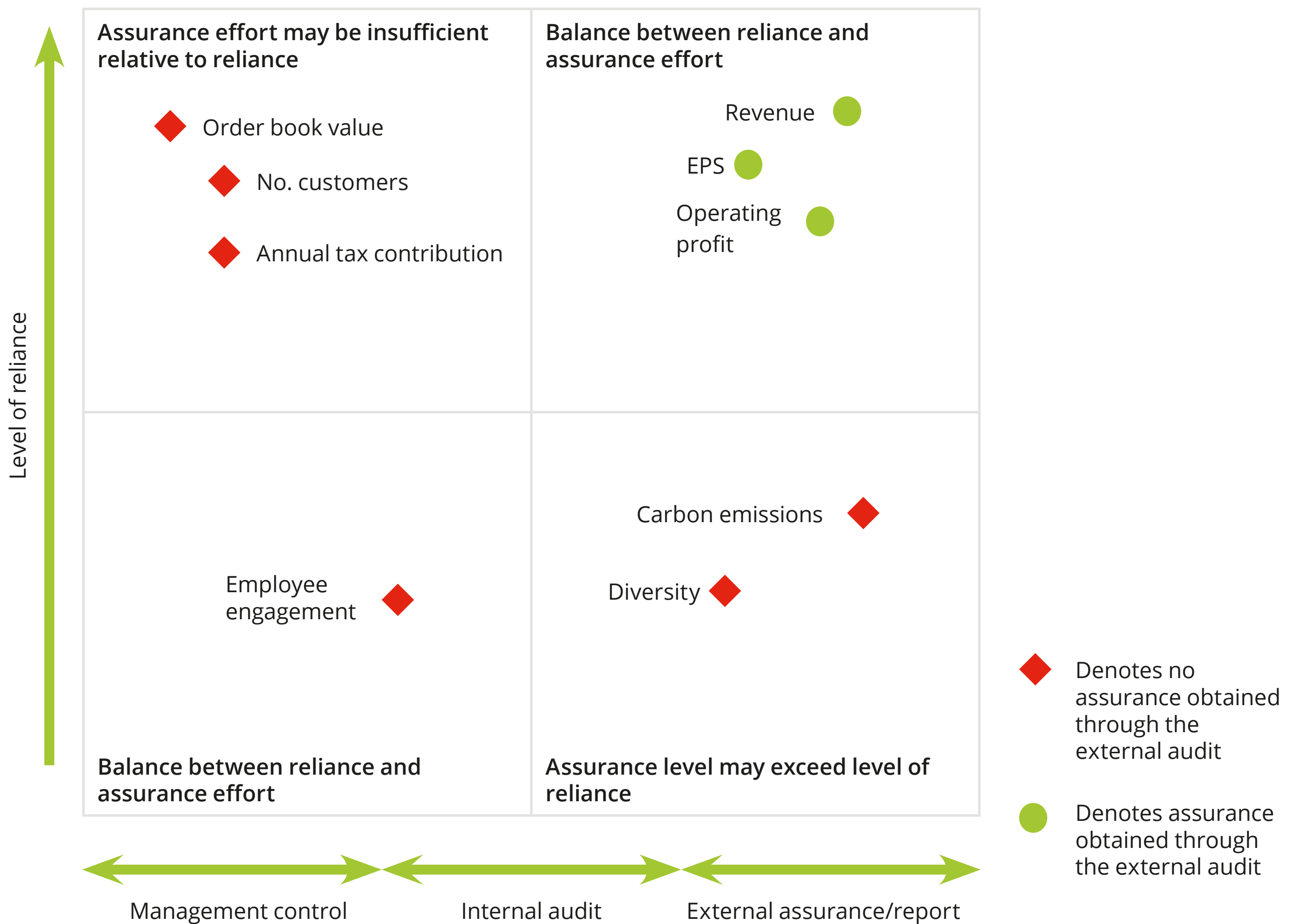
- Report by exception on matters including the directors' statements relating to whether the annual report and accounts taken as a whole is fair balanced and understandable, the section describing the work of the audit committee, compliance with certain provisions of the Listing Rules and the Listing Rule requirement relating to going concern and long-term viability.
- Comment if the auditor has anything material to add or draw attention to in respect of principal risks and uncertainties, and the viability statement.

What levels of assurance are currently obtained around information disclosed in the front half?
Companies should of course follow a robust process for the compilation of information in the front half of the annual report and produce a clear audit trail or "verification file".

Directors can obtain assurance about information in the front half from a variety of sources:

- Assessing the internal control processes governing the compilation of the information.
- Testing of those internal control processes by internal audit.
- Third party specialists preparing information in discrete areas, such as carbon emissions.
- Additional work performed by the external auditor within the current audit framework.
- Additional assurance provided under separate engagement by your auditor or other third party, either directed to the process and control environment or perhaps direct testing of the information presented.

A simple matrix illustrates this neatly:



What additional assurance you might seek to obtain
Once you have assessed both the importance of the information and the level of assurance you currently obtain, you can think about what else you might want to do. This might also be influenced by where you think future reliance may be placed – for example, sustainability metrics are becoming increasingly important as more ESG funds rely on these metrics.

Additional internal assurance

One way of providing assurance to the directors over information in the front half could be to work with your internal audit department to develop an assurance framework that could be applied to some of the key controls surrounding the preparation of the underlying information. Internal Audit could then perform work in those areas on a recurring basis to provide assurance the controls are operating effectively.

Additional independent external assurance

Generally, the types of additional engagements we see performed on other information in the front half are performed under ISAE 3000, which is a framework developed by the International Federation of Accountants (IFAC) to provide assurance over non-financial information. The most common area this is currently applied is around key non-financial metrics such as carbon footprint and other aspects of sustainability reporting.

However, ISAE 3000 can generally be tailored to most other types of non-financial information and the processes in place to arrive at this information, in order to provide separate assurance to the company and its directors.

Front half assurance – aide memoire

1. Are you clear on how the front half of the annual report is compiled?
2. Has an exercise been undertaken to establish the key information that different stakeholders focus on?
3. What levels of assurance are currently obtained around information disclosed in the front half?
4. What additional assurance would you like to obtain and over which parts of the front half?

Contacts

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The role of the audit committee in audit quality

In this article we examine the questions audit committees should be asking of their auditors AND management to drive delivery of consistent, high-quality audit.

One of the FRC's 2018/21 strategic objectives is to promote justifiable confidence in UK audit. This is because high quality audit promotes transparency and integrity and provides investors and other stakeholders with a significant level of assurance that financial statements give a true and fair view and provide a reliable and trustworthy basis for taking investment decisions.

There continues to be much debate about whether what audit is currently designed to do is sufficiently responsive to the needs and expectations of stakeholders. With this in mind the FRC has engaged with two key stakeholder groups, investors and audit committee chairs, to seek their current assessment of confidence in audit. And an interesting disparity has been observed: investors have reported that they are more concerned about audit quality than they were a year ago; whilst feedback from audit committee chairs is that they have a more favourable view of audit quality but do have concerns about the level of choice within the UK audit market.

So what were the specific quality issues identified by the FRC during their 2017 inspections? The following areas were identified as requiring particular focus and should be considered by all audit committees:

Lack of professional scepticism and challenge of management	Audit teams should be able to demonstrate how they have challenged management when auditing key judgement areas (for example, goodwill impairment or long-term contracts).
Bank audits	If you serve on the audit committee of a bank, **then there should be a focus on the audit work done around loan loss provisions and related IT general controls.**
Group audit oversight	The **audit committee should challenge the group audit partner to demonstrate sufficient involvement, oversight and direction of the work of the component auditors.** This is particularly important where the audit of significant components involves judgemental areas which may be subject to management bias.
Audit of pension balances	Pension scheme assets are significant balances and even small changes can have a material effect on company financial statements. Valuation judgements can be extremely complex and **audit committees need to be satisfied that audit teams have provided adequate challenge to management assumptions.**
Lack of consistency	The AQR inspections have revealed some inconsistencies in the quality of work performed within audit firms. To drive greater consistency, the FRC has asked firms to undertake rigorous Root Cause Analysis and to develop appropriate action plans to address any issues highlighted. **Audit committees should ask the auditors about their Root Cause Analysis and related action plan**, to gain confidence that this is being addressed appropriately.

The areas set out above focus heavily on the role of the external auditor in delivering a high quality audit. It is also important to recognise the important role that management plays in audit quality. This is increasingly being recognised in the debate about the future of the profession, and whether the UK should introduce a UK equivalent of Sarbanes-Oxley to enhance management focus on financial reporting controls. For now, we recommend that audit committees should be considering the following:

- Are there clear and robust processes around the production of financial information such that information provided by management for the audit is timely, clear, complete and presented with a culture of "right first time"?
- Are the accounting systems producing reliable information and audit trail, with particular emphasis on control over material judgements, adjustments and journal entries?
- How seriously does management take weaknesses in internal control?
- Have management (and internal audit) kept the audit committee informed about changes in or threats to the control environment and the technologies that underpin it?
- Is there full transparency or resistance to providing certain information?
- Is management fighting every audit adjustment?

This emphasis on the role of management was echoed by the Corporate Reporting Review Team's recent Annual Report which made the point that companies need to avoid basic errors in reports and accounts caused by a poor control environment around compliance with reporting requirements.

The Future of Corporate Reporting and Audit

To respond to the challenges to the current model for audit in the UK, the FRC has launched two significant projects. The first looks at the future of corporate reporting, specifically how companies' provision of information can best serve the needs of investors and other stakeholders. As part of this work, as investor and stakeholder requirements are clarified, the FRC will review the need for greater levels of audit and assurance for Boards and in the public interest. The review will look at whether audit should go beyond the financial statements and be more forward-looking; and provide greater assurance on areas such as business probity, conduct, compliance and viability.

Competition in the UK Audit Market

Launched by the **Competition & Markets Authority** on 8th October 2018, this six month study will examine three main areas: Choice, Resilience and Incentives.

The role of the audit committee in audit quality – aide memoire

1. Is the audit committee paying sufficient attention to the FRC's thematic review reports?
2. Have you considered the issues raised in the CMA study?
3. Is the audit committee satisfied that management is playing its part in the effectiveness of the external audit process?

Reporting on tax

In this article we explain the current, rapidly changing environment for tax and mention some recent tax transparency developments in the UK and internationally.

This is a brief run-down which will be supplemented by an upcoming Governance in Focus publication addressing these matters in further detail and drawing out other current areas of interest in tax and tax reporting.

This article assumes a steady state after 29 March 2019.

Changes to the tax environment

There continues to be widespread, rapid and significant change to the laws and practices governing the determination of tax liabilities and reporting requirements for any businesses with an international footprint, including UK headquartered businesses.

Specific examples of recent international changes include:

- The OECD's Base Erosion and Profit Shifting project (BEPS) is leading to the enactment, on a somewhat coordinated basis across many countries, of new rules on matters such as the tax deductibility of interest expense and the elimination of hybrid mismatches exploiting differences between national tax systems. The pace will be maintained in 2019 with the European Union's "Anti-Tax Avoidance Directive" requiring member states to adopt common standards in a number of areas, and the OECD's "Multilateral Instrument" imposing agreed modifications to many bilateral double tax agreements.
- The OECD also continues to publish new guidance on transfer pricing, with country-by-country reporting to tax authorities of financial results now mandatory for most large groups.
- The US enacted sweeping reforms to its federal tax system in December 2017. The headline was a reduction of the corporate income tax rate to 35% to 21%, however this was accompanied by far-reaching and complex changes to the determination of taxable income, meaning that actual US tax liabilities for many companies may not in fact decrease.

In addition to this, it has been well publicised that in October 2017 the European Commission opened an in-depth investigation into the so-called Finance Company exemption in the UK's CFC rules. This exemption effectively permits only one quarter of certain intra-group interest income to be taxed under UK CFC rules, as opposed to a full inclusion which would otherwise arise.

The Commission's initial view is that this regime is discriminatory and represents unlawful State Aid. A final decision of the Commission is awaited. As at autumn 2018, numerous major UK PLCs had made disclosures in their financial statements indicating that they had benefited from the exemption and thus faced a risk of being demanded to repay the cumulative financial benefit in the event of a negative decision from the Commission. To add to the complexity, the UK is contemplating law changes which will introduce additional conditions for obtaining the Finance Company exemption (if it survives) from 1 January 2019 onwards.

Public and media scrutiny of corporate tax affairs remains widespread, and tax authorities in many countries feel empowered to challenge robustly any perceived tax avoidance arrangements.

In the UK, companies are considering the tax implications of Brexit. For most businesses, tax will be just one of myriad complexities that arise from the UK's exit from the European Union (EU), but the tax issues that arise could be significant and so should be considered as part of the businesses' overall Brexit readiness planning.

There is also an expanding range of UK tax rules focussed on internal tax governance which are becoming increasingly important to how HMRC manages taxpayers and directs its resources.

Tax transparency and reporting

Regular media reporting regarding the tax arrangements of well-known brands is maintaining high levels of public interest in the tax affairs of large businesses. A recent FRC targeted review showed increasing levels of disclosure on tax in annual reports and other company publications. These include additional numeric information on effective tax rates and narrative on tax governance and uncertain tax positions, including anticipated rule changes such as BEPS.

Country-by-country reporting

Country-by-country reporting (of tax and accounting information) to tax authorities formed part of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan in 2015. The new disclosure requirement addresses a perceived lack of transparency regarding the geographic split of business operations and associated taxes paid.

The United Kingdom has implemented the country-by-country reporting provisions and has signed the multilateral competent authority agreement for the automatic exchange of the reports between countries. Guidance has been issued by HMRC but uncertainties regarding the interpretation of the requirements remain. Companies are still refining their approach to compliance.

There is an ongoing debate regarding whether the reporting should be made public – this would increase the level of scrutiny and put additional focus on the need for both accurate reporting, and a justifiable geography business model.

Tax strategy publication in the UK

Large businesses and partnerships are also now required to publish a UK tax strategy online. For private businesses, this could involve unfamiliar external stakeholder scrutiny and some reputational risk.

As there is public attention and therefore internal focus on taxation, agreeing an approach for companies that are newly reporting or changing their reporting in this area is likely to involve senior people from across the business.

Businesses' strategies must include information on:

- risk management and governance;
- tax planning;
- tax risk appetite; and
- approach to dealing with HMRC.

HMRC guidance recommends specific content under these four headings that expand beyond the bare legislative requirements. Many businesses have also provided additional content voluntarily, such as quantum of taxes paid, in order to address the interests of regulators and other key stakeholders.

Financial penalties apply for non-compliance which increase if the strategy remains unpublished. HMRC is also likely to seek to challenge statements and scrutinise underlying tax governance frameworks as part of their Business Risk Review process which is to be relaunched in 2019. Businesses therefore are looking to ensure that they have appropriate internal documentation which sets out how they manage tax risks and make key decisions. Failing to assure HMRC that the strategy has been embedded within the business would be likely to result in increased scrutiny, greater exposure to tax-geared penalties and a deterioration of their relationship with HMRC.

Making tax digital

HMRC is aiming to become one of the most advanced tax authorities in the world, and the Making Tax Digital (MTD) initiative will enhance the way that it deals with its customers.

MTD covers both individuals and businesses across a number of taxes. For businesses over the VAT registration threshold, VAT is the first tax selected for digitisation in the UK. This will take effect for many businesses from 1 April 2019, although there are deferrals to later in the year for more complex organisations.

There are three key digital components to Making Tax Digital for VAT (MTDfV):

Digital records
Businesses will need to store transaction data digitally, although that does not mean they will have to store each individual invoice and receipt. Data required includes an AP and AR transactional listing and a digital VAT account from which the VAT return is prepared.

Digital links
VAT returns must have digital links to digital records – spreadsheets can remain, but they will needd 'digital links' to source system. HMRC has announced a soft landing period of 12 months, however digiital links will be mandatory from April 2010.

Digital Submission
Most businesses currently submit their VAT returns through manually re-keying into HMRC's online portal. In line with the move towards digital, the online portal will close and taxpayers will no longer be able to submit VAT returns this way. Instead, all submissions must be done digitally.

To prepare for these changes, all affected businesses will need to ensure they have access to appropriate systems (e.g. for digital submissions).

For some organisations this may be a simple task of licensing an off-the-shelf software product. Others will take this as an opportunity to transform their internal VAT processes, looking at how they might be able to automate VAT coding decisions in ERP systems; how they might use data analytics to test the accuracy of reporting and spot trends; or how they use the experience from VAT to prepare for similar changes coming to other taxes (e.g. Corporation Tax) in the coming years.

Reporting on tax – aide memoire

1. Is your board kept up to date with the key changes in the tax environment that impact your business and the jurisdictions in which you operate? Do you know how these will affect you, both in terms of tax impact and make-up of the tax function?
2. Is your current tax reporting clear and informative? Have you considered whether additional useful detail could be provided to explain tax disclosures, either in the financial statements themselves or in any tax strategy you publish?
3. Is the business preparing for digitisation of tax submissions in the UK and is the tax function planning to take advantage of the change to drive future process efficiencies?

Contacts – Tax

Deloitte offers clients a broad range of fully integrated tax services. Our approach combines insight and innovation from multiple disciplines with business and industry knowledge to help your company excel globally.

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Subsidiary governance

It would be fair to say that until recently subsidiary governance has not been a topic of particular concern for many parent company boards. The governance frameworks in which many group companies have been operating have simply developed over time and typically have not kept pace with the changing regulatory landscape and the increasing globalisation of many businesses. What worked when a group was established or first started to grow, is often not fit for the present day. In this article we examine the importance of subsidiary governance.

So why is subsidiary governance under the spotlight now?

Technology has made the world a smaller place and made opening a business in even more jurisdictions possible. Organisations are becoming increasingly global and complex. The number of entities being acquired or established to facilitate expanding operations means group structures are constantly changing. Legal entities are being used to ring fence and mitigate risk, perhaps using special purpose vehicles at individual contract level, but, also at organisational level to separate out business lines within an organisation. Individual business lines within large organisations are increasingly operating as smaller standalone groups within the larger group. Therefore those subsidiary boards have more responsibility and influence and there is increasing concern with how they are governed.

There is also increasing interest from HMRC and local tax authorities in understanding how tax risk is managed and governed, and how that links to the wider governance framework. Tight control on the use of legal entities is integral to an organisation being able to substantiate the use of a particular entity within the group and identify those that are no longer required.

Add this to the current political climate which has seen a significant amount of regulation in the years following the financial crisis in respect of corporate governance and stakeholder engagement. The recently introduced S172 reporting requirement for large subsidiaries also shows that interest in subsidiary governance is very much on the increase.

Why does it matter?

The risks are high. The failings of a subsidiary are seen as the failings of the group as a whole. Customers and stakeholders do not differentiate between the parent company and the operating subsidiary within a group. The news headlines and reputational damage do not discriminate. The onus is therefore on the board of the parent company to ensure that there is a robust and effective subsidiary governance framework in place to mitigate risks to the wider group, be they reputational, financial or operational, as well as to the subsidiaries in question.

Good subsidiary governance is also good business. If done well it supports quick and effective decision making, creates value and drives efficiencies, both operationally and for communication internally within the group. If the parent company board, the subsidiary board and key stakeholders understand its value and it is truly embedded in to the culture of the organisation, good subsidiary governance can be a key success factor.

What model is best?

There are a variety of effective governance models with different components at their core. The approach that any given organisation takes has to depend on how that organisation is structured, where it operates and how it is managed. Groups which have a centralised operating model may favour owning subsidiary governance centrally and determining the core components, which are then adopted and adapted by each subsidiary dependent on its business line and the jurisdiction in which it operates. Groups which operate with a higher degree of decentralisation may permit key operating subsidiaries to establish their own governance frameworks, which are then subject to reporting and effectiveness reviews from the parent company.

That said, there simply is no 'one size fits all'. The appropriate governance model will vary from one organisation to another and will depend on many factors, such as the industry in which it operates, its size and complexity. Importantly, it will also need to develop over time and be adapted to meet the needs of the organisation of the future.

What does good subsidiary governance look like?

The following are the key components and characteristics that are typically found in stronger governance models.

- Strict control on the use, establishment and closure of legal entities, supervised by a strong central company secretarial function.
- Tiered entity structure that emphasises the strategic importance of the use of corporate entities therefore ensuring that the level of autonomy and control is appropriate.
- Subsidiary Boards, where the composition has been carefully considered against a subsidiary's strategic importance ensuring the correct balance between central representation, local expertise and non-executives (mostly found in regulated industries).
- Shared support functions such as tax, legal and finance that implement regular and consistent review processes and provide transparency and control over devolved local headquarters.
- Clear delegated authority matrix which manages the need for both central oversight as well as autonomy for local subsidiaries.
- Procedures for managing stakeholder engagement within the subsidiaries' operations and the parent organisation.
- Centralised annual reviews and sign off on corporate data and the effectiveness of subsidiary governance by those accountable for that subsidiary.
- Director inductions and training on the subsidiary governance framework and policies, as well as relevant local legislation.

The organisations that demonstrate the most effective subsidiary governance have all of these components present to a lesser or greater degree, but at the heart of the success of the subsidiary governance framework is the culture and the extent to which the parent company and the subsidiaries understand the importance of getting it right.

What next?

The boards of parent and subsidiary companies alike should be putting the issue of subsidiary governance firmly on the agenda. Those companies that want to demonstrate to their customers and stakeholders that they take corporate governance seriously should think about reporting on their subsidiary governance framework, explaining what its key components are and how the parent and subsidiary boards manage and review its effectiveness.

Subsidiary governance – aide memoire

1. When was the last time your governance framework was reviewed – are you comfortable that it remains fit for purpose?
2. How strong are controls on the use, establishment and closure of legal entities?
3. How much consideration is given to the composition and nature of Subsidiary Boards?
4. What level of accountability is expected of Subsidiary Boards?

Contacts – Deloitte Tax & Legal

Daniel and his team have extensive experience of delivering global legal entity management and subsidary governance services across a broad range of UK and multinational clients. They also provide assistance to clients in designing legal and corporate secretarial operational models and technology roadmaps to help clients support their global expansion and drive efficiencies.

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Appendix: Key questions for this reporting season

Responsible business

Section 172 in practice and on paper

- Consider the areas drawn out in the GC100 Guidance and how well they are addressed at the organisations you are involved in – is there a clear plan of how these matters are being actioned?
- Do you have a clear view on the key stakeholders for your organisation and the effectiveness of the engagement mechanisms being used – is there sufficient board visibility of this?
- Has an exercise been done to confirm which entities within the group will be required to prepare the Section 172 Statement – is there a clear process for development and review of these statements across the group which incorporates sufficient time for full consideration by the board and reflects the fact that the statement will be covering board activities for the full year commencing on or after 1 January 2019?

Your reputation in the hands of social media

- Does the organisation have the right listening tools in place to fully utilise social media?
- Does the organisation have a clear policy for how it will use social media in a crisis?
- Does the organisation have access to the necessary social media expertise and resources it will need in a crisis?

Stepping up on climate change

- Do you have a good understanding of how climate-related risks (extreme weather event, longer term physical changes, regulation, technology change) may impact your business?
- Have you considered how these risks may differentially impact your supply chain, customers and competitors? Have you identified relative opportunity and relative threats?
- Can your Board articulate the management and mitigation strategies your organisation is applying to the different areas of climate change risk?
- Have you considered whether and how to incorporate the recommendations of the TCFD in the annual report and discussed with management whether any readiness activities need to be conducted?
- Is there anything material you are aware of in relation to climate change that may impact your company's longer term prospects and therefore should be addressed and disclosed to investors?
- Are you sufficiently aware of the carbon footprint of your company's operations, direct and indirect, so you have a feel for the potential areas of impact were a carbon tax to be introduced as a driver of change?

Purpose and the Sustainable Development Goals

- Do you have a clearly articulated company purpose?
- Have the Sustainable Development Goals been examined in the context of your organisation's role in society?
- Are company purpose and societal impact evident in your strategy and business model?

Talking about diversity

- Are you familiar with the board's policy on diversity, how that relates to succession planning and whether it meets the new demands of the 2018 UK Corporate Governance Code? Is the policy clearly reported in the annual report, together with objectives and outcomes?
- Does your board treat diversity both at board level and throughout the organisation as an opportunity and a matter of strategic importance? Is it given sufficient time at board level?
- Do you have a clear view on the diversity challenges throughout your organisation, the actions being taken to increase diversity where necessary, and this year's gender pay gap results? Do you have an understanding of your ethnicity pay gap?

Risk & viability

Identifying and addressing emerging risks

- Do we monitor our entire business ecosystem and the broader risk landscape for emerging threats to our strategy, operations, and reputation?
- Do we have a process for monitoring the assumptions underlying our strategy and investment decisions and for enhancing those decisions accordingly?
- Do we have a good understanding of our integrated risk management programme and are we able to provide comprehensive oversight?
- Have we harnessed data and analytics to create an enterprise-wide view of risk and to deliver timely risk information to decision makers at all levels?

Brexit and the viability statement

- Do we truly understand the impact Brexit could have on our business – its strategy, business model and future viability?
- Has the board articulated the nature of the company's Brexit risk and set its risk appetite in order to plan effectively?
- Have we built into that assessment the broader risks to the economy and availability of workforce?
- If Brexit has not been classified as a principal risk before, should it be classified as such this year? Are we satisfied that any contingency plans are sufficiently robust?
- Has management modelled the impact of Brexit in a consistent manner to how other longer term viability statement scenarios are assessed? Does this include modelling Brexit impacts to materialise in combination with other principal risks?
- Is the board satisfied that the modelling scenarios used by management for the impact of Brexit on the company are complete and that their impact upon the business is considered to be realistic?
- Have the assumptions underlying our assessment of the impact of Brexit been both validated and stress tested?

Business model disclosure

- Does your business model clearly communicate how you create value (both in terms of cash generation and non-financial value) over the longer-term?
- Is it clear for the reader as to what this longer-term period is?
- Is your business model disclosure comprehensive, covering all elements investors find useful that are relevant to your business, either in a single disclosure or through clear and meaningful cross-referencing?
- Does your disclosure include the business models of all your significant businesses, or refer to where that information is, and the value of combining them within one group?
- Are the key drivers of your business model(s) clear?
- Does your disclosure demonstrate how your business is unique?
- Does the business model graphic improve the ability to understand the business model for those outside your organisation?

Principal risks

- Does the description of principal risks identify how they are specific to the company?
- Are the risk disclosures detailed and specific enough to understand why the risk is material and over what time period?
- Is it clear to the reader how the company categorises and prioritises principal risks?
- Are movements in principal risks, including movements into and out of the principal classifications, explained?
- Do the mitigating activities include specific information that allows the reader to understand the company's response and current stage of mitigation?

The viability statement

- Does the disclosure differentiate between the directors' assessment of long term prospects and their statement on the company's viability, and clarify why different time horizons are used?
- When disclosing long-term prospects has the board considered their stewardship responsibilities, previous statements they have made (especially in raising capital), the nature of the business and its stage of development, and its investment and planning periods?
- Does the viability statement disclose any relevant qualifications and assumptions when explaining the directors' reasonable expectation of the viability of the company?
- Is the link between the viability statement and principal risks clear to the reader, particularly in relation to the scenario analyses?
- Are the stress and scenario analyses disclosed in sufficient detail (and quantification) to provide investors with an understanding of the nature and potential impact of those scenarios, and the extent and likelihood of mitigating activities?

Preparing for the red dawn in cyber regulation

- Do you have an independent view of realistic cyber threats to your organisation?
- Do you know how effectively your security systems and processes would perform under real world cyber attacks?
- Have you recently tested this in a robust way and learnt the lessons from doing so?

Brexit: Assessing the impact on personal data flow
- Has your organisation mapped critical personal data flows to your entities and suppliers from the UK to locations outside the EU?
- Has your organisation considered if existing data flow arrangements can be leveraged to continue the current data flows?
- Do you know what if any additional steps are required to send and receive personal information in the UK?

Remuneration

Executive pay in the spotlight
- Are you at risk of challenge in relation to the current investor hot topics, e.g. high pay-outs under one-off incentive plans or new hire packages coming in at a level higher than the predecessor?
- Are you taking the opportunity to engage with shareholders on more innovative incentive arrangements?
- Has there been a review of your executive pension arrangements and appropriate consideration for the arrangements for new hires in line with the changes to the UK Corporate Governance Code and evolving investor guidance?
- Is there a plan in place to address the other key remuneration changes in the Code for periods commencing on or after 1 January 2019, e.g. widening the remit of the Remuneration Committee and the ability to use judgment and discretion?

Year-end reporting & assurance

Key messages from the FRC's Corporate Reporting Review Team
- Are the FRC areas of focus for the 2018/19 reporting season clearly on the agenda for consideration by the audit committee?
- Is the audit committee satisfied that the control environment for compliance with financial reporting requirements is robust and fit for purpose?

The Non-Financial Information Statement
- Are all the elements of the Non-Financial Information Statement covered in your Strategic Report, including due diligence activities on key policies and the outcomes of those policies?
- Is there a clear statement, or a plan to include a clear statement, which sets out (through cross-referencing) where all the elements of the Non-Financial Information Statement can be found in the Strategic Report?

Articulating the board's monitoring and assessment of corporate culture
- How can we use technology to analyse, interpret and present information?
- Do we need to invest in human resources or internal audit, develop skills and capabilities or encourage the use of multi-disciplinary teams?
- Does internal audit have the degree of independence needed and a clear mandate to look at culture?
- Is management using root cause analysis where cultural issues are found, examining not just what went wrong but why?

Front half assurance
- Are you clear on how the front half of the annual report is compiled?
- Has an exercise been undertaken to establish the key information that different stakeholders focus on?
- What levels of assurance are currently obtained around information disclosed in the front half?
- What additional assurance would you like to obtain and over which parts of the front half?

The role of the audit committee in audit quality
- Is the audit committee paying sufficient attention to the FRC's thematic review reports?
- Have you considered the issues raised in the CMA study?
- Is the audit committee satisfied that management is playing its part in the effectiveness of the external audit process?

Reporting on tax
- Is your board kept up to date with the key changes in the tax environment that impact your business and the jurisdictions in which you operate? Do you know how these will affect you, both in terms of tax impact and make-up of the tax function?
- Is your current tax reporting clear and informative? Have you considered whether additional useful detail could be provided to explain tax disclosures, either in the financial statements themselves or in any tax strategy you publish?
- Is the business preparing for digitisation of tax submissions in the UK and is the tax function planning to take advantage of the change to drive future process efficiencies?

Subsidiary governance
- When was the last time your governance framework was reviewed – are you comfortable that it remains fit for purpose?
- How strong are controls on the use, establishment and closure of legal entities?
- How much consideration is given to the composition and nature of Subsidiary Boards?
- What level of accountability is expected of Subsidiary Boards?

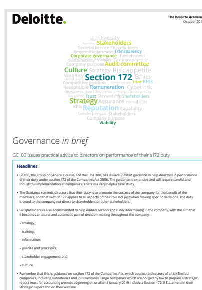
Further resources

Throughout this publication we have mentioned some of our other publications where they offer a deeper dive on the governance topics of interest, or where we believe they can add insight to your role as a board member.

This section pulls together those additional resources with a brief introduction to each of them, so they are easier to refer to when required.

As always, do get in touch with your Deloitte partner or with us in the Deloitte governance team if you would like to discuss any areas in more detail. All our governance publications are available to read and download from www.deloitte.co.uk/governancelibrary.

Governance in Brief



GC100 issues practical advice to directors on performance of their s172 duty explores the updated guidance issued by the GC100 to help directors in performance of their duty under section 172 of the Companies Act 2006, including the six specific areas they recommend to help embed section 172 in decision making, with the aim that it becomes a natural and automatic part of decision-making throughout the company.

FRC issues advice on annual reports for 2018/19 reporting season considers the FRC's Annual Review of Corporate Reporting, the recommendations in the FRC's year-end advice letter to preparers and the aspects of financial statements and broader corporate reporting that the FRC is looking to companies to focus on in the coming year.

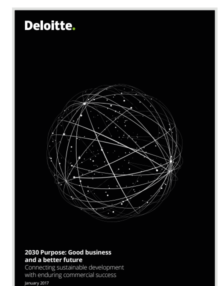
FRC issues new UK Corporate Governance Code: the FRC published the new UK Corporate Governance Code together with revised Guidance on Board Effectiveness in July 2018. The changes are far-reaching in some areas and reflect the Prime Minister's broad social reform agenda and desire to restore trust in UK business. The new Code applies for periods commencing on or after 1 January 2019.

BEIS issues legislation to deliver key corporate governance reforms explores the changes laid before Parliament in The Companies (Miscellaneous Reporting) Regulations 2018, including reporting requirements on CEO pay ratios, how directors have complied with section 172(1) of the Companies Act 2006, and corporate governance arrangements in large private and unlisted public companies. The regulations apply for reporting on financial years starting on or after 1 January 2019.

The QCA updates its Corporate Governance Code as AIM tightens rules considers the London Stock Exchange changes meaning that AIM companies now need to report on their application of a recognised corporate governance code on their website with effect from 28th September 2018. To coincide with the changes to the AIM Rules, the Quoted Companies Alliance (QCA) issued a revised and fully updated QCA Corporate Governance Code.

Other Deloitte publications

Chair of the Future asks: what skills, capabilities and experiences will be required to be a successful Chair in ten years? How will boards operate and what will be their priorities?



2030 Purpose: Good business and a better future explains that is increasingly evident that enduring commercial success is linked to a commitment to sustainable development. To fully benefit from this association, businesses need to encapsulate it in a clear purpose. That purpose should be compatible with the Sustainable Development Goals and needs to shape the way the business is both designed and run.

Closing Out 2018 discusses the principal financial reporting issues in respect of current annual reports, covering areas of regulatory focus identified by the FRC and ESMA together with issues arising from the current economic environment and developments in reporting standards.

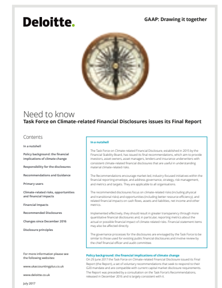
Annual report insights 2018 gives a comprehensive picture of narrative and financial reporting trends for UK listed companies, together with ideas and examples to help them improve their annual reports.

Global Human Capital Trends 2018 explores the rise of the social enterprise and why social capital has become just as important as human, financial and physical capital. In the social enterprise, good citizenship is a CEO-level strategy.

Hearing the stakeholder voice is a guide intended to help companies identify the key actions required to implement and report on effective engagement mechanisms, which will be a requirement of the UK Corporate Governance Code from 2019, as well as exploring the challenges boards may face along the way

Thinking allowed: climate related disclosure explores how corporate reporting is evolving to meet the expectations of investors with regard to climate change. In this publication we look at some of the issues involved and how companies and audit committees might respond to the challenges, drawing on a report issued by the FSB Task Force on Climate-related Financial Disclosure, to integrate the implications of climate change in their corporate reporting effectively.

Need to know — Task Force on Climate-related Financial Disclosures issues its final report discusses the final report recently issued by the Task Force on Climate-related Financial Disclosures. The recommendations aim to provide investors, asset owners, asset managers, lenders and insurance underwriters with consistent climate-related financial disclosures that are useful in understanding material climate-related risks.



Your guide: Directors' remuneration in FTSE 100 companies presents analysis and insights regarding executive directors' remuneration in the FTSE 100, based on the 2018 AGM season.

The Deloitte Centre for Corporate Governance

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