Deloitte.

On the board agenda 2022

December 2021

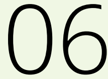
Contents

01
Foreword

02
The regulatory agenda

03
Climate change

04
Internal controls – with some focus and hard work your framework can be a key business asset

05 
Getting it right: your fraud risk assessment

06
The role of leaders in building ransomware resilient organisations

07
Taxation

08
Diversity & inclusion

09
Remuneration – UK board pay in a global talent market – a model fit for purpose?

10
Reporting update – CRR findings and focus areas for year-end reporting

11
Reporting update – FRC Review of corporate governance reporting

12
Reporting update – four key FRC reports to consider when reviewing your annual report

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Foreword

Foreword

Dear Board Member,

It is tempting to hope, as societies gradually learn how to live with COVID, that we might return to some notion of pre-pandemic normality. Of course, there is no such thing in the rapidly changing world of business and geopolitics we now live in. 2022 will bring more than its fair share of challenges to the board agenda: The digital opportunity demands continued attention; the war for talent is intense; input costs are rising and supply chains unpredictable; consumers are squeezed and increasingly choosy; governments believe they have a new legitimacy to regulate more, having provided for their populations during the pandemic; populations are loud and forceful on issues that matter; and the voices of stakeholders in business are just as quick and demanding. Above all, COP26 painted a whole new dimension.

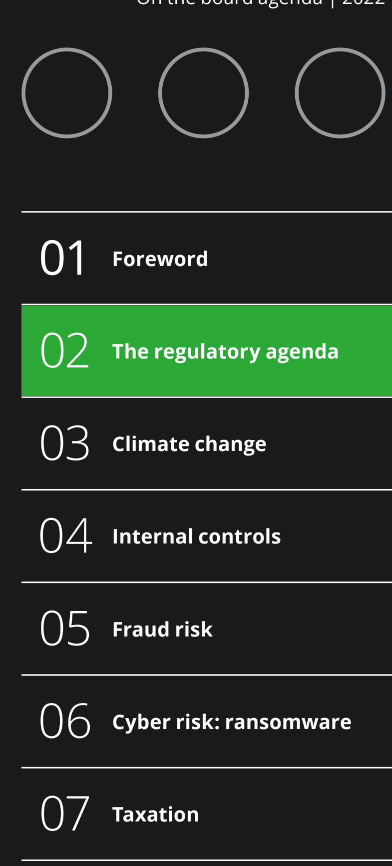
All this reinforces one simple message - that boards must maintain a diligent focus on innovation, performance and high standards at their companies; first, to promote differentiation, and second, to protect their licence to operate. Across the board, expectations of business are rising – business is not just the wealth creator; business is the driver of improvements in social mobility, fairness and inclusion; business is the trusted protector of our data; business is the guardian of our environment, and the innovator and investor to solve the climate crisis. This range of expectations is not just to be addressed in the boardroom, but must be made real in the culture and operations of our companies, and beyond our companies in the value chain, and in the communities we rely on and serve.

It is a fascinating time to be a director. It is a real privilege to be serving in today's demanding environment, to stand up and make a difference. The issues of today call for directors who are up for these challenges, directors who believe in trust being the cornerstone of business, who are transparent in communications and who don't just embrace but advocate for change and for high standards. It is with this in mind that we offer you *On the Board Agenda 2022*. And we look forward to welcoming you at our discussions in the Deloitte Academy in the New Year.

Yours truly,

William Touche
London Senior Partner

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

The regulatory agenda

The regulatory agenda

BEIS White Paper Update

At the time of writing we are waiting for the government response to the consultation on "Restoring Trust in Audit and Corporate Governance". Meantime, the FRC continues to drive forward those changes it can without legislative powers. In this article we set out what we have been hearing since the consultation closed in July and the latest information on future direction for the BEIS White Paper proposals.

The government is reported to have received over 600 responses submitted to the BEIS team in response to this White Paper and it is likely now that the proposals will be sorted into one of three categories:

- to be taken forward through primary or secondary legislation;
- to be taken forward by the new regulator; or
- to be dropped.

We will learn more on publication of the feedback statement, but our understanding is there was broad support for the following proposals:

1. *The Resilience Statement* – with some reservations about the level of prescription proposed, we have heard positive feedback on the proposals for the evolution of the current going concern and viability statements and a focus on long-term risks and how they could impact the business model and strategy.
2. *The Audit and Assurance Policy* – putting aside the question of a shareholder vote on the policy, we have consistently seen through polling of Deloitte Academy members that boards and audit committees can see value in drawing together a clear picture of the different elements of corporate reporting and the nature and level of assurance currently obtained on those.
3. *Fraud* – with the prospect of having to report on activities undertaken to prevent or detect material fraud, many boards have re-assessed the robustness of their activities in this area and whether they would stand up to closer scrutiny. A more formal approach to the annual consideration of fraud and financial risk assessment will introduce more rigour in assessing the resilience of organisations and thereby support better management and mitigation of risks.

We understand that the following proposals are also likely to be taken forward in a manner broadly similar to that proposed:

1. Stronger supervision of corporate reporting by the regulator – to an extent the FRC is already doing this through an expanded scope of reviews for the 2021/22 cycle; and
2. Clarification of distributable profits - this proposal called for improved definition and disclosure of distributable profits.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

The regulatory agenda continued

Three proposals where more detailed analysis of costs vs benefits may be undertaken are:

- The attestation on internal controls
- Minimum standards for audit committees
- The expanded definition of public interest entity

The mechanism proposed for opening the audit market, managed shared audit, has also been the subject of strong feedback and it is likely that further options, including the use of a market share cap, are being considered. This could be an area where the government elects to give powers to the FRC to resolve the issue working closely with the market including Audit Committee Chairs and the audit firms.

EU Call for evidence: Corporate reporting - improving its quality and enforcement

The EU has released a call for evidence on the path towards corporate governance and reporting reform in the EU. The call for evidence closes on 4 February 2022.

The objectives set out are:

- **Corporate governance:** ensure that companies strengthen the quality of their corporate reporting and to reinforce the responsibilities of company boards and audit committees to achieve this objective. The initiative will look at the role and responsibilities of company boards for corporate reporting, their accountability and the role that internal controls can play in achieving high-quality reporting. It will also assess how audit committees can become more effective.
- **Statutory audit:** enhance audit quality and audit supervision by increasing auditors' incentives to focus on their public interest role, removing (potential) conflicts of interest and ensuring effective, efficient and consistent audit supervision.
- **Supervision of corporate reporting:** ensure effective, efficient and consistent supervision of corporate reporting. It should also increase transparency of the work of supervisors, allowing for appropriate accountability and communication to interested stakeholders and the general public. To achieve the above objectives, the Commission will examine the current legislative framework covering the three areas above.

The problems this aims to address are:

- First, as regards corporate governance, there are concerns that **boards of listed companies have insufficient responsibilities** regarding the quality of corporate reporting, in particular in relation to **systems of controls and the prevention of risks of fraud and going concern.** Moreover, audit committees are sometimes non-existent or have a rather weak position inside listed companies. There are concerns about the lack of transparency in their activities, and a lack of clarity about their supervision.
- Second, the Commission's market monitoring report reveals deficiencies in the area of audit. **Issues with audit quality** and divergent Member State approaches on supervision of auditors reduce the contribution that statutory audits could make to the quality of corporate reporting. Moreover, there is a continued **high level of concentration** on the audit market, and barriers to cross-border audits for PIEs, which could lead to a lack of auditor choice. Reports of national audit oversight bodies point to **significant deficiencies both in audit firms' internal quality control systems and in individual audit files.**

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

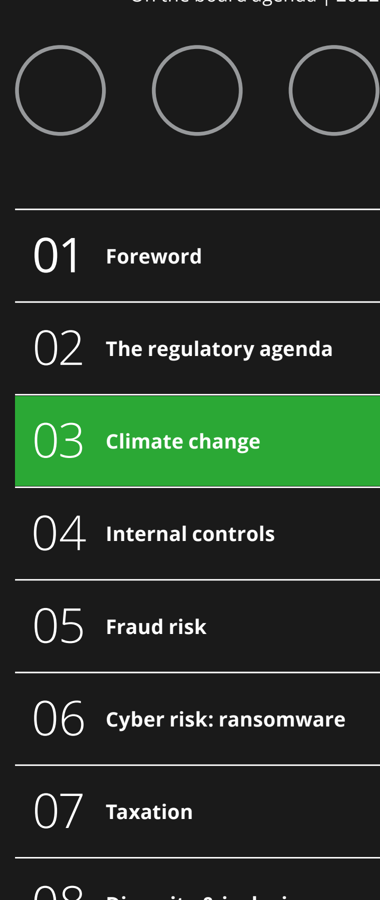
The regulatory agenda continued

- Third, a lack of effective and consistent supervision can also undermine the credibility of corporate reporting. Flaws in the supervision at Member State level have an impact throughout the EU. The fitness check and ESMA enforcement reports highlight a number of **concerns on the supervision of corporate reporting, with significant divergences in the activities and the staffing of supervisors of reporting.** This makes it difficult to ensure consistent and high-quality enforcement throughout the EU. ESMA also found a **high proportion of material misstatements** despite the often limited resources of supervisors.

In addition to the links embedded within this article, we would also like to draw your attention to these resources:

- BEIS White Paper
- Deloitte newsflash on the White Paper
- Summary of Deloitte response to the BEIS White Paper
- Deloitte: Developing your company's Audit & Assurance Policy

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change

Climate change

Now that COP26 is done and the world debates the likely effectiveness of the commitments made, it is now for business leaders, government and consumers to focus on the actions that they can and should be taking to tackle climate change. For directors of UK listed companies with December year ends, one imminent challenge will be providing the eleven recommended disclosures from the TCFD framework. In this article we outline this new requirement, identify the key challenges and provide some highlights from the recent Deloitte Global survey of audit committee members in relation to their oversight of climate change.

Mandatory climate-related financial disclosures – new for this year end

New listing rule LR 9.8.6R(8) is applicable to all commercial premium listed companies for periods commencing on or after 1 January 2021 and aims to promote higher-quality climate-related financial disclosures in line with the recommended disclosures of the Taskforce for Climate-related Financial Disclosures (TCFD).

Companies in scope must include a statement in their annual report setting out:

- Whether they have made disclosures consistent with the TCFD recommendations and recommended disclosures in their annual report.
- Where they have not made disclosures consistent with all of the TCFD's recommendations and recommended disclosures, an explanation of why and a description of any steps they are taking or plan to take to be able to make consistent disclosures in the future – including the timeframes for being able to make those disclosures.
- Where they have included some, or all, of their disclosures in a document other than their annual report, an explanation of why they have done this.
- Where in their annual report (or other document) the various disclosures can be found.

Understanding what good disclosure looks like and what investors want to see

In October 2021 the FRC Lab issued 'Taskforce on Climate-related Financial Disclosures (TCFD): ahead of mandatory reporting'. This report sets out questions for companies to consider addressing in response to each TCFD pillar and the related eleven recommended disclosures and also includes some examples of better reporting practice where companies have addressed these questions and the issues highlighted by investors. Key messages on the challenging disclosure areas include:

Impact in the financial statements

Investors are challenging companies to reflect information on climate-related issues in the financial statements where material, and requesting that auditors challenge and test management's assumptions.

Material climate change risks and uncertainties discussed in narrative reporting should be appropriately considered in the financial statements. Better disclosures present a coherent linkage between narrative reporting and accounting judgements and estimates addressing specific uncertainties associated with climate change which users may reasonably expect to materially affect balances in the financial statements.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change continued

These could include factors such as the outlook for commodity prices, expectations of growth, or potential changes to regulation or support schemes. Where the effect is material, management is required to develop an expected position on these uncertainties, for the purposes of estimates such as useful lives, impairment or valuation. In some cases, disclosure of these assumptions is required, and in others it may be best practice.

Pledges and references to Net Zero

A number of companies are reporting climate change commitments, for example pledges to reach 'net zero', and disclosing indicators around climate change, but these are often ill-defined, difficult to understand and compare, and have the potential to be misleading.

Where commitments to Paris or emissions targets represent a major component of a company's strategy, companies are expected to:

- Clearly explain what these terms mean, in the context of the company, ensuring that disclosures about such commitments are not misleading.
- Explain which emissions are included in the targets and ensure metrics included in greenhouse gas reporting align to these targets.
- Clearly distinguish 'aims' and 'ambitions' from policies which are actively being pursued and are included in business plans and budgets.

Metrics & targets

The disclosure of metrics and targets is a key expectation of the TCFD framework. However, this remains a more underdeveloped area of company reporting. Investors have noted that many companies are reporting more targets, which they welcome. However, there is a great deal of scepticism as to whether the targets are being acted upon and integrated into the company's strategy. Investors often find reporting in this area to be unclear and lacking in detail, particularly in relation to the overall target and the interim milestones that need to be achieved in order to get there.

The scope and basis of calculation of metrics is often unclear and the outcomes for the business as a whole should be reported rather than "good news stories" related to a small part of the business.

It is recommended that:

- Companies should give a fair and balanced explanation of the outcomes of their environmental policies, including performance against any previous targets.
- If targets or KPIs have changed from the prior year, this should be clearly explained, including the reason for the change.
- Boards should consider providing an explanation of the relevance of each environmental KPI in the context of the resilience of the business model to climate-related risks, in line with their responsibility for narrative reporting.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change continued

Scenarios

Reporting on scenarios remains a key area of investor interest, and is currently an area of weaker disclosure. Some companies disclose climate change scenarios that may affect viability, but detail is scarce. Discussion of scenarios is rarely explicit in considering the impacts of climate change on the company's customers or suppliers and potential mitigations.

The TCFD provides that companies should develop and apply scenario analysis to the impact of climate change. These disclosures should document:

- Detailed key inputs, assumptions, analytical methods and outputs
- Sensitivities to key assumptions
- Management's assessment of the resilience of its strategic plans to climate change

Disclosure of climate scenarios could be improved by:

- Providing sufficient detail of the scenarios and stress tests used for readers to understand their key features.
- Discussing clear outcomes of the scenario analysis in terms of how these outcomes influenced strategic planning and the actions taken as a result.
- Describing how the outcomes of the scenarios relate to the outcomes advocated in the Paris Agreement, where relevant.
- Ensuring that narrative discussion of climate scenarios is consistent with the assumptions and disclosures in the financial statements. Users may find additional explanation helpful. This includes how both financial statement assumptions, and sensitivities considered, correspond to narrative disclosures of climate change.

Examples of reporting practice are provided in the TCFD Status Report 2021 and Deloitte's Annual Report Insights 2021.

Monitoring and enforcement of TCFD disclosures

In November 2021, the FCA issued Primary Market Bulletin 36 which clarified its monitoring and enforcement activities in relation to the new listing rule (LR 9.8.6R(8)).

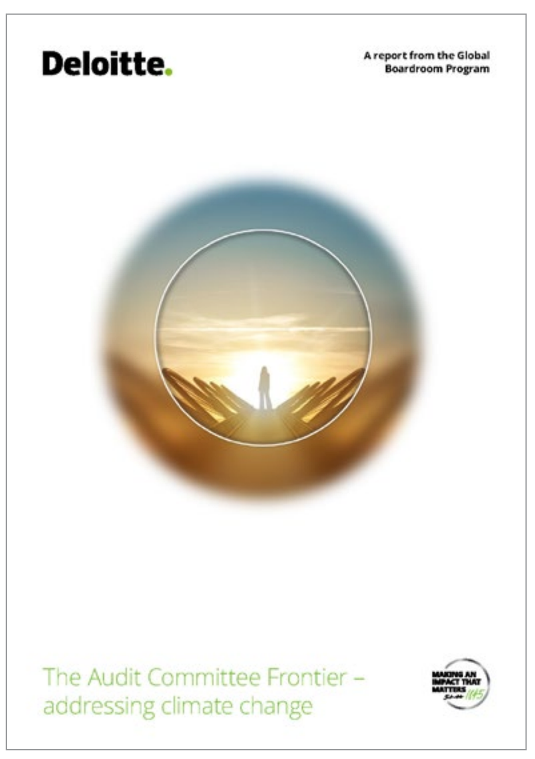
Monitoring will focus on situations where regulatory intervention may be required to ensure listed companies comply with the rule and improve the quality of their disclosures so that they are providing sufficient, decision-useful climate related information for investors. In the first instance, if a listed company's disclosures do not appear to meet the requirements of the Listing Rules, the FRC, as part of its routine reviews of annual financial reports, is likely to contact the company setting out the issues and asking for further information. Based on this information, the FRC may ask the company to take corrective or clarifying action, such as undertaking to enhance their disclosures in subsequent reports and accounts. The FCA expects matters to be satisfactorily addressed through this intervention from the FRC without the need for further action regarding the published disclosures. If the FRC is unable to reach a satisfactory conclusion through engagement, the matter will be referred to the FCA to take appropriate action.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change continued

If a listed company fails to make a statement in their annual financial report regarding the disclosure of climate-related financial information under the TCFD framework, as required by the Listing Rules, then the FCA will request that a listed company publishes the TCFD statement via a Regulatory Information Service (RIS) in line with the Listing Rules as soon as possible after discovery. Any non-compliance will be viewed seriously and will lead to action using the full suite of powers, as well as sanctions, where appropriate.

Audit committees and the challenge of climate change



The Deloitte Global publication 'The Audit Committee Frontier – addressing climate change' includes the results of a survey of over 350 audit committee members from over 30 geographies together with the views of those with extensive experience in the board, regulatory and reporting systems.

Audit committees are unprepared for climate change

The announcement of a new International Sustainability Standards Board (ISSB) (see further detail below) is a major milestone in global efforts to set businesses on the path to net-zero. Audit committees have a critical role to play in the new reporting landscape. But how prepared are they to go green?

Audit committee members surveyed revealed that 42 percent believe that their organisations' climate responses are too slow and lack strength. But, nearly 50 percent said they did not have the information, capabilities, and mandate to fulfill their climate related responsibilities.

These responses are sobering and indicate that much work remains to be done in many of today's boardrooms in order to come to grips with the climate emergency and its increasingly catastrophic consequences.

A clear strategy is needed

For the majority of audit committee members in the survey, the top internal obstacle is the lack of a clear and agreed carbon reduction strategy, an action plan with milestones, and a way to hold management accountable for it (65%). Nearly half singled out poor data and management information quality as challenges for audit committees in overseeing climate change (46%).

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change continued

Understanding how the physical effects of climate change and transition risks affect business operations and resilience is another challenge. Especially so when just under half of the audit committee members in the Deloitte Global survey do not consider themselves "climate literate". 40 percent said they must rely on company management or outside parties when considering climate impacts.

Despite environmental destruction and its dire consequences being one of the most urgent societal issues of our time, and despite growing pressure from investors for audit committees to more explicitly consider climate impacts, only six percent of respondents said that they discuss the topic at every meeting of the board's audit committee. Most audit committee members, globally, never or rarely had climate change on their agenda (58%).

In some ways, while disappointing, the results are also not surprising; most directors and audit committee members are learning alongside the mainstream population. Developing and monitoring new climate change measures is a new practice for most directors. Greater investment in learning is required.

Audit committee members can also point to no shortage of external challenges. Key concerns here related to the lack of common global reporting standards (60%) and difficulties to keep up with the pace of change in reporting regulations and practice (46%). Fortunately, this is changing fast with the announcement at the recent COP26 meeting in Glasgow of the new International Sustainability Standards Board under the IFRS Foundation.

However, bringing the uncertainty and complexity of climate change into the core of conventional management and governance processes is challenging. Informative climate reporting requires a complex transformation of reporting systems, data collection, and new skills within the finance function. Also, 46 percent of respondents to the Deloitte Global survey identify that solutions require coalitions and alliances beyond their own organisation to achieve real progress, and these are difficult to achieve.

Those reporting or planning to report on Scope 3 emissions, which the organisation is indirectly responsible for, indicated some serious challenges, including the ambiguity of measurement standards (78%) and lack of understanding of the perceived value of this information (52%).

Considering, however, that Scope 3 emissions are likely to be the most material part of a company's carbon footprint, companies need to get more comfortable with preparing and exchanging information to facilitate greenhouse gas reporting in the value chain.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change continued

Boards need to do more

There is much more that today's boardrooms could do to ensure clarity in how companies report climate commitments and measure climate progress. Coming to grips with climate change means undertaking a comprehensive climate assessment and reflecting the outcomes in the financial statements. This involves organisations assessing how the changing climate affects their operations, supply chain, customers and the wider ecosystem on which they depend to create enterprise value.

Still, the vast majority of respondents (70%) said that they have not completed a comprehensive climate change assessment. Most of them assume the issue had no material impact on the organisation. Just 18 percent of respondents said that their financial statements fully reflected the outcomes of a climate impact assessment. This alone indicates a clear need to accelerate activity.

"While audit committees are beginning to address how assumptions about the future should be reflected in financial statements and risk assessments, there are steps that can be taken now to improve the decision-making process and put boards and their organisations on a successful track to respond to the climate crisis," says **Jean-Marc Mickeler, Deloitte Global Audit & Assurance Business Leader.**

Findings from the survey suggests that 70 percent of companies already look to the CEO as taking overall responsibility for climate strategy, just as the CEO is overall responsible for company strategy.

"The crux of the matter is that climate must be integrated with company strategy," notes **Veronica Poole, Vice Chair of Deloitte UK and Deloitte Global IFRS and Corporate Reporting leader.** *"From this integration commitments can be made, which, in turn, reorient the whole business."*

Practical advice

In the Deloitte Global survey, audit committee members had good advice for other audit committee members: Improving climate education came out on top (87%) followed closely by ensuring good management information as part of regular reporting to the board (79%), and having the all-important internal alignment around the company's climate strategy (78%).

"Through greater education and engagement, audit committees can help their organizations take more decisive climate action," says **Sharon Thorne, Deloitte Global Board Chair.** *"This means ensuring their organisations are assessing their own environmental risk profiles, establishing mitigation plans to reduce their carbon footprints, ushering in global ESG standards, and accurately reporting on their progress."*

There really isn't a choice. The transition to a low-carbon economy has begun and we all have a part to play.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Climate change continued

Major step forward on the road to global sustainability standards

One of the key challenges identified by audit committees in tackling climate change matters was the current lack of global common standards but this situation is changing with the establishment of the International Sustainability Standards Board announced at COP26. The new ISSB will sit under the umbrella of the IFRS Foundation alongside the International Accounting Standards Board. In a move which signalled even more consistency and alignment of the current sustainability disclosure frameworks, it was announced that the Climate Disclosure Standards Board (CDSB – an initiative of CDP) and the Value Reporting Foundation (VRF – which houses the Integrated Reporting Framework and the SASB Standards) will be consolidated into the ISSB by June 2022.

The announcement was accompanied by the publication of prototype climate and general disclosure requirements developed by the Technical Readiness Working Group, a group formed by the IFRS Foundation Trustees to undertake preparatory work for the ISSB. These prototypes provide a clear indication of the direction of travel for the ISSB and should be considered carefully by boards and audit committees to assess the readiness of their organisations to report these new disclosures under requirements likely to be formally issued during 2022.

Implementation in individual jurisdictions will follow a process of endorsement similar to International Financial Reporting Standards, but the timescales are likely to be accelerated as much as possible so that the impact of these new global standards can be felt as early as possible.

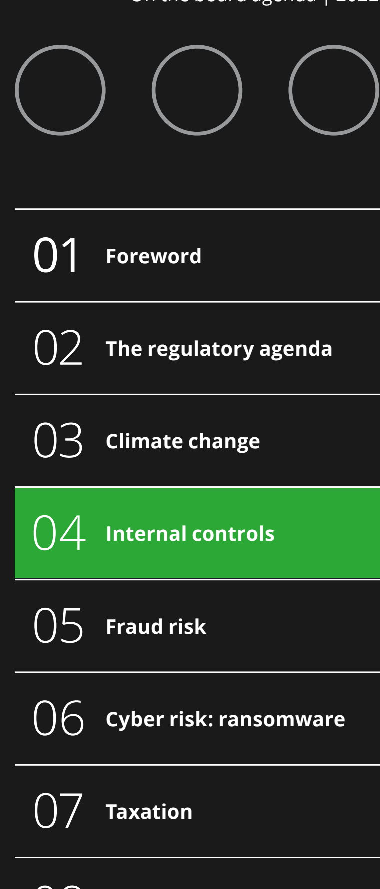
To read more on the ISSB announcement, click here.

In addition to the links embedded within this article, we would also like to draw your attention to these resources:

- TCFD Final report
- FRC Climate thematic
- FRC Lab: Climate reporting October 2019
- Building credible climate commitments
- Tectonic shifts: How ESG is changing business, moving markets, and driving regulation
- Living your purpose: A roadmap to integrated thinking and reporting

“Timescales are likely to be accelerated so that the impact of these new global standards can be felt as early as possible.”

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



Internal controls – with some focus and hard work your framework can be a key business asset

Internal controls – with some focus and hard work your framework can be a key business asset

In this article we highlight what boards should be focusing on now to meet their existing responsibilities under the UK Corporate Governance Code, in the light of recent commentary on the future of "UK SOX".

For several years now we have explored in previous 'On the board agenda' articles and in our publication 'Internal control and the board: What is all the fuss about?' how the UK Corporate Governance Code already establishes a clear responsibility on the whole board to establish a framework of prudent and effective controls. However, supporting guidance for UK listed companies is not sufficient and this has resulted in varied implementation and varied levels of probing by boards and audit committees.

We believe that in order to ensure well documented compliance with the UK Corporate Governance Code, boards and/or audit committees should assess where they are against a recognisable framework, and have offered the following simple guide:

Step 1

- Start with a detailed understanding of the business model
- Undertake a financial risk and fraud risk assessment
- Establish clear and robust entity level controls to ensure the right "tone from the top"
- Define a hierarchy of delegated authorities from the board

Step 2

- Obtain clarity over in scope systems and related general IT controls
- Generate robust process documentation for material business cycles, with clear process owners
- Identify the material controls

Step 3

- Define and evidence a robust process for on-going monitoring of the design and operating effectiveness of material controls
- Define and evidence a robust process for a year-end assessment of the design and operating effectiveness of material controls

Step 4

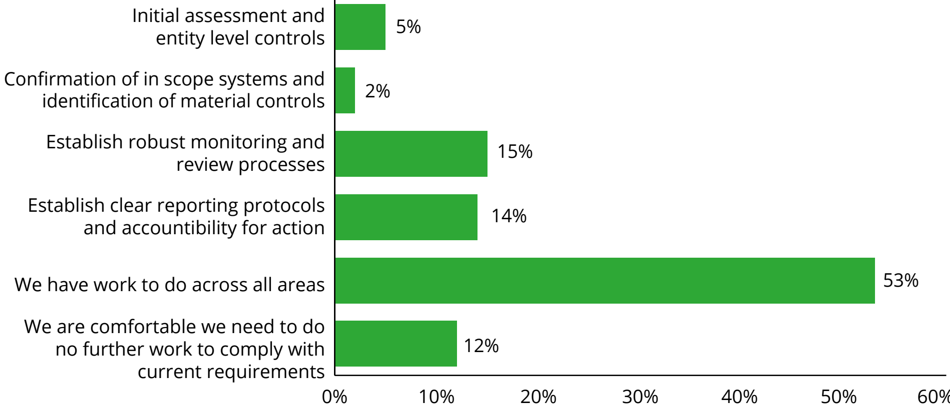
- Define a significant control failure or weakness that would require detailed consideration and disclosure of remediating actions
- Define reporting processes including remedial action tracking

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Internal controls – with some focus and hard work your framework can be a key business asset continued

The BEIS White Paper has explored whether some form of management attestation of controls should be introduced. It may well be that such an attestation is needed to inject some rigour into company focus on controls. A Deloitte Academy discussion on internal controls revealed that many directors feel that their companies have more work to do.

In relation to the four step internal control framework and what you see at your organisations, where do you have more work to do?



There is an increasing awareness that the existing Code requirements are in fact wide reaching and well expressed, but have been inconsistently and perhaps not thoroughly applied. Furthermore, limited attention has been paid to the ongoing monitoring and review activities, required to comply with the Code, by boards and regulators. This is changing with the wide-ranging discussions on controls in the UK and also with the FRC now extending its supervisory remit beyond the financial statements to the whole of the annual report.

Amongst directors, there is also a growing realisation that many companies have been relying more on exception reporting and trust, than on objective evidence gathering and inspection that effective financial controls are in place, and many directors now realise that there is value in a rigorous and transparent framework, including inspection, for processes and controls. In a recent speech for the ICAEW, Sir Jon Thompson (FRC CEO) said: "Whether Ministers push ahead with the legislative change on UK SOX or not, it will be relatively easy for us to raise the bar further with revisions to the UK Corporate Governance Code, or for us to include reporting on internal controls in minimum standards for audit committees."

On page 50 we explain that the FRC's latest *Review of corporate governance reporting* is calling for boards to report more explicitly on the scope and outcome of their annual review of the effectiveness of risk management and internal control systems.

Where next?

There has been extensive discussion about whether the UK should follow COSO or another simplified framework as the benchmark against which effectiveness should be judged. The elements in the four-step framework above are common to COSO and are simply the building blocks by which a control framework can be objectively defined. But how can any new requirement be applied in a proportionate manner? The answer lies in how such a framework is applied in your business.

To keep controls in proportion and relevant to your business attention should be focused on controlling the risks that truly matter. Too often we see insufficient time and depth of thinking on this step - with the result that every operational

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Internal controls – with some focus and hard work your framework can be a key business asset continued

aspect of a balance is addressed with a light touch, with inadequate depth of thinking on the significant financial reporting risks. It is here in particular where value lies.

Questions for boards to consider:

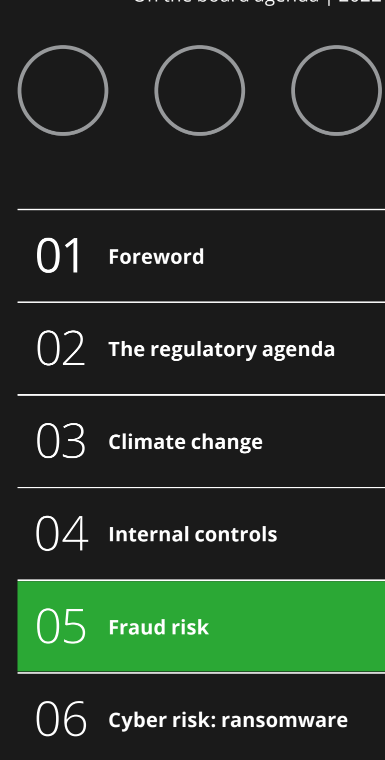
- What assumptions are we making when we sign off that an effective framework is place that meets the UK Corporate Governance Code requirements?
- Do we have the right balance between trusting that controls are in place and documentary evidence? Are we at risk of an evidence gap?
- Should the audit committee be receiving more comprehensive papers supporting risk assessment and control monitoring and the annual effectiveness review? Is the evidence base sufficient?
- Does our process include an appropriate breadth of functions, e.g. tax, treasury, central finance team and other key head office functions? And are the properly resourced to undertake the rigorous thinking required?
- Has there been an appropriate assessment of entity level controls?
- Have we really got to grips with general IT controls over our core systems? What about those areas still relying on spreadsheets?
- Have we got the balance right between operational financial controls and the controls around the financial reporting judgements?
- Are we providing a truthful picture in our annual report about the state of our controls processes, our monitoring during the year and our annual review of the effectiveness of controls?
- Should we be discussing areas in our "control journey"? How they are developing? Where is our focus of attention this year and next?

As noted on page 6, at the time of writing we are waiting for the government's feedback statement on the BEIS White Paper. For now, our key messages are that first, the UK Corporate Governance Code already demands a rigorous control framework – and, second, that done well, a robust internal control framework represents a key business asset.

In addition to the links embedded within this article, we would also like to draw your attention to these resources:

- FRC Guidance: Risk Management, Internal Control and Related Financial and Business Reporting
- COSO framework 2013 – Executive summary

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



Getting it right: your fraud risk assessment

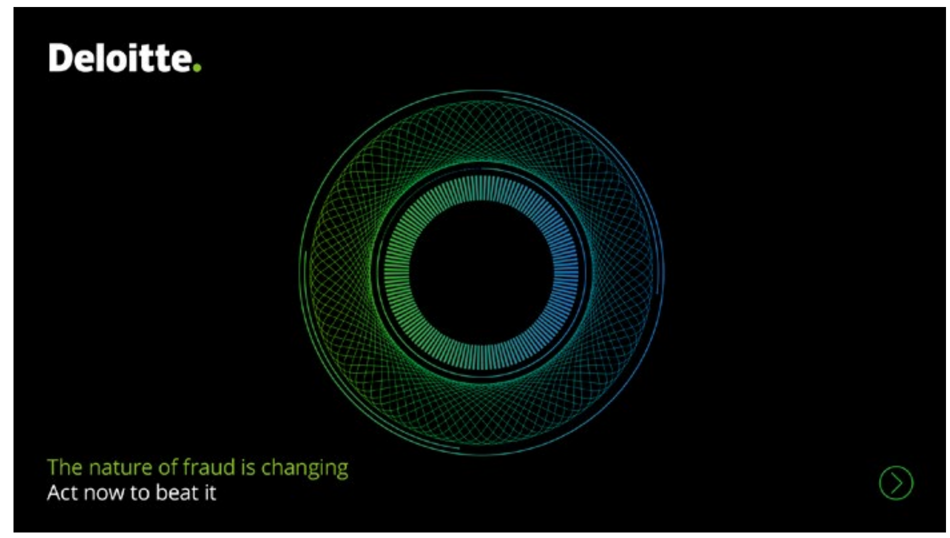
Getting it right: your fraud risk assessment

Most organisations will be aware of the significantly increased level of fraudulent activity facilitated by the considerable financial and operational pressures due to lockdowns and the stressed economic environment; the rapid shift in working patterns has also provided opportunity, leaving many at risk of having their controls and procedures compromised, at a time when economic conditions provided greater incentive to commit fraud.

Fraudsters continue to evolve their methods with frightening sophistication, with many frauds facilitated by technology – cyber-attacks, email interception or phishing attempts.

Deloitte's new report and survey "The nature of fraud is changing: act now to beat it" draws in-depth qualitative research conducted with senior leaders including board members and audit committee chairs, exploring the challenges that different organisations are facing as they tackle fraud risk. It also includes discussion on developing a fraud risk assessment and explores features of proactive fraud management.

"We don't check to see if fraud has happened, we check to see if fraud could happen. When it does happen it's usually the result of a confluence of things and that makes it hard to design out of the system."



The survey looks at the different approaches between organisations regarding their position on addressing fraud and fraud risk, ranging from proactive at one extreme to reactive at the other. The report identifies and provides useful detail regarding five key areas that seem to determine where a company sits on that spectrum:

- Clarity – defining fraud;
- Controls – the importance of fraud risk assessment and the challenge of getting it right;
- Culture – led by the CEO and the board, the right culture is essential;
- Communication – using it to improve risk culture and governance; and
- Checks – who controls the controls?

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Getting it right: your fraud risk assessment continued

Proactive fraud management

The report notes some characteristics of proactive fraud management, which may be a useful benchmark for boards to consider when evaluating their own approach.

Risks are well defined	Risk assessments are reviewed regularly	Clear values and a strong anti-fraud culture	Greater degree of board scrutiny and challenge	Full segregation of duties/ lines of defence set up

Developing a fraud risk assessment

The report includes a helpful guide on how to go about producing a fraud risk assessment. Key steps and considerations, explored in more detail in the full report, include:

1. Involve the right people	Go beyond the risk and compliance teams to involve a broader stakeholder group, involving the first and third lines of defence. Ultimately responsibility for having an effective anti-fraud framework in place is down to the board, with an accountable executive overseeing and approving the assessment and any resulting remedial steps.
2. Ensure all areas of the business are captured and define the scope of fraud	Consider all possible sources of risk across the business, splitting the evaluation into areas including sales, HR, IT, inventory and not forgetting finance / the financial statements. Evaluate these for the different types of fraud risk you might face, including areas such as internal fraud, external fraud risk from suppliers and customers, cyber-attacks, bribery risk, manipulation of financial reporting.
3. Initial information gathering – data sources to consider	Gather information to inform your assessment, including both quantitative information (financial losses due to fraud, market data, KPIs) and qualitative information (staff insights, internal audit reports, customer complaints, whistleblower reports, market trend analysis).
4. The approach to identifying fraud risks and controls	Determine which techniques to use to conduct fraud risk and control identification. These could include questionnaires, workshops, reviews of existing fraud risk frameworks and walkthroughs. For walkthroughs, adopting a "fraudster's mindset" can make identifying vulnerabilities significantly easier.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Getting it right: your fraud risk assessment continued

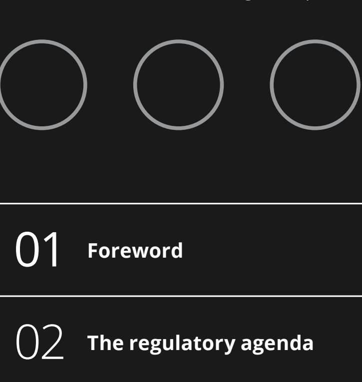
5. Analysis and control mapping	Using the first four steps of the process, the key fraud risks have been identified. Step five then maps the existing controls in place to mitigate the risks, evaluates the design and operating effectiveness and determines the remaining level of fraud risk that requires remediation.
6. Documentation	Documentation is a critical step to ensure key fraud risks and controls have all been captured and that processes and controls have been communicated clearly with others in the organisation. Typically this is captured in a risk and controls matrix, grouped by operating unit or function. High level heatmaps showing the residual likelihood and impact of each fraud risk identified can be useful at board level.
7. Remedial measures and recommendations	Prioritise the steps that need to be taken to close any remaining vulnerabilities, developing a clear action plan to execute the recommendations, ensuring the necessary board level oversight and buy-in. A fraud risk assessment should remain a dynamic live document that is updated on an ongoing basis to support fraud management efforts.

"The nature of fraud is changing: act now to beat it" is thought provoking – revealing the importance of ongoing evaluation of fraud risks and safeguards throughout the organisation, including suitable, concise reporting to the board which will help drive the right level of focus.

Contact

Jules Colborne-Baber
+44 (0)7803 207417
jcolbornebaber@deloitte.co.uk

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

The role of leaders in building ransomware-resilient organisations

The role of leaders in building ransomware-resilient organisations

65% of business leaders identified ransomware as the single greatest threat[1] to their organisation over the next 12 months, while only **33% have prepared** for such an attack

Extortion in the digital age

The threat of ransomware is no longer a quiet trend, and leading organisations have identified that through sufficiently resilient and secure backups and building blocks for recovery, the impacts of a ransomware event are largely mitigated. This change in approach firmly returned the initiative to organisations, and this has resulted in increasingly diminishing returns for attackers using traditional ransomware methods.

However, the past twelve months have represented a major turning point in the evolution of ransomware. Attackers have started to shift their focus toward data theft with the threat of leakage prior to the encryption of data and systems, to hold additional leverage over their victim: this is becoming known as the "Double Extortion" policy.

As a result, data theft and the threat of release have arguably become as engrained in ransomware operations as the encryption itself, and threat groups collectively see the value in utilising their time on a network to covertly extract data to increase the likelihood of the victim paying the ransom. The lucrative and fast pay-off of this model has made these types of hybrid attacks increasingly attractive to cyber criminals, presenting distinct regulatory and technology challenges for organisations.

Lessons learned from the front lines of cyber incident response

The recent incidents that Deloitte has been called to support carry a recurring theme: ransomware is not just an IT issue; it is a business issue, and the business must drive the wider response and recovery. However, in practice this does not always happen.

A lack of cohesion between business leaders managing the operational and regulatory impacts of an incident, and the "resolver" teams driving the technical investigation and remediation can exacerbate the criticality of the incident due to a misalignment in strategic direction.

Legal requirements continue to be a blind spot, and organisations are largely unaware of when to seek counsel in the midst of a crisis. This can have devastating consequences: for example, an unintentional disclosure of evidence could impact the business decision not to negotiate requiring a hurried change of tactic.

Additionally, the desire to move straight to business-as-usual will often be at odds with the realities of the situation. Recovery must be incremental and driven by business priorities which will ultimately guide future state improvements, with leadership setting the pace.

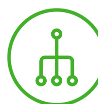
01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

[1] https://www2.deloitte.com/us/en/pages/about-deloitte/articles/press-releases/exec-ransomware-concerns-high-but-few-are-prepared-for-such-attacks.html

The role of leaders in building ransomware-resilient organisations continued

Ransomware adversaries are becoming more organised, less restrained and, worryingly, more innovative. The shift to a "double extortion" model predicated on the theft of data alongside encryption of the data itself presents its own unique challenges. Threat actors see the value in data, and have the motive and means to hold it to ransom with increasing tenacity; preparation is key, and an organisation's anti-ransomware strategy must be influenced from the top.

Figure 1. Observations from the front lines of incident response and enterprise recovery

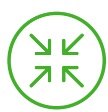


Strategic intent must influence technical decision-making and enterprise recovery

Ransomware is a whole-of-business issue, requiring a whole-of-business response

Incidents are not always brand damaging events – communications and tactical transparency are key

Without a global standard across entities, each is as vulnerable as the weakest link



Attackers are becoming more organised, less restrained and more networked; so should you

Five principles for an effective enterprise response and recovery capability

Principle 1 – Burst Capacity

The first minutes and hours following identification of an incident are often the most critical. Infection and spread is swift, therefore resolver teams must deploy quickly with appropriate representation from all corners of the business. Composition of these groups is key, and establishing channels and break-glass mechanisms for facilitating rapid mobilisation with the necessary external specialist support will ensure cohesion and accountability as the situation develops.

Principle 2 – Communications

The importance of a well-articulated process for engaging and communicating with internal stakeholders and external entities cannot be overstated. Incidents do not always have to be brand damaging events; the public and regulators will forgive organisations who are well prepared, transparent, and act with integrity, while putting up barriers can attract criticism. Business leaders must control the narrative and the flow of information as one voice, through clear guidance and thresholds for engaging with interested parties.

Principle 3 – Business Priorities

Strategic intent needs to be determined from the offset and continuously reviewed, and must influence technical recovery and decision-making. Leadership must agree enterprise priorities for recovery as part of organisational business continuity, and communicate this early to set the pace for the response. Technical aspects will be restrictive, however synchronisation between business leaders and resolver teams will ensure that technical remediation activities are aligned with strategic direction.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

The role of leaders in building ransomware resilient organisations continued

Principle 4 – Muscle Memory

Organisations who have well thought-out, well defined plans, and have practiced execution of these plans through mock exercises avoid common pitfalls and panic-driven decision making, resulting in much quicker, more decisive responses. Wargaming must be an iterative and recurring theme of an organisations cyber strategy which emphasises mutual understanding of roles and activities at each phase of the response.

Principle 5 – Building Blocks of Recovery

The focus of the business must always be on recovering the service rather than the server. Understanding the technical DNA of an organisation, including infrastructure, applications, and data sets that underpin services is critical. The preservation of these critical building blocks is essential, and we have seen the emergence of the immutable backup as the technology industries response to this challenge. Basic process mapping and offline storage of key data sets is an important first step in defining these building blocks; if you are unsure, start with Active Directory!

Questions business leaders should be asking to probe the depth of their incident response and recovery capability:

- **Maturity**. Has our organisation reviewed our people, process and technology with a specific focus on ransomware and destructive cyber attacks to understand where our response and recovery gaps exist?
- **Detection**. What proactive measures are we taking to detect the indicative signs of malicious activity and identify attacks earlier in their lifecycle?
- **Planning**. Does our organisation's executive level crisis plans address ransomware attacks specifically?
- **Containment**. Does our organisation possess a robust tactical procedure for containing key parts of our business from quickly spreading ransomware?
- **Identification**. Do we know what and where our business critical assets are, and have we established clear procedures for enabling pre-emptive isolation and rapid recovery?
- **Exercising**. Have we performed cyber exercises and simulations to rehearse the response of our technical teams and decision-makers?
- **Segregation**. Have we implemented air gapped solutions to protect our backups and artefacts of recovery?
- **Awareness**. Is the board aware of the threat of ransomware to our business, and clear on their role during a major response?

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

The role of leaders in building ransomware resilient organisations continued

Preparation is your first line of defence

Enterprise Response and Recovery begins with planning, and understanding overall readiness for an incident is an important first step. Proactive identification of where control and process gaps exist based on the evolving threat landscape will help guide strategic planning, cyber initiatives and investments in people, process and technology.

Despite best laid plans a cyber attack can still happen, and so it is crucial to implement countermeasures and defences at each layer of the organisation to provide multiple opportunities for early detection, containment and remediation.

FRC Lab project: Cyber, Data and Digital Risk

In September 2021 the FRC's Financial Reporting Lab announced a new project on cyber, data and digital risk, expected to result in a range of published outputs over 2022. The project scope will include:

- how companies' risk management practices are evolving to counter cyber, digital and data risks;
- how boards are building expertise in cyber, digital and data; and
- how external disclosures such as risk reports, viability and (in future) resilience statements should communicate cyber, digital and data risk and what specific disclosures would be useful when such risks crystalise.

There is currently limited guidance on external disclosures in these areas in the UK and understanding the needs of investors in this space will be very helpful for companies drafting future annual reports.

SEC focus on cyber and data privacy

The SEC has issued a number of fines regarding cyber risk disclosure during 2021 for both domestic and dual-listed registrants. The most recent SEC guidance on this topic was published in 2018 and new guidance is expected shortly.

In one case there was a breach of cyber security controls leading to data loss, however a subsequent company filing flagged the risk of a cyber breach but without including the information that a breach had in fact occurred. This meant there was both an inaccurate statement in the filing that was deemed by the SEC to be material and that the company involved did not have disclosure controls that the SEC deemed appropriate to ensure the filing contained accurate information.

Boards should consider whether they have effective mechanisms in place so that those finalising external reports are able to capture and disclose risks that emerge and facts that come to light up to the date of sign-off.

Contacts

William McLeod-Scott
Partner – Head of Enterprise Response and Recovery
wmcleodscott@deloitte.co.uk

Nick O'Kelly
Partner – Head of Cyber Incident Response
niokelly@deloitte.co.uk

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Taxation

Taxation

2021 has been a year of change in taxation approach for individual geographies and globally. In this article we flag some key changes that have either taken effect or are soon to do so in the UK, including from the recent Autumn Budget, together with changes anticipated in the US and changes resulting from collective international action.

UK Corporation Tax rate change

In the 2021 UK Budget the Government announced several legislative changes to corporation tax. These included an increase in the rate of corporation tax to 25% with effect from 1 April 2023. Businesses with profits under £250,000 will be taxed at lower rates.

As the increase in the UK corporation tax rate does not take effect until 1 April 2023 there should be no impact of the rate change on the calculation or measurement of current taxes until after 1 April 2023. From a deferred tax perspective, the change to the tax rate was substantively enacted on 24 May 2021 and therefore careful consideration will be required for companies with balance sheet dates after substantive enactment in order to schedule out the temporary differences that are expected to reverse post 1 April 2023. Any temporary differences expected to reverse before 1 April 2023 will need to continue to be measured at the 19% tax rate.

If there is significant judgement involved in determining the extent to which the temporary differences will reverse pre 1 April 2023 (at 19%) vs post 1 April 2023 (at 25%) then additional disclosure may be required (see Year-end reporting update).

Banking surcharge

All banking companies in the UK must currently pay an additional tax surcharge on all taxable profits in excess of £25m per annum. This falls within the definition of an income tax and is accounted for in the tax line. The surcharge rate is currently set at 8%.

The Autumn 2021 budget announced that the surcharge will be reduced to 3% with effect from 1 April 2023, and the surcharge allowance will increase from £25m to £100m at the same date.

As the changes do not take effect until 1 April 2023, there should be no impact on the calculation and measurement of current taxes until after this date.

From a deferred tax perspective, it is expected that this change will be substantively enacted in early 2022 and therefore careful consideration will be required for companies with balance sheet dates after substantive enactment in order to schedule out the temporary differences that are expected to reverse post 1 April 2023. As the reduction will not be substantively enacted at 31 December 2021, companies should still reflect the previous surcharge rate of 8% when calculating deferred tax balances at this date. This may give a different answer to the actual impact when the deferred tax balances unwind (to the extent that they are expected to unwind after 1 April 2023). To the extent this impact is material, companies should include additional disclosure explaining the reduction from 8% to 3% and the increased allowance, and the expected impact upon the deferred tax balances.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Taxation continued

Other Budget measures

A number of other measures were announced during the 2021 and 2022 UK Budgets. Use the links below to join our panel of experts as they discuss the implications of the Budget announcements:

- R&D changes – expansion of the definition of R&D for tax purposes to include data and cloud computing costs, and proposed changes to refocus the reliefs towards activities carried out in the UK.
- Capital allowances super deduction – 130% tax deduction for qualifying spend on plant and machinery incurred between 1 April 2021 and 31 March 2023.
- Freeports – the government has announced the location of eight Freeport sites within England which will benefit from several reliefs including in relation to Stamp Duty Land Tax, enhanced capital allowances, and customs duty.
- Indirect tax changes – various proposals including in relation to business rates, landfill tax, duties and air passenger duty.

Notification of uncertain tax treatments

At Spring Budget 2020, the government announced that large businesses would need to notify HM Revenue & Customs (HMRC) of uncertain tax treatments. These new rules will apply in relation to Corporation Tax, VAT, and Income Tax returns that are required to be filed on or after 1 April 2022.

The Government released updated draft law on 4 November 2021 and it is expected that the law will be finalised in the Finance Act in early 2022.

Scope

The notification requirement will apply to large businesses – both companies and partnerships – which exceed set financial thresholds based on the Senior Accounting Officer and Publication of Tax Strategies regimes.

A requirement to notify will arise where there is a tax advantage, or related tax advantages, of £5m or more in a relevant period and either:

1. A provision for uncertain tax treatments has been made in the financial statements; or

2. The tax treatment is different to HMRC's known interpretation or application.

Exemptions

Certain exemptions apply to exclude specific uncertain tax treatments from the requirement to notify. The notification requirement applies separately in relation to each relevant tax.

The deadlines for notifying are as follows:

- Where the relevant return is an annual return (e.g., Corporation Tax), on or before the date on which the return is required to be made; or

- Where the relevant return is not an annual return (e.g., VAT), on or before the date on which the last relevant return for the financial year in question is required to be made.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Taxation continued

Actions to take now

Businesses may already have in place a risk management framework to assess and respond to potential tax risks in light of existing requirements such as the Publication of Tax Strategy (which implies formal governance over tax planning arrangements) and Senior Accounting Officer (which does the same for compliance).

However, the new requirement to notify HMRC is likely to encourage in-scope business to review their framework and ensure they have new robust processes and procedures in place in order to accurately identify, evaluate, and report uncertain tax treatments across the relevant taxes.

For further information on preparing for the notification of uncertain tax treatments regime, an on-demand webinar is now available.

BEPS Pillars 1 and 2

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) recently endorsed the key components of the two-pillar approach to international tax reform. The agreement has set an ambitious and challenging timeline for both Pillars and whatever the final rules, most global businesses of any scale are likely to be impacted.

Pillar One: Nexus and profit allocation rules (Amount A)

Amount A targets the largest multinational groups focusing initially on those with at least EUR 20 billion of consolidated revenue and net profits of over 10% (i.e., profits before tax to revenue) and will require them to pay tax in the locations where their customers and users are located. A formulaic approach will be used to allocate a percentage of profits between each jurisdiction.

Pillar One should effectively require in scope multinationals to pay at least some tax in the markets they interact with.

Pillar Two: Global minimum tax

Pillar Two, the key components of which are commonly referred to as the "global minimum tax", introduces a minimum effective tax rate of at least 15%, in each jurisdiction calculated based on a specific accounting based ruleset. Groups with an effective tax rate below the minimum in any particular jurisdiction would be required to pay top-up tax in their head office location or in the location of other affiliates. The tax would be applied to groups with revenue of at least EUR 750 million, making it far more widely applicable than Amount A under Pillar One. Find out more about these proposals for major international tax policy reform.

With action required in 2022 ahead of a scheduled 2023 implementation, board awareness of the issues at stake is important, noting the potential implications on the group's effective tax rate and increased compliance requirements.

US tax reform

President Biden has recently published his plans for further reform to the US federal tax system. These plans are currently being debated by Congress, and any legislative changes would need to be passed by both the House of Representatives and the Senate (not a given) before being signed by the President, in order to become law.

Although the final details of the reform may be different to the proposals below or may fail legislative hurdles, it is worth being familiar with the key proposals and understanding the potential impact on company taxation.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Taxation continued

There should be more information available by the end of this calendar year.

Key proposals include the following:

- No changes are proposed to the corporate tax rate which would therefore stay at 21% for federal purposes.
- An Alternative Minimum Tax is proposed at a rate of 15% where a group has 'Adjusted Financial Statements Income' (AFSI) of at least $1bn, calculated using a three year average. The AFSI calculation is a new calculation defined in the draft legislation.
- The effective rate of tax on GILTI (Global Intangible Low Taxed Income) would rise to 15% (currently 10.5%), and on FDII (Foreign Derived Intangible Income) would rise to 15.8% (currently 13.125%). Various other changes to GILTI are also being introduced.
- Changes would be made to the FTC (Foreign Tax Credit) rules. GILTI credits could be carried forward for up to 5 years (currently they cannot be carried forward at all) and foreign taxes can also be credited against up to 95% of GILTI income (currently only 80% can be covered by FTCs). However, the ability to carry back FTCs would be repealed for all "baskets" (different types of income). The use of some FTCs are also proposed to take place on a country-by-country basis.
- A new limitation on interest deductibility is proposed where there is a disproportionate level of borrowing in the US. The proposed new limitation would apply to any US entity that forms part of an international reporting group where its net interest expense exceeds its allocable share of the group's net interest expense (calculated on the basis of EBITDA) by more than 110%. This would apply for groups with a three-year average net interest expense of at least $12m.
- The rate of tax on BEAT (Base Erosion Anti-Abuse Tax) would rise progressively from 10% to 18% over the next few years. There is however an exception where the BEATable payment is made to a jurisdiction that taxes the income at a rate of at least the BEAT rate. As the BEAT rate is going up progressively over a number of years that number will change; the rule relates to the rate in place at that time.
- The majority of these changes would not be introduced until periods starting after 31 December 2022. However, the BEAT changes are proposed to come in one year earlier (so potentially from January next year).

Contacts

Alexandra Warren
+44 118 322 2391
alwarren@deloitte.co.uk

Chris Gault
+44 118 322 2354
cgault@deloitte.co.uk

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Diversity & inclusion

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Diversity & inclusion continued

There are many studies which highlight the performance benefits from diversity and inclusion. In this article we pull together the messages from recent research published by the FRC on diversity and board effectiveness, the 5-year summary and final report by the Hampton-Alexander Review and proposed new regulatory "benchmarks" and disclosure.

In July the FRC issued 'Board Diversity and Effectiveness in FTSE 350 Companies', research conducted in conjunction with London Business School, Leadership Institute and SQW. The main findings of the research concluded that:

- The greater representation of women in the boardroom is reshaping culture and dynamics and benefiting businesses from a social justice as well as a performance perspective.
- It is the responsibility of the Chair of a board to drive inclusion throughout the organisation.
- Regulators and companies must focus on collecting more data on the types of diversity, board dynamics and social inclusion.
- The Nomination Committee itself should be diverse and have a clear mandate to work with search firms that access talent from wide and diverse pools.

"Diversity without active inclusion in the form of welcoming boardroom interactions is unlikely to encourage directors who look 'different' from others around the table to step forward and contribute."

In February this year, the Hampton-Alexander Review issued a 5-year summary and final report concluding the important work which has been done to increase the representation of women in senior leadership positions and on boards of FTSE 350 companies. Concluding on the work of the Review, Sir Philip Hampton acknowledged that in five years FTSE 350 Boards have on average met or exceeded the target of 33% women on boards, and women in FTSE 350 leadership roles have increased by almost 20%, albeit just falling short of the 33% target. Sir Philip also set out two clear recommendations for boards:

- companies should as a matter of best practice have a woman in at least one of the four roles of Chair, CEO, SID and CFO, and investors should support such best practice; and
- companies should publish a gender pay gap for their board and their executive committee.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Diversity & inclusion continued

"The lack of women in the boardroom is where it all started a decade ago, and it's the area of greatest progress. However, we now need to achieve the same gains for women in leadership, and indeed more."

The first of Sir Philip's recommendations has been taken forward in an FCA proposal for a new Listing Rule which will require certain companies to provide a 'comply or explain statement' on whether they have achieved certain proposed targets for gender and ethnic minority representation on their board. The proposed targets are as follows:

- At least 40% of the board are women (including individuals self-identifying as women)
- At least one of the senior board positions (Chair, CEO, SID or CFO) is held by a woman (including individuals self-identifying as a woman)
- At least one member of the board is from a non-White ethnic minority background (as categorised by the ONS)

In cases where in scope companies have not met all of the targets, companies would be required to indicate the targets they have not met and to explain the reasons for not meeting the target(s). It is important to note that this statement is **not** intended to be part of the UK Corporate Governance Code compliance statement.

The companies in scope of this proposal are UK and overseas issuers with equity shares admitted to the premium or standard segment of the FCA's Official List. Open-ended investment companies and 'shell companies' will be excluded.

The following numerical data will also be requested under the proposal:

Table 1: Gender reporting categories

Gender	Number of Board Members	% of Board	Number of senior positions on the board (CEO/CFO, SID or Chair)	Number in executive management	% of executive management
Men (including those self- identifying as men)					
Women (including those self-identifying as women)					
Non-binary					
Not specified/prefer not to say					

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Diversity & inclusion continued

Table 2: Ethnicity categories

ONS ethnicity category	Number of Board Members	% of Board	Number of senior positions on the board (CEO/ CFO or SID)	Number in executive management	% of executive management
White British or White Other					
Mixed/Multiple Ethnic Groups					
Asian/Asian British					
Black/African/ Caribbean/ Black British					
Other Ethnic Group					
Not specified/prefer not to say					

The consultation period closed on 20th October 2021. Subject to the outcome of the consultation, it is proposed that the new Listing Rule requirements will apply to accounting periods starting on or after 1 January 2022 but companies are encouraged to consider making disclosures on a voluntary basis in annual financial reports published before then.

Investors are also setting clear expectations on ethnic diversity: "Our expectation is that companies set ambitions related to the ethnic composition of their organisation, throughout the workforce, with a particular emphasis at the board level, which generally sets the tone from the top. For companies that fail to meet our transparent and rules-based minimum expectations, there will be voting and investment consequences." LGIM, October 2020

Questions for boards to consider:

- Does the board need to rethink how they understand diversity and the importance of inclusive behaviours?
- Are the policies and plans for enhancing the organisation's diversity appropriately balanced between the short and long term with concrete actions to drive effective inclusion at every stage?
- Are reasonable attempts being made to educate and gather data on wider aspects of diversity beyond gender, e.g. ethnicity and socio-economic background?
- Is the composition of the Nomination Committee appropriately diverse?

In addition to the links embedded within this article, we would also like to draw your attention to:

• Parker review – 2020 update

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Remuneration – UK board pay in a global talent market – a model fit for purpose?

Remuneration – UK board pay in a global talent market – a model fit for purpose?

UK board pay in a global talent market – a model fit for purpose?

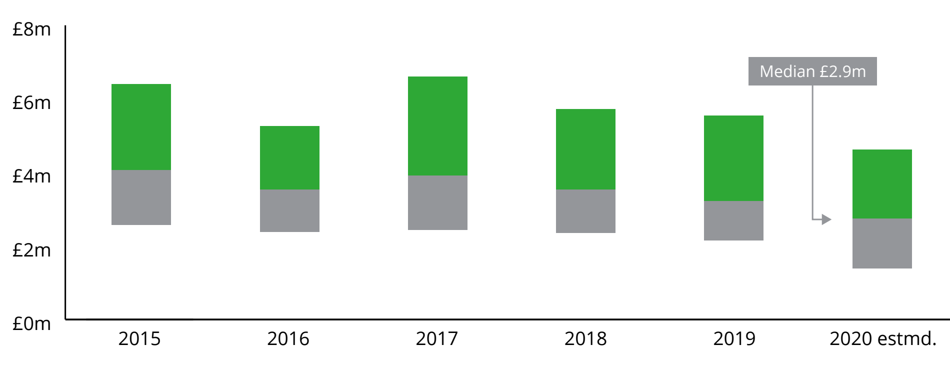
UK listed pay environment – restraint and reform

The 2021 AGM season was the most challenging in recent years, with 13% of FTSE 100 and 14% of FTSE 250 companies receiving 'low votes' (less than 80% of votes in favour) on the annual remuneration report. Around one-third of companies also put a new remuneration policy to vote, with over one-fifth receiving low votes on their proposals.

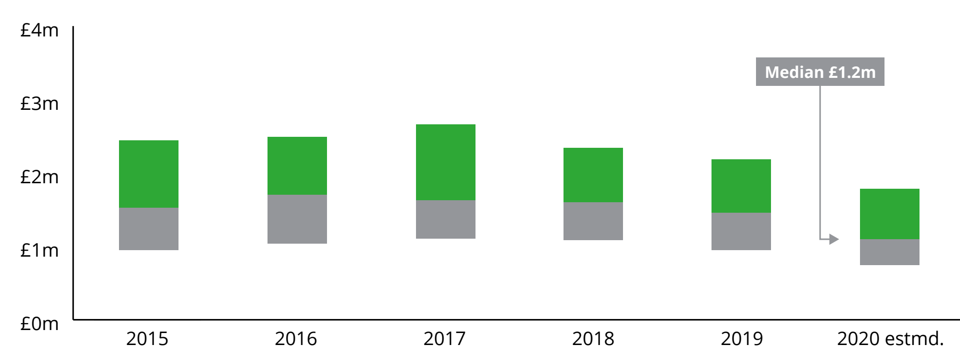
Despite a stormier season and continued headlines around executive pay we have actually seen a period of restraint and reform in the executive remuneration landscape for UK listed companies over the last five years. While COVID-19 provided a unique backdrop (with around 40% of FTSE 350 companies taking voluntary pay cuts), the total 'single figure' remuneration for FTSE 100 and FTSE 250 chief executives has been declining year-on-year since 2017, compared to the US where median total CEO pay in the S&P500 rose in 2020 for a fifth consecutive year.

Chief executive officer – FTSE 350 'single figure' total remuneration

FTSE 100 CEO - 'single figure' total remuneration (quartile range)
Chief executive



FTSE 250 Chief executive – 'single figure' total remuneration (quartile range)
Chief executive



UK governance reforms and investor pressure have led to a number of changes in the structure and quantum of executive packages, which have shifted pay arrangements closer to shareholder demands. In many respects, the UK now has one of the most highly 'regulated' pay environments for senior executives in listed companies. For example, pension contributions have been reduced to align with rates available to the wider workforce in nearly all listed companies and executive shareholding guidelines typically now apply for two years after leaving employment. We have also seen increasing pressure on remuneration committees to apply negative discretion when considering formulaic incentive outcomes, with around one-third of companies adjusting pay out-turns downwards in the last year. In terms of long-term incentive structures, typically no shares are now released to executives until five years from grant, and we have seen a notable shift towards the adoption of restricted share plans, with a 50% discount to award levels under performance share plans in line with investor expectations.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Remuneration – UK board pay in a global talent market – a model fit for purpose? continued

FTSE 350 – Code reforms and wider remuneration trends

Executive remuneration (FTSE 350) - code reforms and wider trends

			2015		2021
Pension alignment	✓	Median pension for new joiners (% of salary)	25%	→	10%
Long-term incentives - no shares released before five years	✓	% of companies releasing no LTI shares until 5 years	c.45%	→	c.100%
Post-employment shareholding requirements	✓	% of companies operating formal post-employment shareholding requirement	0%	→	c.95%
Discretion and incentive payouts	✓	% of companies operating downward discretion	0-5%	→	10% - 30%
Alternative incentive models	✓	% of companies operating restricted share plan (50% reduction on LTIP level)	0-5%	→	c.10%

UK in a global talent market?

In isolation, these measures make sense and put the UK at the forefront of governance standards globally, but the question has to be asked whether the balance has tipped too far? In a competitive global talent market, the structure of pay and the nature of the wider governance environment are often as material as the absolute quantum on the table.

Against a backdrop of Brexit and COVID-19, in recent years we have seen increasing noise around the challenge for UK listed businesses in competing for top executive talent in a global market. This has been a persistent theme in the directors' remuneration reports of some of the largest global FTSE 100 companies, and we have seen a more divided narrative emerging in the UK media around the ability to differentiate pay for the highest performing executives. Many investors remain sceptical of these arguments due to there being relatively few public examples of UK-based executives leaving FTSE companies to join overseas competitors. However, this is contrast to the unreported experience of many global companies who have struggled to attract global talent when recruiting key roles in recent years.

During the 2021 AGM season, four FTSE 100 companies received a 'low vote' on policy proposals to increase incentive opportunities for an executive team with a proven track record and delivery of exceptional shareholder value creation. Notwithstanding this, proxy and investor opposition to package increases has been relatively unwavering. We have also seen high profile examples of investor dissent where more bespoke arrangements are put forward – for example, one-off share awards, hybrid models (performance and restricted shares) or dual policies applying to UK / US executives.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Remuneration – UK board pay in a global talent market – a model fit for purpose? continued

In a period of unprecedented disruption and transformation, many boards are looking beyond their internal talent pool for particular skillsets and are willing to pay to attract and retain leaders with a track record of success. We are seeing more examples of boards willing to weather a 60% vote on pay proposals if it is considered right for the business. However, increased levels of shareholder dissent are unlikely to benefit the UK plc environment and may lead to even greater legislative action.

Managing executive talent

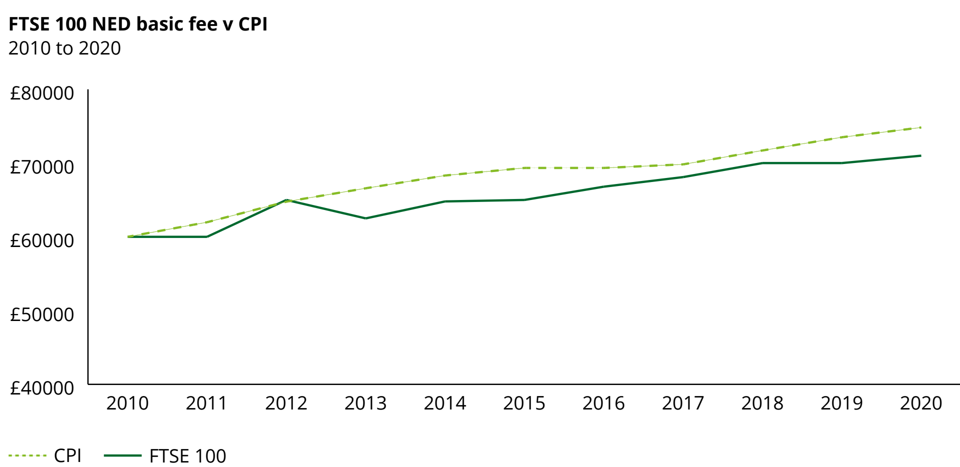
Part of the challenge lies in the ability of boards to manage executive performance, which can involve difficult conversations. Investors can point to historical practice where the majority of annual bonus plans have paid out at c.70% of maximum or more – with over three-quarters of executives typically achieving above target performance each year.

Shareholders also look for evidence of strong succession planning and will question a scenario where it is argued that the loss of a CEO may fundamentally derail the business. Good succession planning is about identifying individuals and developing required skillsets over time, ensuring that future leaders are invested in the culture of the business and are driven by future leadership opportunities - with pay being just one consideration.

Non-executive talent market

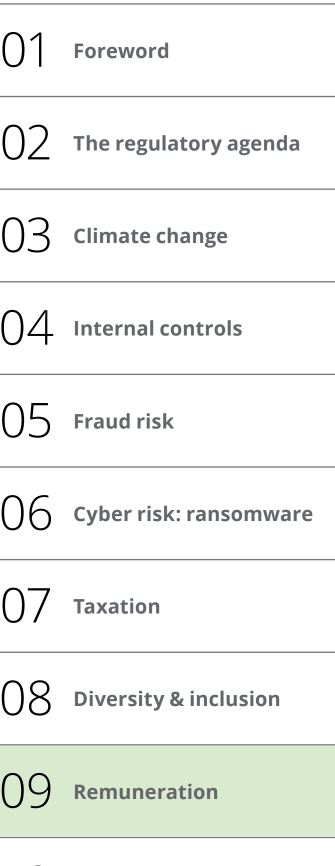
In terms of non-executive director (NED) fees, we have seen a similar theme of restraint despite a significant shift in the expectations and profile of the NED role. Base fees for non-executives have failed to track inflation, and increasingly we see committee chairs question whether a typical fee premium of c.25% of the basic fee is commensurate with the growing demands and reputational risk of the role.

In our discussions, investors have been more open to increased fees for non-executive directors, in particular where set in the context of an increased time commitment. However, in the current environment, not surprisingly there is often a reluctance to translate a change of scope into fees. The last 18 months have demonstrated the criticality of diverse and experienced boards, and we expect to see some companies take bolder decisions on NED pay to ensure they can attract the best talent. In addition, there appears to be growing acknowledgement amongst regulators that fees for NEDs should increase.



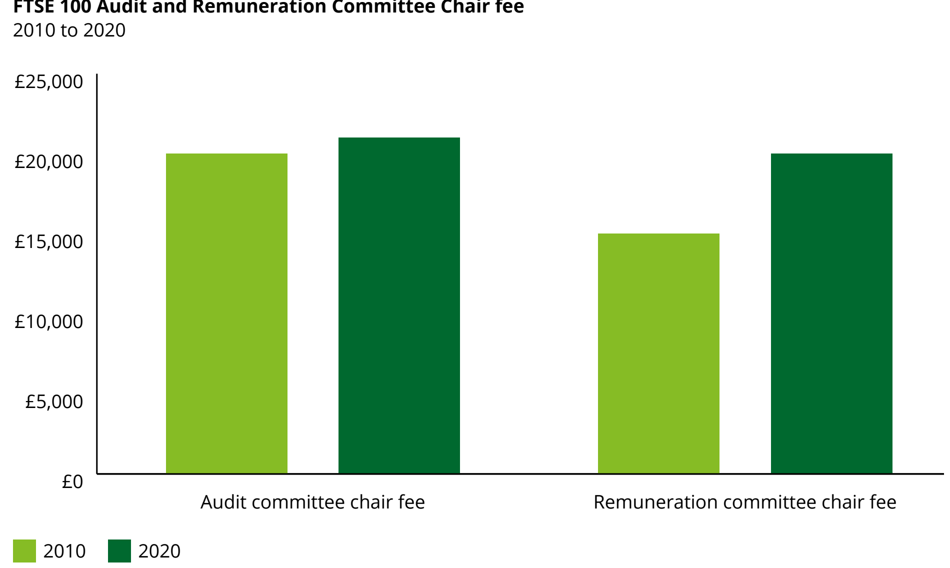
> "Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account."

Principle H, 2018 Code


01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Remuneration – UK board pay in a global talent market – a model fit for purpose? continued

FTSE 100 Audit and Remuneration Committee Chair fee
2010 to 2020



"Non-executive directors [...] should consider ways of reaching out to increase their visibility with the workforce and gain insights into the culture and concerns at different levels of the business. This is likely to involve spending more time in the business."

Guidance on Board Effectiveness, 2018 Code

Final thoughts

Increased dialogue between boards and investors will be necessary to address the challenges for large, global companies operating in the listed environment, to ensure they can attract the best selection of candidates to deliver continued prosperity for UK plc.

With a growing focus on executive pay through the wider stakeholder lens, the ability of remuneration committees to demonstrate a responsible approach to pay not just at executive level - but around the wider workforce and fairness agenda - will be critical in building trust required to change the status quo. Boards need to be better at identifying and managing mediocre versus star performers, and shareholders better at holding them to account.

Contact

Stephen Cahill
+44 20 7303 5264
scahill@deloitte.co.uk

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Remuneration – UK board pay in a global talent market – a model fit for purpose? continued

Deeper engagement: Investor behavior in the 2021 proxy season

This report from the Deloitte Global Boardroom Program reflects on investor voting in major countries, analysing trends across annual general shareholder meetings (AGMs), together with a commentary of the published voting guidelines of institutional investors, from pension funds to sovereign wealth funds to asset managers.

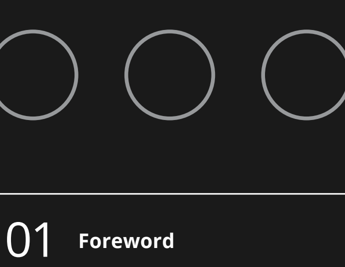
Some key findings from the report include:

- The analysis of voting guidelines reveals large differences in where and when investors will vote against directors, support shareholder proposals, or support say-on-pay resolutions. These differences are not readily apparent and, when compared across investor groups, can even be contradictory; and
- social issues, the 'S' in ESG, have come to the fore since the start of the pandemic. Investors have put forward more social-related shareholder proposals this year than in previous years: companies are fielding proposals from shareholders about the diversity of their workforce, hiring and retention practices, and beyond.

In addition to the links embedded within this article, we would also like to draw your attention to these resources:

- Your Guide – Directors' remuneration in FTSE 100 companies
- Your Guide – Directors' remuneration in FTSE 250 companies
- Deloitte Annual Remuneration Strategy Conference 7-minute read

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – CRR findings and focus areas for year-end reporting

Reporting update – CRR findings and focus areas for year-end reporting

There is a great deal to bear in mind when preparing this year's annual report. In this article we pull together key messages from the FRC's recent bulletin aimed at CEOs, CFOs and audit committee chairs and its annual review of corporate reporting. Topics covered include the continuing challenge of judgements and estimates in the light of the COVID-19 pandemic, the stresses from the rapid opening of the economy and the transformation of business models. The new challenge of reporting on climate change is covered separately in the Climate change section.

The suite of FRC publications

In October 2021 the FRC issued three linked publications setting out corporate reporting expectations and areas of focus for the 2021/22 reporting season:

- Bulletin: Key matters for 2021/22 reports and accounts (Bulletin) – this includes a summary of the most important findings identified in the various FRC reports, thematic reviews and Financial Reporting Lab reports published during 2021. For some key observations to bear in mind this year end, see the Four key FRC reports section.
- The FRC's Annual Review of Corporate Reporting 2020/21 (Annual Review) – this is the detailed publication and includes detail on the FRC's corporate reporting monitoring activity and findings over the year, case studies and example disclosures.
- Annual Review of Corporate Reporting 2020/21: Corporate Reporting Highlights (Corporate Reporting Highlights) – a short summary covering the key findings from the Annual Review and the FRC's expectations for reporting over the year ahead.

The FRC's Bulletin includes only limited observations from the Annual Review of Corporate Reporting 2020/21 and should be read in combination with either the Annual Review itself or the Corporate Reporting Highlights, depending on the level of detail required.

The FRC has indicated that routine monitoring of 2021/22 annual reports will focus on climate-related risks and disclosures and on judgements and estimation uncertainty in the face of the continuing impact of the pandemic.

Annual review of corporate reporting "Top Ten" findings

The table that follows summarises the "Top Ten" key findings from the FRC's Annual Review of Corporate Reporting, published in October 2021 – in order of how often these areas were raised. There is additional detail in our Governance in brief: FRC advice on annual reports for 2021/22 reporting season and our year-end corporate reporting publication, Closing Out, will be published during December 2021.

"The FRC has indicated that routine monitoring of 2021/22 annual reports will focus on climate-related risks and disclosures and on judgements and estimation uncertainty in the face of the continuing impact of the pandemic."

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – CRR findings and focus areas for year-end reporting continued

Area of focus	Description
Judgements and estimates	Companies should ensure that they: • explain the specific accounting judgements made and their effects on the financial statements; • identify assets and liabilities at risk of material adjustment within the next financial year and the key assumptions underlying their measurement; and • provide information about the sensitivity of assumptions to changes, or ranges of possible outcomes.
Revenue	Companies are expected to provide accounting policies for all significant areas of revenue, which cover the timing of revenue recognition, the basis for recognising any revenue over time, and the methodology applied. They should also provide clear detail about the nature, estimation and features of variable consideration.
Statement of cash flows	The FRC continues to observe issues with cash flow statements, including those that should be captured through robust pre-issuance reviews. Those reviews should ensure: • consistency of reported cash flows with amounts reported elsewhere in the report and accounts; • classification of cash flows and cash and cash equivalents complies with the requirements of the standard; and • cash flows are not inappropriately netted.

Area of focus	Description
Impairment of assets	Climate change and the continuing effects of the COVID-19 pandemic mean that impairment remains an area of focus. Impairment indicators should be followed up robustly and, where mentioned elsewhere in the annual report, it should be clear how they have been reflected in impairment reviews.
APMs	APMs should not receive more prominence than IFRS figures, for instance through management commentary that focuses on APMs. Companies should ensure they bear in mind that adjustments should include gains as well as losses, where relevant. Also see the Four key FRC reports section.
Financial instruments	Companies should disclose the use of factoring or reverse factoring, where relevant. They should also disclose the approach and significant assumptions applied in the measurement of expected credit losses; and concentrations of risks and information about covenants, where material.
Strategic report and the Companies Act	Points highlighted for attention include: • the balance of the strategic report, covering both positive and negative aspects without bias; and • highlighting and explaining linkages between information in the strategic report and elsewhere in the annual report and financial statements.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – CRR findings and focus areas for year-end reporting continued

Area of focus	Description
Provisions and contingencies	Describe the nature of each material provision or contingency, together with the timeframe over which it is expected to become certain and the basis used to determine the estimate of the outflow.
Leases	Companies should disclose entity-specific accounting policies for material areas. Judgement areas around definition of a lease and length of lease should be explained. Companies should provide enough information in the notes to enable users to assess the effect of leases on financial position, performance and cash flows.
Income taxes	Companies should describe the nature of the evidence supporting the recognition of material deferred tax assets, together with any significant accounting judgements or sources of estimation uncertainty.

Reporting on corporate governance

In the Bulletin, the FRC highlights the work it has done in advance of legislation giving it powers over the full annual report. Where the FRC has been writing to companies about areas of corporate governance disclosure it believes that these actions have led to an improvement in reporting, and it plans to continue.

The key observations raised by recent corporate governance focused reports are the importance of reporting on outcomes, rather than process, and the importance of reporting clearly any departures from Code provisions, supported by effective explanations.

The FRC's 2021 Review of corporate governance reporting is covered on pages 51 to 53.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

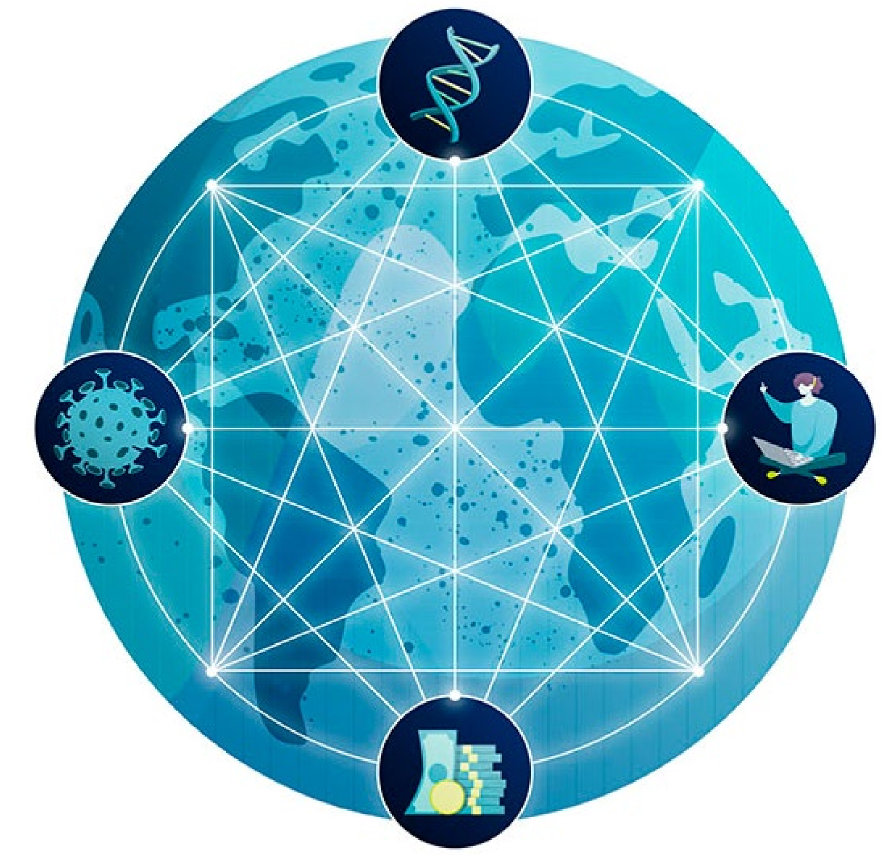
Reporting update – CRR findings and focus areas for year-end reporting continued

From surviving to thriving – Annual report insights 2021: surveying FTSE 350 reporting

This year's report examines trends across five key areas – purpose, people, planet, prosperity and the COVID-19 pandemic. The survey provides insight and inspiration, accompanied by examples of better practice and regulatory hotspots as companies prepare for the next reporting season.

The new online format allows easy navigation through the chapters pointing boards towards key points to consider and highlighting to report writers 'what to watch out for'. Some highlights of this year's findings include:

- 86% of companies clearly stated their purpose within the first opening pages of the annual report, and 77% of those explicitly referred to stakeholders within that purpose statement.
- 70% of FTSE 100 companies disclosed board-level ethnicity and had already met the recommendations of the Parker review to have one ethnically diverse board member by 2021.
- 28% identified climate change as a stand-alone principal risk, with almost half of these companies also referring to climate in their financial statements.
- Nearly a third set out changes to their business model or strategy as a response to COVID-19.



01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – FRC Review of corporate governance reporting

Reporting update – FRC Review of corporate governance reporting

In this section we provide an overview of the areas where the FRC believes corporate governance reporting could be improved. Their comprehensive report 'Review of corporate governance reporting' published on 25 November aims to promote good practice in governance and reporting.

The review highlights progress against a number of areas raised previously, and sets some enhanced expectations around matters such as board appointments, succession planning and diversity. In addition, against the background of the BEIS White Paper recommendation for a UK internal controls attestation, the FRC is calling for more explicit reporting on the scope and outcome of the annual review of the effectiveness of risk management and internal control systems.

On 25 November the FRC published its Review of Corporate Governance Reporting which is based on a sample of 100 companies drawn from the whole premium listed market. The comprehensive report presents the findings from the review and sets out the FRC's expectations for the future application of the Code and reporting. The issue of this report is a positive example of the FRC's positioning as an improvement regulator as it transitions to ARGA. It should be studied carefully by all those involved in the preparation of the annual report. In addition, reviewers, particularly members of the audit committee, should ensure that their companies are well prepared in advance of their year ends to address the recommendations and to consider matters for ongoing improvement.

The report highlights areas of high-quality reporting, but also draws attention to improvement needed in areas such as disclosures on board appointments, succession planning and diversity. The report also found that more focus on reporting the effectiveness of internal control and risk management systems would enhance the level of confidence in the company's control framework.

In the foreword Sir Jon Thompson makes the following point:

"As the FRC transitions to ARGA we will continue to work with companies to deliver the highest standards of practice and reporting, going beyond declarations of intent or boilerplate comments but clearly demonstrating the impact of actions."

In last year's review of corporate governance reporting, the FRC expressed its disappointment in the way that companies had met the new 2018 Corporate Governance Code. This year they identify a general improvement in reporting. The review highlights the continuing need for high quality governance which is linked to effective decision-making by Boards and management, and for greater clarity as to how a company is applying the Code's principles and clearer explanations where there are departures from the Code provisions so that shareholders and stakeholders have greater confidence in the quality of governance.

The review starts by making clear that the FRC believes that good reporting is characterised by clear and consistent explanations, supported by real-life examples of application and cross-referencing between related initiatives and sections.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – FRC Review of corporate governance reporting continued

The report reiterates expectations set out in last year's review and, where relevant, introduces new expectations to support the findings from this year's assessments of governance reporting. There should be:

- Greater attention on the alignment between reported good governance and company practices and policies, strategy and business models.
- Increased focus on assessing and monitoring culture by using different methods and metrics and providing clear evidence of a feedback loop.
- Better reporting of succession planning, and how this links to assuring the make-up of the board and delivering diverse challenge.
- Improved reporting on outcomes and actions, rather than declarations or statements of intent without detail, e.g. reporting on the performance of particular decisions, which may come in the form of key metrics supported by narrative or case studies. Statements in relation to climate commitments are an example of where detail is required.
- Specific disclosure of the governance structure (who and what) and processes (how and when) in place to manage risk that clearly demonstrates the way that the company identifies, monitors and mitigates risks.
- Better explanation of how executive remuneration is aligned to a company's purpose, values and strategy.

In addition, the FRC draws attention in particular to ensuring clarity in the disclosures of:

- departures from any Code provision and supporting explanation;
- engagement with shareholders and the workforce in relation to remuneration, and the impact on remuneration policy and outcomes;
- the impact of engagement with stakeholders, including shareholders, on decision-making, strategy and long-term success;
- where suppliers are identified as a key stakeholder group, the methods utilised for engagement with suppliers to reduce risks and ensure continuity of supply;
- how the board has assessed the level of climate-related risk and, as a result of that assessment, oversees climate-related risks, as well as other committees and initiatives involved in the decision-making process;
- diversity policies together with objectives and targets and demonstrating their connection to company strategy;
- the process for how the board has determined the company's risk appetite and the risk appetite for each of the company's principal risks; and
- the outcome of the review of the risk management and internal control systems.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – FRC Review of corporate governance reporting continued

Review of the risk management and internal control systems – enhancing the quality of reporting

The report makes clear that, following a review of the effectiveness of risk management and internal control systems (as required by Code Provision 29), the FRC expects that companies should comment on the outcome from the review.

"If they are satisfied that their systems are operating effectively, they should state this in the annual report. Similarly, any identified inefficiencies or weaknesses should be specified in the report, followed by an explanation of any remedial actions that have been or will be taken."

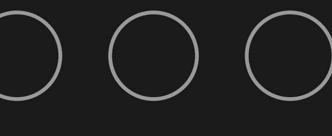
As a reminder, Code Provision 29 states the following: *"The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls."* This is supplemented by paragraph 58 in the existing Guidance which states that: *"The board should summarise the process it has applied in reviewing the effectiveness of the system of risk management and internal control. The board should explain what actions have been or are being taken to remedy any significant failings or weaknesses."*

The positive statement about effectiveness suggested in this report represents a clear statement of intent from the FRC around direction of travel. The UK Corporate Governance Code and its underpinning guidance is already demanding of boards, but reporting in annual reports is not as comprehensive as the FRC would like. As noted on page 19, in our article on internal controls, in recent speeches Sir Jon Thompson has indicated that the FRC could use the Code as a vehicle for raising the bar on internal controls if the government decides not to legislate. The FRC now expects companies to report on the outcome of their reviews, moving the bar up from current practice where most companies just describe that they have undertaken the annual review, without giving detail of the process followed and outcomes from the review.

However, moving toward providing a positive statement on whether risk management and internal control systems are operating effectively requires careful consideration by the board and audit committee, including assessment against a controls framework such as the one we have developed as shown on page 18. The level of supporting evidence also needs to be carefully considered. It is also important to remember that Code Provision 29 covers all material controls, not just financial reporting controls.

Companies intending to make these effectiveness disclosures should reflect carefully on the framework and process to support any additional disclosure. They should hold discussions with their auditors – as there will be implications for auditors as auditing standard ISA 720 requires them to specifically conclude whether the section of the annual report that describes the review of effectiveness of risk management and internal control systems is materially consistent with the financial statements and the knowledge obtained during the audit. Auditors will need to consider the level of work required to reach a conclusion on a statement which provides a positive confirmation that systems are operating effectively.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – four key FRC reports to consider when reviewing your annual report

Reporting update – four key FRC reports to consider when reviewing your annual report

This section highlights areas for boards and audit committees to be aware of when reviewing the annual report. These are areas where the FRC has set out clear expectations of good practice either through thematic reviews or the work of the Financial Reporting Lab.

1. Reporting on stakeholders, decisions and Section 172

In July, the Financial Reporting Lab (the Lab) published 'Reporting on stakeholders, decisions and Section 172'. The report emphasises that information on the company's stakeholders and principal decisions taken by the board can help investors understand how the company is progressing in fulfilling its purpose and achieving long-term success.

Information investors want to see on stakeholders...	Information investors want to see on principal decisions...
• Who are the key stakeholders? • Why are these stakeholders important to the company's success? • What is important to the company's key stakeholders? • What actions is the company taking to build and maintain strong relationships? • What could affect key stakeholders and how do they affect the company? • What metrics do management use in relation to stakeholder relationships? • What are the metrics used by the board in order to oversee stakeholder relationships?	• What were the decisions of strategic significance during the year? Then for each of those decisions: • How and why did the board or management reach the decision? • How were stakeholders considered in reaching the decision? • What were the difficulties or challenges in making the decision? • What are the expected and/or actual outcomes of the decision?

Section 172 statements can be a helpful bridge between disclosures on stakeholders and decisions. The Lab report states that the Section 172 statement should demonstrate progress in pursuit of purpose and long-term success and connect the narrative with company's business model and strategy.

Spotlight on suppliers – investors want to understand more about this key business relationship:

- What type of companies make up the supply chain?
- How many suppliers does the company have for each critical component?
- How well does the company know and keep track of its suppliers?
- What actions has the company taken to support its suppliers, including through its payment practices?
- What metrics are used to monitor whether to continue the relationship or make changes to it?

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – four key FRC reports to consider when reviewing your annual report continued

2. Reporting on risks, uncertainties, opportunities and scenarios

In September, the Lab published 'Reporting on risks, uncertainties, opportunities and scenarios'. The findings cover four areas where investors want to build their understanding based on risks and uncertainties faced by companies:

When reviewing consider whether the report describes …

Governance and process	Approach
• relevant governance structures and processes in place covering risks • how effectively these have functioned • how quickly a company can modify these to react to external factors	• the impact of the risks and uncertainties in the context of a company's business model, strategy and purpose and whether and how key performance indicators (KPIs) and other metrics are tailored • the company's assessment of its viability using more company-specific information that relates to longer time periods • factors a company considers when determining or changing its risk appetite • mitigating actions and strategic activities and how the company may respond to risks and uncertainties in the future • whether, how, and why risks have evolved over time

Nature	Scenarios and Stress testing
• the company's view of the macro and micro-economic and geopolitical environment • how external factors are monitored and how they are incorporated into scenario analysis and planning for the future • the company's assessment of the importance of the risks, uncertainties and opportunities faced • the likelihood and impact of the risk, uncertainty or opportunity • which risks have been considered as part of the company's viability assessment • what category of risk or uncertainty the company faces (internal, external, strategic, operational or financial)	• the different scenarios and situations considered, and stress tests performed, and • how these tie into other areas of reporting and the company's view of the future

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – four key FRC reports to consider when reviewing your annual report continued

3. Thematic Review: Viability and Going Concern

Building on these reports from the Lab, the FRC published its thematic review of companies' viability and going concern disclosures which found several areas where viability and going concern reporting could be improved. The review examines a selection of annual reports and accounts, identifies areas where viability and going concern disclosures could be improved and provides examples of better disclosures in the hope that companies will provide much more informative disclosure than is currently the case.

Questions for the board and audit committee to consider:

Viability statement	• Does our report explain the choice of the period of assessment, particularly if it has been shortened due to the pandemic? • Is our assessment period aligned with other forward-looking areas of the financial statements, i.e. forecasts or models used in impairment analysis and deferred tax asset recoverability? • Does it include consideration of debt repayment profiles, nature of business and its stage of development, planning and investment periods, strategy and business model and capital investment? • Does our report provide specific company and scenario details to enable the user to understand which risks have been considered in which viability scenarios? • Have we considered the two stage approach to the viability statement: short-term prospects, taking into account the company's current position and principal risks, and the long-term?
Resilience to risks and mitigating actions	• Does our report provide company specific and clear descriptions of the mitigating actions that would be taken should the principal risks crystalise? • Does our report provide enough information on the company's ability to withstand the risks posed to viability? • Have we considered providing details of drawn and undrawn facilities in place and reliance upon such facilities; explanation of reliance on government funding; details of covenants including headroom; and information on post balance sheet changes to liquidity?
Assumptions and judgements	• Does our report provide sufficient qualitative and quantitative analysis to enable a reader to fully understand the assessment? Is this information sufficiently detailed, company specific? • Does our report clearly explain the inputs and assumptions used in forecast scenarios? • Does our report explain the sensitivity analysis, stress and reverse stress tests carried out and provide details of the inputs (quantitative as well as qualitative detail) and outcomes of any such analysis?

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Reporting update – four key FRC reports to consider when reviewing your annual report continued

4. Thematic Review: Alternative Performance Measures (APMs)

In October, the FRC published the results of its thematic review into the use of Alternative Performance Measures (APMs) by UK-listed companies. The review is based on 20 companies from different sectors and identifies areas of good practice, opportunities for improvement and areas to be avoided.

Has the board ensured that:

- APMs are not presented in ways that give them greater prominence than amounts stemming from the financial statements?
- The report explains the limitations of APMs when compared to GAAP measures?
- There is a reconciliation of APMs to the most directly reconcilable line items, subtotals or totals presented in the financial statements, not to other APMs?
- The disclosure provides an explanation of terms such as 'underlying profit' or 'core operations' and the basis for identifying adjustments as 'non-underlying' or 'non-core'?
- The report consistently presents APMs, i.e. is there comparative information for all APMs?

Has the audit committee:

- Reviewed the overall presentation of APMs to ensure that they are not given undue prominence?
- Evaluated APM accounting policies and approved any revisions?
- Challenged the nature and amount of adjusting items?
- Considered the clarity of reconciliation?

The Future of Corporate Reporting – a quick status report on this FRC initiative

In July the FRC issued a feedback statement following publication of its thought leadership paper on the Future of Corporate Reporting, published in October 2020. There were over 75 responses to the consultation. Overall support was received for a corporate reporting model that accommodates the information needs of investors and wider stakeholders; the development of guiding principles; the concept of the 'reporting network'; the role of technology and the development of standards for non-financial reporting. However, there were calls for the FRC to consider further the practical challenges of implementing the proposals, e.g. considerations of materiality, assurance and proportionality.

The next step, after taking into consideration the feedback received, is to consider how best to develop some of the ideas over the short, medium and long term. The evidence base that has been collected will inform ARGA's strategy for corporate reporting and promote improvements and innovation, exploring best practice with a wide range of stakeholders.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

Contacts

Contacts

The Deloitte Centre for Corporate Governance

If you would like to contact us please email corporategovernance@deloitte.co.uk or use the details provided below:

Tracy Gordon
Tel: +44 (0) 20 7007 3812
Mob: +44 (0) 7930 364431
Email: trgordon@deloitte.co.uk

Corinne Sheriff
Tel: +44 (0) 20 7007 8368
Mob: +44 (0) 7824 609772
Email: csheriff@deloitte.co.uk

William Touche
Tel: +44 (0) 20 7007 3352
Mob: +44 (0) 7711 691591
Email: wtouche@deloitte.co.uk

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update

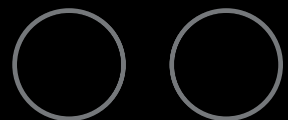
The Deloitte Academy

The Deloitte Academy provides support and guidance to boards, committees and individual directors, principally of the FTSE 350, through a series of briefings and bespoke training. The Deloitte Academy is available to board directors of listed companies, and includes access to the Deloitte Academy business centre between Covent Garden and the City.

Members receive copies of our regular publications on Corporate Governance and a newsletter highlighting upcoming briefings and recently published insights. There is also a dedicated members' website www.deloitteacademy.co.uk which members can use to register for briefings and access additional relevant resources.

For further details about the Deloitte Academy, including membership, please email enquiries@deloitteacademy.co.uk.

01 Foreword
02 The regulatory agenda
03 Climate change
04 Internal controls
05 Fraud risk
06 Cyber risk: ransomware
07 Taxation
08 Diversity & inclusion
09 Remuneration
10 Reporting update



Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2021 Deloitte LLP. All rights reserved.

Designed by CoRe Creative Services. RITM0876152