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Annual report insights 2020

Surveying FTSE reporting

Contents

Executive summary

Welcome to this year's survey of FTSE companies' annual reports. In what has undoubtedly been a year unlike any other we have decided to restructure our survey to focus on the hot topics that companies themselves are focusing their attention on, including COVID-19. COVID-19 illustrates how quickly an environmental, social and governance (ESG) issue can affect financial returns, reinforcing the need for resilient business models and the importance of fostering relationships with all stakeholders beyond financial returns for shareholders.

The growing awareness of the relationship between purpose and profit and growing recognition by companies of the need to deliver sustained value to a range of stakeholders is leading to redefinition of the social contract between business and society. It therefore comes as no surprise that ESG factors feature prominently in the boardroom. They are also gaining ever more attention from investors, who realise that these are essential in order to understand the drivers of value and risk within an organisation and the evidence suggests that companies that embed purpose and ESG effectively can outperform those that don't. The areas described above are sometimes referred to as 'the four Ps' – purpose, people, planet and profit. We have dedicated a section of our survey to each of these. An annual report continues to provide a unique opportunity to tell a company's story across these spheres, to explain their interaction and to demonstrate 'integrated thinking'.

Regulation is also driving a change in thinking and behaviour. To this end, the past year saw the introduction of the new requirement for directors to set out in the annual report how they have fulfilled their duty to different stakeholders in accordance with s172 of the Companies Act. The 2018 version of the UK Corporate Governance Code also became effective, hence our survey looks at how companies responded to both these new requirements.

We also consider reporting changes that companies will need to address in future reports, such as Streamlined Energy and Carbon Reporting (SECR), the recommendations of the Task Force for Climate-related Financial Disclosures (TCFD) and certain aspects of Sir Donald Brydon's report on the future of corporate reporting. As ever, we provide insight and inspiration, accompanied by examples of better practice and regulatory hotspots as companies prepare for the next reporting season. A selection of our key findings, primarily from a review of 50 FTSE 350 companies' reports (see Appendix 2 for sampling methodology) is presented below.

Purpose

As was widely reported, the past year saw chief executives of more than 180 large US companies commit to “lead their companies for the benefits of all stakeholders – customers, employees, suppliers, communities and shareholders”. Given this corporate environment it was encouraging that 78% of companies surveyed (2019: 57%) included a clear and prominent statement of their purpose that went beyond generating profits for shareholders, with 90% of those statements referring to specific stakeholder groups beyond shareholders, most commonly including customers. It was also pleasing that over half of those companies referring to stakeholders other than shareholders included one or more metrics relating to those groups in their key performance indicators (KPIs), demonstrating that clear targets and metrics are used to measure performance against objectives other than financial profit.

The introduction of the s172(1) statement also provided directors with an opportunity to explain how they have fulfilled their duties to lead their businesses in a responsible way that is sustainable in the long-term. 90% of companies included a clearly identifiable s172(1) statement. It appeared as though some may have found it easier to discuss certain stakeholder groups than others and that there is room for improvement in future years. Encouragingly, 84% took the opportunity to draw out board decisions as recommended by the BEIS Q&As on the s172(1) statement, something which certainly helped bring the statements to life for a reader and demonstrated how boards had understood stakeholder needs.

People

Companies will frequently describe their workforce as their most prized asset. However, only 74% of companies identified employee-linked metrics within their KPIs, and only 58% went further by also describing value created for employees in their business model. The value embedded within a company’s workforce is sustained and increased through enhanced engagement, fair and consistent practices, a commitment to diversity in all its forms and a culture that connects people to purpose. 90% of boards described the mechanisms they use to monitor company culture – most commonly, in 76% of cases, in the form of an employee engagement survey. The past year also saw the 2018 UK Corporate Governance Code and changes to the law both introduce the need for companies to provide more insight into the relationships they have with their employees.

All s172(1) statements surveyed included information on how directors had considered the interests of employees in pursuing long-term success for the business. 58% demonstrated understanding of employee concerns, either through extended discussion or by explaining how concerns are being or had been addressed. 74% of the companies surveyed had used a workforce engagement mechanism described in the 2018 Code, with 46% electing to engage through a designated non-executive director. No companies surveyed elected to appoint an employee director.

Another hot topic in this area relates to diversity. Companies in the UK have been encouraged over several years not only to implement comprehensive diversity and inclusion policies, but to focus on BAME diversity as well as gender diversity. Under the 2018 Code, companies are required to report annually on their diversity policies, including and going beyond gender. Since the annual reports in our survey sample were published, there has been an urgent focus on addressing historical inequalities, with recognition by businesses and society that systemic change is necessary. The Black Lives Matter movement has been a catalyst.

Although 50% of companies identified board-level targets relating to gender diversity, only a minority of those companies also identified targets relating to ethnic diversity. Most of those targets echo the Parker Review in aiming for one BAME board member by 2021. 12% of companies provided a disclosure around broader workforce objectives relating clearly to ethnic diversity although there was little discussion of supporting activities.

Planet

In its Annual Review of Corporate Reporting, published in October 2019, and in an open letter to all Audit Committee Chairs and Finance Directors, the Financial Reporting Council (FRC) emphasised their expectation that boards address and report on the effects of climate change. In the 2020 World Economic Forum Global Risks Report, published just before the pandemic, business leaders continued to identify climate-related issues as the top 5 long-term risks. It therefore came as no surprise that 90% of the reports surveyed explicitly acknowledged climate change, 22% identified it as a stand-alone principal risk and 24% as part of a broader principal risk. More sobering was the fact that only 4% explicitly referred to climate change in their financial statements.

It was encouraging to see that 64% of the reports surveyed were making reference to TCFD in some way – 22% were making fulsome disclosures in line with TCFD, whilst the remainder were working towards compliance. However, only four companies described, at least in part, how climate-related issues serve as an input to their financial planning process, the time periods used, and how these risks and opportunities are prioritized.

All quoted companies are required to disclose scope 1 and 2 GHG emissions within their directors' report. However, 40% went further than the legally required disclosures and stated scope 3 emissions. These were from a variety of industries and included a few which had not made any indication of adopting TCFD. It was also encouraging to see 14% of companies comply with the new SECR requirements, with 10% of them adopting them earlier than required.

Profit

Value creation was most frequently discussed in the business model in the context of investors, customers and employees, although quantification in monetary terms was largely restricted to returns for investors. The FRC Guidance specifically calls out decisions around capital allocation and dividends to be a key example for boards to refer to in their s172(1) statement, as these typically impact the long-term prospects of the business. 74% of companies provided an insight into capital allocation, with 54% quantifying their allocation, although this tended to be in relation to dividends, debt repayments or capital expenditure. 56% gave an indication as to the level of distributable reserves they had for paying dividends to shareholders.

The broader value created by a company in achieving its purpose often drives the variable elements of directors' remuneration as a means of incentivising directors to succeed in their role. It was encouraging to see that 76% had incorporated broader ESG factors into their most recent remuneration policy, although in some cases it appeared to impact relatively limited amounts. 62% included employee matters and 24% included environmental objectives, typically as part of a series of targets to be met in order to qualify for a bonus.

70% of companies included disclosure in their annual report around the resilience or sustainability of the business model although, similar to last year, only 14% in the viability statement.

Brexit remains a hot topic and a driver of uncertainty for many companies. 40% referred to Brexit within their longer term viability statement, while 74% mentioned Brexit elsewhere in their strategic report outside of the risk section. Boards are talking about it, too, with 62% mentioning Brexit in their corporate governance statements, often as part of a list of key matters discussed by the board or else in the Audit Committee reports in relation to risk. Only 28% of companies mentioned Brexit in their financial statements.

78% of companies presented alternative performance measures (APMs) on the face of the income statement. 36% of those companies elected to present their APMs through the use of additional columns, although the IASB's exposure draft on management performance measures proposes a prohibition on such a presentation.

Pandemic

For this section of our survey we examined 20 FTSE 350 March year-ends' reports. All made reference to COVID-19, with 55% setting out a distinct section to summarise their response. Although all companies disclosed a principal risk or elements thereof relating to the pandemic, no companies identified a material uncertainty relating to the use of the going concern assumption. Additionally, despite the uncertainty, in making their longer-term viability statement no companies changed their lookout period (of three, five or seven years) as a result of the pandemic.

85% of companies made reference to COVID-19 in their s172(1) statement, often linking to information on stakeholder engagement. At times it was however unclear what the board specifically had done in response to the pandemic and the decisions they had taken as a result. 85% did however discuss the impact, if any, the pandemic had had on declaring dividends.

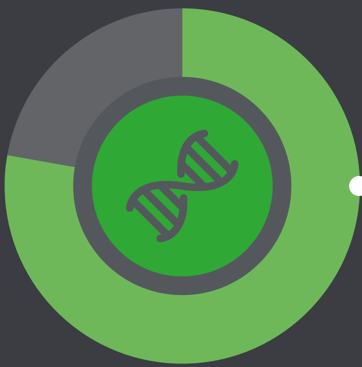
Turning to the financial statements, 45% disclosed a financial impact of COVID-19 as 'exceptional' or similar. The most commonly cited sources of estimation uncertainty impacted by COVID-19 were determining recoverable amounts of assets under IAS 36 and estimating expected credit losses under IFRS 9. However, a variety of other areas of estimation uncertainty were also repeatedly identified as having been impacted by COVID-19, including inventory provisioning and the valuation of unquoted pension scheme plan assets. These findings resonated with the FRC's thematic review of the financial reporting effects of COVID-19, which stressed the importance of clear and transparent disclosure in the year ahead.

The future

The past year has seen an increased acknowledgement by companies of the interaction between financial returns and broader stakeholder relationships. Further change lies ahead though. Investor demands for greater insight into how companies are looking to deliver sustainable value over time will undoubtedly continue; other stakeholders' voices will become louder in demanding accountability and clear measurement and reporting that demonstrates this; and regulators will undoubtedly zoom in on all of the areas identified above.

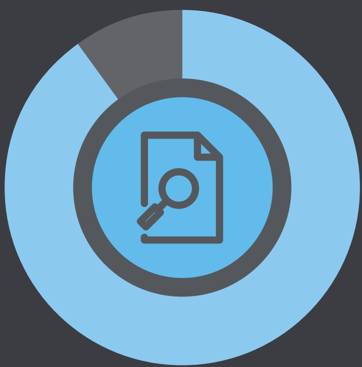
Actions emerging from the Brydon review will also seek to restore further trust in the corporate system and strengthen companies' social contracts. We are now on the pathway to mandatory TCFD reporting from 2022, with a 'comply or explain' approach proposed by the FCA for 2021 and further legislation and regulation in the pipeline. There are also stronger moves towards standardised ESG metrics and reporting, with the forthcoming IFRSF consultation proposing a sustainability standard-setter under its umbrella and the work by the IASB on Management Commentary focusing on more comprehensive reporting of business models and enterprise value creation. As all these areas continue to develop, this survey provides an invaluable accompaniment as companies continue on their reporting journey.

Purpose



78% gave a clear, prominent statement of their purpose beyond making profits for shareholders

90% of those statements referred to specific stakeholder groups beyond shareholders



90% provided a clearly identifiable s172(1) statement

84% drew out examples of decision making within their s172(1) statement

The concept of company purpose has come to the fore in recent years. Company purpose is an articulation of why it exists, typically capturing the way in which the company aims to create a positive impact on stakeholders. Purpose should therefore guide everything the company does, connecting through governance, strategy, risk, KPIs, and capital allocation decisions.

In the UK, consideration of company purpose must respond to the directors' duty under s172 to promote long-term success of the business while having regard to its reputation and stakeholders. In the US, the Business Roundtable, an association of chief executive officers of America's leading companies, made a statement in the summer of 2019 acknowledging that the purpose of a corporation reaches further than shareholder returns and that delivering value for all stakeholders is important to the success of that company[1].

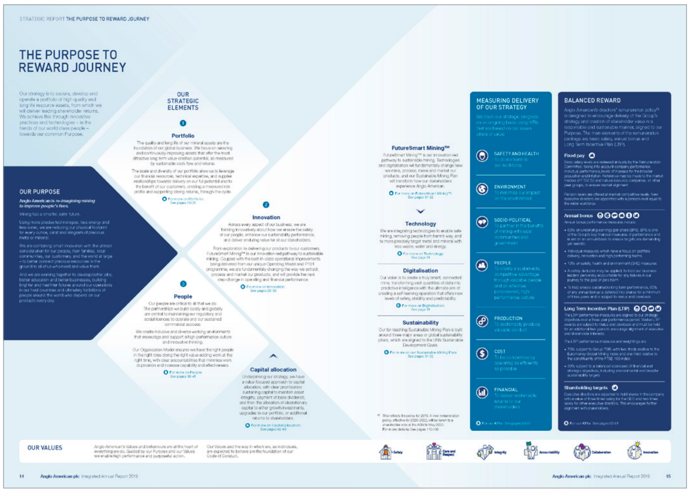
Larry Fink, CEO of Blackrock, emphasised the importance of company purpose in his annual letters to CEOs. He has described purpose as "the engine of long-term profitability", citing that "a company cannot achieve long-term profits without embracing purpose and considering the needs of a broad range of stakeholders"[2].

78% of companies (2019: 57%) gave a clear, prominent description of their purpose beyond making profits for shareholders upfront in their annual report. A handful of other companies referred to a company purpose much further on in the report within the corporate governance statement, which felt somewhat buried, giving the impression that perhaps 'purpose' was something that the board had considered or constructed without it then coming to life and giving the company as a whole a clear direction.

For many companies, which clearly stated their purpose upfront, that purpose acted as a driver for the rest of the annual report, demonstrating the authenticity of the purpose through examples of how it played out in daily operations. Vodafone Group Plc, for example, set out their strategic framework on an opening page, their purpose of "We connect for a better future" driving their principal aim which, in turn, directed their strategy and priorities.

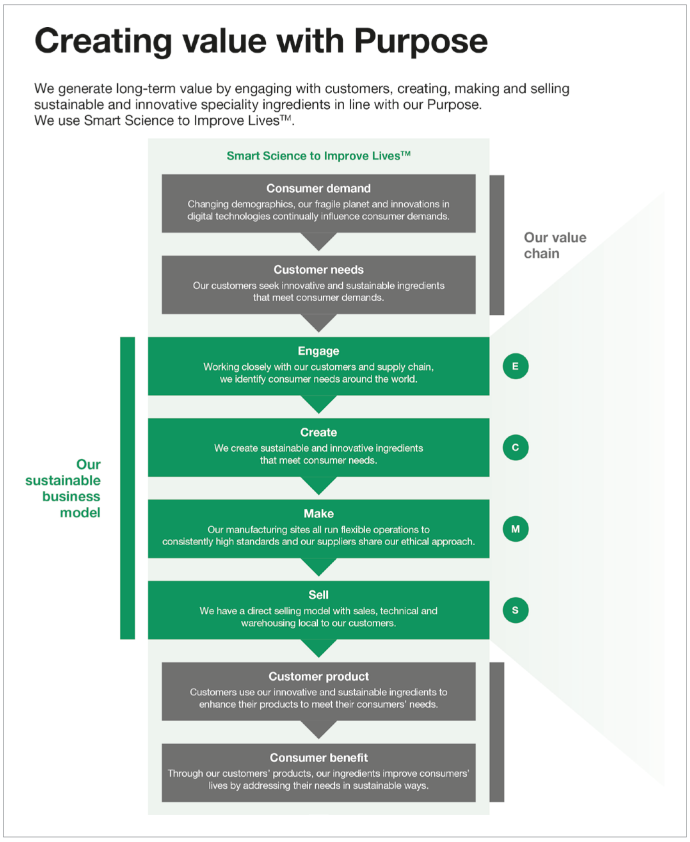
Other companies demonstrated authenticity of their purpose by linking it clearly to strategy and reward, such as Anglo American plc, or to their business model, such as Croda International Plc.

Anglo American Plc



A small number of companies appeared to struggle to articulate their purpose beyond simply making good products to sell, and for these companies it was difficult to see how their purpose resonated either within their business or within their reporting.

Croda International Plc



Of those without a clear purpose upfront, many had a 'vision' or 'mission' often encompassing an aim to be the best in their sector. A small number of companies appeared to struggle to articulate their purpose beyond simply making good products to sell, and for these companies it was difficult to see how their purpose resonated either within their business or within their reporting.

In the context of crisis management, such as during the COVID-19 pandemic, a company's purpose – supported ideally by a strong balance sheet – should drive it to make the right decisions for the longer term, both for its shareholders and for its wider stakeholders (see the Pandemic section, below).

Company purpose and broader stakeholders

Purpose should be connected to the desired impact on stakeholders (ideally specific stakeholder groups) to differentiate it from a broader company 'vision'. Of those companies clearly stating a purpose upfront, 90% referred to specific stakeholder groups beyond shareholders within that statement. For some companies which did not refer specifically to a particular stakeholder group, such as Rightmove plc whose purpose is "to make home moving easier in the UK", their purpose resonated throughout the report and it was through the business model and broader review of the business that it became clear which stakeholder groups were relevant.

Connectivity throughout an annual report, including linking relevant information in the financial statements to the strategic report, is hugely important given the volume and variety of information contained within today's annual reports. However, as the FRC Guidance recognises, it would be impracticable to highlight and explain all relationships and interdependencies that exist within the annual report while also ensuring the strategic report is both concise and understandable. In consequence, priority should be given to the relationships and interdependencies that are most relevant to the assessment of development, performance, position and future prospects of the business.

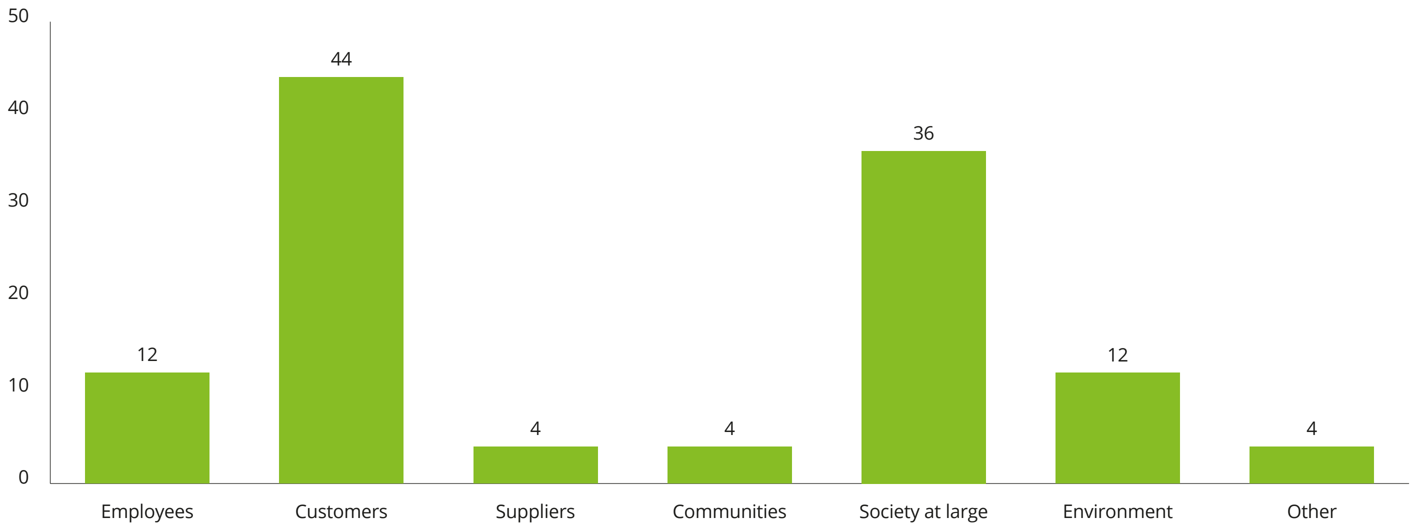
The connection between purpose and impact (i.e. a company's positive impact on people, planet and profit) is essential. It was pleasing to see, therefore, that 60% of companies whose purpose referenced stakeholders beyond shareholders had included all those same stakeholders within the business model as groups for whom value is created.

Similarly, 60% of companies whose purpose referenced stakeholders other than shareholders had a KPI for at least one of those stakeholder groups. Almost all of these were in respect of either customers or employees, such as customer satisfaction or employee engagement scores, and it was good to see that almost all aligned with the description of value creation in the business model (where this was provided). A number of companies without KPIs clearly linking to their purpose had referred only to broader society at large within their purpose; quantifying impact on society at large is unsurprisingly difficult, although more granular non-financial KPIs had been disclosed.

Disappointingly several companies with no KPIs relating to a stakeholder group identified in their purpose had omitted to include any non-financial KPIs at all. This raises the question of whether and how the board intends to track the company's impact upon, and outcomes relating to, those stakeholders, given the company purpose encompasses them. KPIs that align with purpose should also be linked through the business model to capital allocation (see the Profit section, below) and remuneration so that users of the annual report can see the holistic way in which purpose is embedded as integrated thinking.

The importance of company purpose and considering a broad range of stakeholders is reflected also in the Brydon review. Aiming to improve trust in capital markets and the corporate system, one recommendation is that the directors present an annual Public Interest Statement as part of the strategic report. This would essentially be a narrative which provides "an opportunity for directors to articulate in a holistic way how the company they govern serves the wider public interest" and how the company has managed this in the year under review. Corporate reporting is already heading this way, with the introduction this past year of the s172(1) statement and the 2018 Code.

Figure 1. Which stakeholders did companies refer to within their purpose statement?



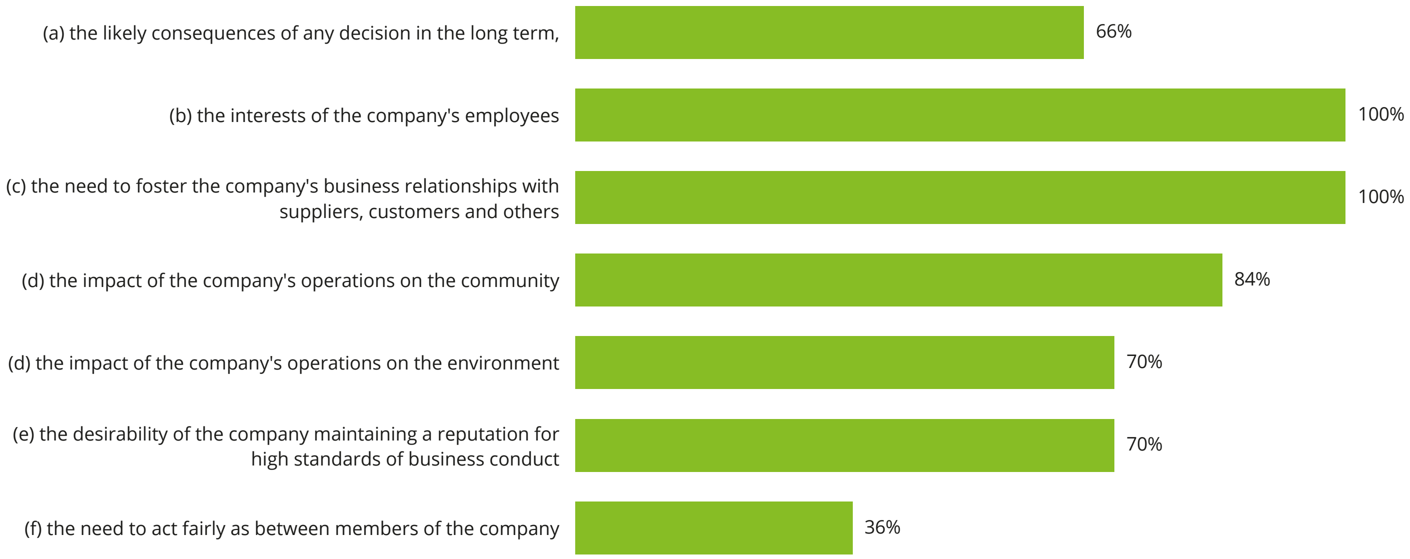
The new s172(1) statement

The s172(1) statement is an opportunity for companies to present in the strategic report how their directors have considered the matters set out in s172(1) of the Companies Act 2006 and how, through their mandatory duties, they are leading a responsible, long-term business. Companies were required to provide this statement for the first time this year. We considered that 90% of companies provided a statement that, as is required, was clearly identifiable as their s172(1) statement. Encouragingly, all companies provided disclosure that dealt with stakeholder engagement, even those companies that did not have a clearly identifiable s172(1) statement.

The UK Companies Act 2006 s172 sets the duty of each director to promote the success of the company for the benefit of the shareholders as a whole, however, the broader matters required to be considered as part of that drive for success make a clear link to a broader purpose as well as profit generation.

Many companies incorporate certain matters set out in s172 through cross-reference to elsewhere in the report. Generally companies avoided too much repetition between the s172(1) statement and the rest of the annual report, however this is an area that some companies could work on in subsequent years.

Figure 2. How many companies clearly discussed each of the matters set out in s172 as part of their s172(1) statement?



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Supporting the introduction of the s172(1) statement, the BEIS Q&As encouraged companies to explain the issues, factors and stakeholders the directors consider relevant and how they have formed that opinion, methods of stakeholder engagement, and information on how that affected decision making during the year. Figure 2 demonstrates that all companies have taken on board the need to discuss the most obvious stakeholders – employees, suppliers and customers. However, there is a more varied picture around the other s172 matters, which in some cases are harder to articulate, with only a third of companies drawing out how they act fairly between different shareholder groups and interests. Companies can explain the different types of shareholder and how the company achieves some equity of attention and information. For example, in addition to explaining how they engage with large investors, Tesco PLC provided a case study on opportunities given to private shareholders to meet and talk to the chairman and senior management.

Case study.

Store tours

During the year, the Chairman hosted three tours around the Orpington Extra store, which celebrated its 10th anniversary since opening. This store continues to be a focal point within the Orpington community.

The tour gave private shareholders the opportunity to meet and talk to the Chairman and senior management, receive a presentation on store operations and learn about its role in the local community. Feedback from attendees enables the Board to better understand what is important to our private shareholders and balance this with what our customers want.

Further examples of these different matters and how they have been disclosed can be found in our publication "The new section 172(1) statement – observations from first reporters"[3].

The examples of decisions the board has made are where the s172(1) statement really comes to life for the reader as they provide an avenue for the company to explain how the directors have balanced consideration of short-term benefit for shareholders against the s172 matters that help to drive long-term sustainable success. 84% of companies in our sample took the opportunity to draw out examples of decision making as recommended by the BEIS Q&As.

This case study from G4S plc (pictured right) demonstrates how companies can illustrate the way the directors consider different stakeholder groups.

The G4S plc disclosure also highlights the UK pension scheme members, a stakeholder group that is not explicitly called out in the s172 matters but which is relevant to decision making for some boards.

The best stakeholder disclosures we have identified as part of the s172(1) statement do not restrict the company to discussion of only the stakeholders listed in the s172 matters. Instead, they start from the specific perspective of the company, its business model and its purpose, and identify other stakeholder groups, among which pension scheme members and regulators are the most usual.

Case study: Cash Transaction

On 26 February 2020, G4S announced the sale of the majority of the Group's conventional cash businesses to The Brink's Company. In considering the Transaction and whether to approve it, the board considered the interests of G4S's key stakeholders and the impact of the Transaction was reviewed and discussed as part of the decision-making process.

Shareholders – The board believes the Transaction to be in the shareholders' best interest, as it helps reduce financial leverage and provides the Group with the flexibility to continue to invest.

Customers – Continuity of service and service quality following the disposal were key considerations for customers and the board felt confident that the buyer's experience and organised transition of the relevant businesses addressed these points.

Employees – In considering the Group's employees' interests, the board had to balance employees' natural preference for a process providing clarity and certainty with the confidential nature of the Transaction, with limited information, which could be shared in the period of negotiations. The board concluded that a sale to a market-leading cash solutions provider was in the best interests of employees working for the Cash Solutions businesses in scope of the Transaction who would be joining a provider whose business' entire focus is on cash solutions.

UK pension scheme members – The board considered the impact of the sale on the UK pension scheme members and concluded that it is in both their and G4S's interest that the UK Cash Solutions business is retained within the Group.

The board also considered the likely consequences of the Transaction over the long term and desirability of maintaining a reputation for high standards of business conduct.

Other considerations - The board concluded that the Transaction would allow the Group to focus on the growth of the core integrated security solutions business and the further development of the Retail Technology Solutions business, whilst providing an opportunity to simplify and streamline the Group and to capture cost efficiencies, which supports the board's goal of accelerating profitable growth. This would in turn enable the Group to focus on strengthening its position as an industry-leading global security company.

Stakeholder engagement

The s172(1) statement is intended to allow directors to explain their mechanisms for engaging with stakeholders such as suppliers and customers. In line with guidance, the best disclosures not only explain how the company engages at local or management level, but also where the directors engage themselves and how the information gained from stakeholder engagement reaches the boardroom and influences board decision making. The following example from Centrica plc explains how feedback from customers is obtained, how it reaches the board, and some of the actions the board has taken with that feedback in mind.

Customers

Listening to customers helps us to satisfy their changing needs and reduce costs. We seek feedback on a range of issues such as customer service, new products and pricing. This is done through various methods such as focus groups, listening sessions and surveys, as well as proposition and usability testing.

Action from insight
We track feedback from customer journeys and run customer experience surveys. The Board receives a quarterly customer dashboard with key performance and plans, and uses this insight to make decisions that serve our customers for the long term as well as foster stronger relationships with them. Feedback, for example, informed the Board that customers wanted a cost-competitive provider with market-leading customer service. The Board has consequently been involved in transforming our customers' experience which includes oversight of the digital transformation.

Voice of the customer
The Board wanted to empower customer-facing teams with real-time customer service insights, to help them understand the root causes of issues and shape improvements. This led to the 'Discover' platform launching in UK Home and UK Business, which hosts survey feedback from over 20,000 customers a month. Insights from the platform have stimulated Board approval on new ways of working and key customer journeys, such as easier-to-understand bills and pricing renewal policies.

Read more about the benefits of the digital transformation on
Page 21

Read more about our customer service experience on
Pages 22 and 25

Reputation

A clear purpose embedded throughout an organisation and good governance underpin and strengthen company reputation.

Reputation is enhanced by companies dealing well and transparently with each of the matters set out in s172. It is also enhanced when boards live the culture and values of the business, act with integrity and embed that approach within their companies. The annual report provides companies with an opportunity to reflect on their reputation and how they are maintaining or enhancing it.

Aside from the common references to reputation risk within the discussion of principal risks, 48% mentioned company reputation in passing, while 28% had a more thorough discussion. These discussions were generally within the broader context of corporate responsibility, often focusing on safety of employees and customers and reputational impact of supply chains, while one company discussed its reputation as an innovator within its industry within the context of its strategic objectives.

The annual report provides companies with an opportunity to reflect on their reputation and how they are maintaining or enhancing it.

As described above, 70% of companies discussed their reputation for high standards of business conduct clearly in their s172(1) statement. These companies included explicit reference to maintaining their reputation. For some companies the drive to maintain and build reputation for high standards of business conduct shone through in the s172(1) statement and elsewhere in the strategic report. This was particularly noticeable in the supermarkets in our sample, which of course sell directly to the public and face close scrutiny from government and media.

Purpose and broader ESG matters

It is good to see many companies acknowledging how crucial broader ESG matters are to the success of their business, with the chief executive of Essentra plc stating "ESG is crucial to our ability to maintain stability, deliver our strategies and ensure growth. Good management of this topic is therefore critical to meeting the increasing expectations of all our stakeholders including employees, customers and investors."

Other chief executives are clearly considering broader ESG matters. The chief executive statement in Persimmon Plc, for example, covered a number of their non-financial highlights, including ESG factors, referring to them as key highlights and linking back to the commentary about their stakeholders covered in the purpose statement and business model.

What to watch out for

- ☐ Set out your company's purpose in a clear and prominent manner, and consider how you demonstrate its linkage to impact through both strategy and business model disclosures.
- ☐ Where your company purpose references stakeholders, check that the key stakeholders are identified consistently with other disclosures, such as stakeholder engagement in the s172(1) statement.
- ☐ Ensure your s172(1) statement addresses all parts of the director's duty, particularly how the board has acted fairly as between members of the company, considered the likely consequences of decisions in the long-term and maintained a reputation for high standards of business conduct.
- ☐ When describing stakeholder engagement, describe the stakeholder concerns identified through the engagement activities and the board's understanding of those concerns (for example, through activities ongoing or planned).

People

90% of boards described the mechanisms they used to monitor company culture

For workforce engagement, 46% designated a non-executive director

74% identified employee-linked metrics as KPIs

76% had a principal risk relating to staff turnover or attrition, but only 8% disclosed staff turnover or attrition as a KPI

34% of companies explained clearly why diversity was important to their particular strategy

12% of companies provided a disclosure around workforce objectives relating clearly to ethnic diversity

Company culture

The “bridge” between purpose and people is corporate culture. Principle B of the 2018 Code explains how this should work in practice and the responsibility of the board.

> “The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.”

There is no question for a company applying the Principles of the 2018 Code that purpose must be established and should be supported by well-aligned values, strategy and culture. This Principle is supported by Provision 2, which calls upon the board to “assess and monitor culture”, to ensure that “corrective action” is taken where necessary and, in the annual report, to “explain the board’s activities and any action taken.”

90% of boards described the mechanisms they used to monitor company culture. The most usual of these was the employee engagement survey (76% of companies). This is most useful when companies describe key features of what the survey seeks to understand, whether it is compared to benchmarking data from other organisations, how it is presented to the board and any resulting actions. Other regularly mentioned mechanisms include reports from whistleblowing activity, workforce engagement designated directors, internal audit, and direct engagement activities between directors and staff such as “town halls”.

A handful of companies also mentioned obtaining input on culture from customer surveys, supplier feedback, employee turnover rates, exit interviews and a variety of metrics presented by HR to the board. These metrics regularly included people-related KPIs (see below). The additional sources of information were often linked to either an existing or a planned “culture dashboard” to pull together the relevant culture information in one place and enable a more timely and informed review by the board.

Only one company in our survey sample provided a disclosure about resolving an issue of misalignment of culture and purpose. This company provided a case study and described how the lessons learned were shared across the organisation.

Board decision-making process and workforce engagement

Fundamentally, the consideration of employees and the broader workforce begins in the boardroom. The understanding by boards of employees’ needs and receiving feedback from them is important to drive appropriate decision-making.

s172(1) statement

As described earlier, all of the companies in our survey described in their s172(1) statement how the directors had taken into account the interests of the company’s employees. This illustrates how critical employees are to the long-term sustainable success of the business. Over half of companies not only acknowledged employee issues or concerns but also demonstrated understanding of those concerns, either through extended discussion or by explaining how concerns had been or are being addressed.

In describing employee issues, companies use words that illustrate they are listening – in our survey this included language such as “issues”, “concerns”, “listening”, “hear”, “open discussion”, “conversation”, “informed”. Taking action is illustrated through active words, such as “involved”, “understand”, “introduced”, “created” and descriptive phrases, “actions agreed on issues raised”. A case study from NEXT plc, below, illustrates consideration of a consultation process and possible impacts on employees of store closures.

Case study – Retail store contract consultation

During the year, the Board considered a number of matters where it was important to be mindful of the interests of employees. One example of this was with regard to a number of store closures considered in the year, where the Board was assured of the Group’s approach of seeking to minimise redundancies of affected store staff and, wherever possible, to offer alternative employment in other stores.

A consultation process proposal was also considered in detail by the Board. A key objective of the proposal was to re-set the base contracts in retail stores with the least disruption to all staff. The Board considered the interests of employees, concluding that there would be a reduced overall impact on employees when considered against more disruptive alternatives, and some positive employee benefits in terms of more certainty over working hours to aid the smooth running of stores.

The Board also concluded that, due to the impacts being spread across a geographically dispersed network, there would be minimal impact to customers, local communities and suppliers.

Directors’ report statement

From 1 January 2019, companies with more than 250 employees had to expand their disclosures in their directors’ report regarding employees to include information around employee engagement.[4] 90% of companies had clearly made the new disclosure in the directors’ report, with over half of these deeming it to be of sufficient strategic importance to include the full disclosure within the strategic report itself, and referencing to it from the directors’ report. Some companies referred to the corporate governance statement where we saw an increasing volume of disclosures relating to employee engagement at board level, perhaps in response to the requirements of the s172(1) statement.

2018 Code – workforce engagement

For premium listed companies this new directors' report disclosure, as well as the requirements of the s172(1) statement, overlaps with the increased focus of the 2018 Code on workforce engagement mechanisms.

Although only 10% defined their interpretation of 'workforce', all companies identified that they had implemented a workforce engagement mechanism. Of these, just under three quarters had used a mechanism or combination of mechanisms described in 2018 Code provision 5 – a director appointed from the workforce, a formal workforce advisory panel, or a designated non-executive director. The remainder had described an alternative workforce engagement mechanism. The most usual mechanism was a designated non-executive director (46% of companies), with 14% of companies using a formal workforce advisory panel and no companies in our sample electing an employee director.

Informa PLC's chairman defines their workforce and describes both their chosen engagement mechanism of a designated non-executive director, and further ways the directors engage. The priority the board places on this is emphasised by how prominently it is included in the chairman's review of 2019.

> We consider Informa's workforce to be any colleague who works in the Group, whether on a full or part time basis, from an office or from home, and we give consideration to temporary and contract-based colleagues as well as permanently employed colleagues. As shared in last year's Annual Report, Helen Owers is the Non-Executive Director with designated responsibility for colleague engagement, although it remains an important matter for every Board member. During 2019, Helen worked closely with our HR, Communications and Company Secretarial teams to build on the ways in which our Board already engaged within Informa, to better understand the views of our colleagues and to assess the results.
>
> There is no better way to understand the views of colleagues than through meeting people directly, and the Directors continue to build this into their schedules and responsibilities. We continue to rotate Board meetings around Informa's office locations as a way to meet a range of colleagues, and in 2019 we held town hall events in London, Oxford and Hong Kong as part of this programme. The agenda is largely based on an open, ask-any-questions approach and I would like to thank colleagues for the frank and open discussions and for taking the time to participate.

Standard Life Aberdeen plc explains their designated non-executive director workforce engagement mechanism and provides explanation of the methods used to engage with the workforce, how feedback is provided to the board, the key topics of that feedback and how the executive leadership team (ELT) can be asked to take action. This is in line with the FRC's Annual Review of the UK Corporate Governance Code, published in January 2020, which explains that reports should "include details or real examples of what a company has done to consider and if appropriate take forward matters raised by the workforce."

> **Board employee engagement (BEE)**
>
> Melanie Gee is the designated NED to support workforce engagement and during 2019, she has sought to engage from two standpoints – top-down engagement through direct all-employee surveys on key topics and bottom-up engagement from regular meetings with relevant employee representatives.
>
> At these meetings, there is general discussion of engagement themes which have been raised to the various representatives. At each Board meeting, Melanie gives a formal report on the issues that have been raised through both the general discussion and the surveys, and the Board considers how the ELT can be asked to take any specific actions to address the points raised, and agree who is accountable to implement the action.
>
> The general feedback themes which Melanie escalated to the Board during 2019 included the need for continuing focus on comprehensive and quality communications to help employees understand clearly the ongoing transformation activities, and resolving the outstanding practical challenges arising from these activities cost effectively and pragmatically. The ELT, in particular the Chief HR Officer, the Chief Communications Officer and the Chief Operating Officer (COO), have taken forward the points raised.

Although only 10% defined their interpretation of 'workforce', all companies identified that they had implemented a workforce engagement mechanism.

We considered that over half of companies made it clear how employee feedback had influenced the board's decisions, something that BEIS (through their Q&As) and the FRC Guidance expect to be discussed as part of the s172(1) statement.

HSBC Holdings plc discussed real examples of feedback from employees and how the company has responded.

Acting on feedback

Area of focus	Action
Improving trust in speaking up	According to Snapshot, nearly three-quarters (74%) of our people feel able to speak up when they see behaviour that they consider to be wrong, unchanged from 2018. Only 59% said they were confident that if they speak up, appropriate action will be taken. We want more of our people to have confidence in speaking up to their line managers. In 2020, we began a programme to raise awareness about how to speak up about different types of concerns, how concerns are investigated and, crucially, what action we take as a result of concerns being raised.
Raising awareness of mental health	We worked with experts and colleagues to build a bespoke e-learning curriculum accessible to all 235,000 employees, which was delivered in September 2019. We also built and began rolling out additional classroom learning for managers. These were adapted to ensure they work for local cultures and languages.

Employees as a source of value

The FRC Guidance encourages companies to identify and describe their sources of value in their business models, namely those resources and relationships which support the generation and preservation of value. Employees are commonly identified as such a resource or asset, with 74% making this clear in their business model description.

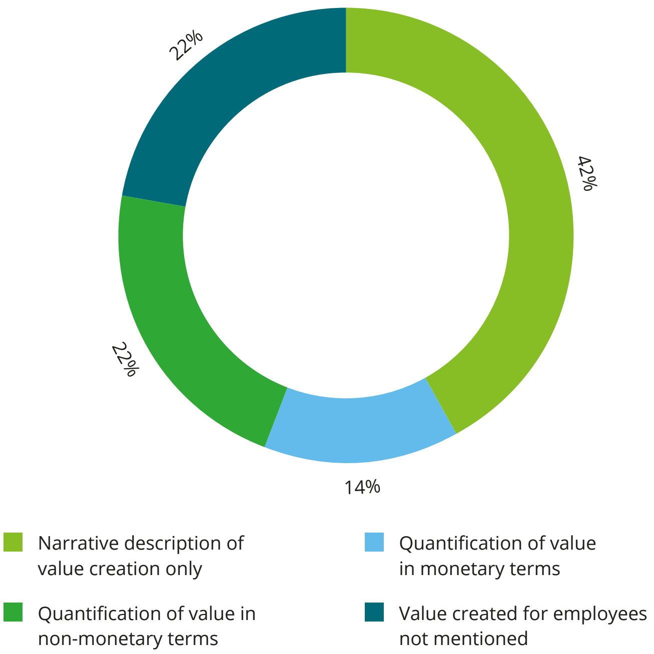
It is important that a company manages, sustains and develops the sources of value, or "capitals" that it relies on. The FRC Guidance requires explanation of actions taken by the company to manage, sustain and develop these sources of value, including those which are intiangible such as the workforce. The outcome of this can be described as the value created for those employees.

78% of all companies described in their business model the value that they create for those employees (Figure 3). Half of those that did not describe value created for employees in their business model had recognised them as a key resource upon which the business relied.

There is a clear presumption by companies that, for employees, having a job and being paid is value enough. Those companies quantifying value created for employees cited salaries, wages and employee benefits, with one company also quantifying separately cash payments made to pension plans. Quantification of value in non-monetary terms tended to be the number of employees or an employee engagement score. A handful of companies included the number of new jobs or promotions in the year, or the number of employees trained. While these quantifications are useful, the best disclosures were those that were accompanied by a more detailed narrative description. Some companies described how they sought to provide "a safe and rewarding environment in which to work" or "challenging and rewarding careers for our colleagues."

By describing the effects that companies have on their key resources (both positive and negative), a closer connection cab be achieved between the business model and related outcomes.

Figure 3. How is value created for employees presented in the business model?



Metrics

Metrics and data form an important part of company decision-making, with broader ESG metrics being a vital part of any balanced scorecard and increasingly being used as a factor in determining directors' remuneration (as discussed in the Profit section). In our survey, many reports made the connection between strategy and performance management by linking each KPI to a specific strategic objective. To enhance communication, companies often made use of icons, with the most effective reporters also providing an explanation of the link between strategy, metrics and targets. Rio Tinto plc linked each KPI to a specific objective within their strategy and to executive remuneration, providing an explanation of those links.

Key performance indicator definition

Free cash flow
Net cash generated from operating activities minus purchases of property, plant and equipment and payments of lease principal, plus sales of property, plant and equipment.

Strategic pillar

Portfolio **Performance**

Relevance to strategy & executive remuneration

This KPI measures the net cash returned by the business after the expenditure of sustaining and growth capital. This cash can be used for shareholder returns, reducing debt and other investment.

Link to executive remuneration
Included in the short-term incentive plan; in the longer term, the measure influences TSR which is included in long-term incentive plans (see page 113).

Associated risks

- Market
- Strategic
- Financial
- Communities and other key stakeholders
- Operational and people

Five-year trend

Free cash flow
$ millions

2015	4,795
2016	5,807
2017	9,540
2018	6,977
2019	**9,158**

Performance in 2019

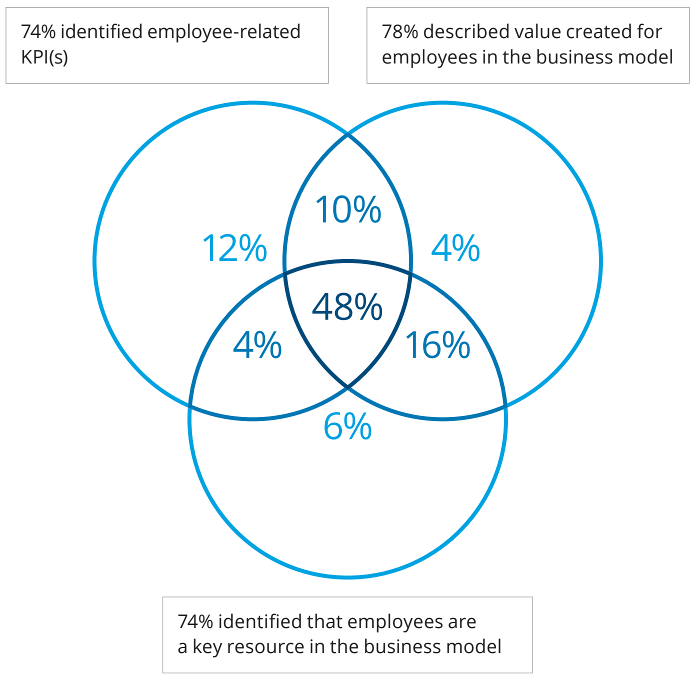
Free cash flow increased by $2.2 billion to $9.2 billion in 2019, primarily due to the increase in net cash generated from operating activities. This was partially offset by lower proceeds from sales of property, plant and equipment. Capital expenditure was in line with 2018.

Forward plan

We aim to continue our focus on free cash flow generation through the cycle. We expect capital expenditure to be approximately $7 billion in 2020 and $6.5 billion in both 2021 and 2022.

74% of companies indicated in their business model that employees are a key resource to their business. It was good to see the large overlap of these and the companies which identified employee-linked metrics as KPIs. This overlap indicates that companies understand the importance of measuring and managing resources that contribute to the company's broader value creation. 78% described in their business model the value created for employees by the company (see above). However, there was some mismatch between identifying employees as a key resource, measurement and explanation of value created, as illustrated in Figure 4. This may have arisen from inconsistent thinking or disclosure.

Figure 4. Connectivity between employee-related KPIs and value creation



Some of the companies clearly recognising the importance of their employees by citing them as being a key asset or resource in the business model and describing the value they created for them, did not appear to consider any related metric they may track as being 'key'. Indeed, six of these companies disclosed an employee-related principal risk, so it was surprising not to see disclosure of a related KPI through which that risk is monitored.

Conversely, where reports include an employee-related KPI (which is, presumably, monitored by the board), but do not identify employees as a material asset or stakeholder group in their business model, it raises questions as to whether the KPIs disclosed are really 'key' or perhaps whether the business model disclosures are complete.

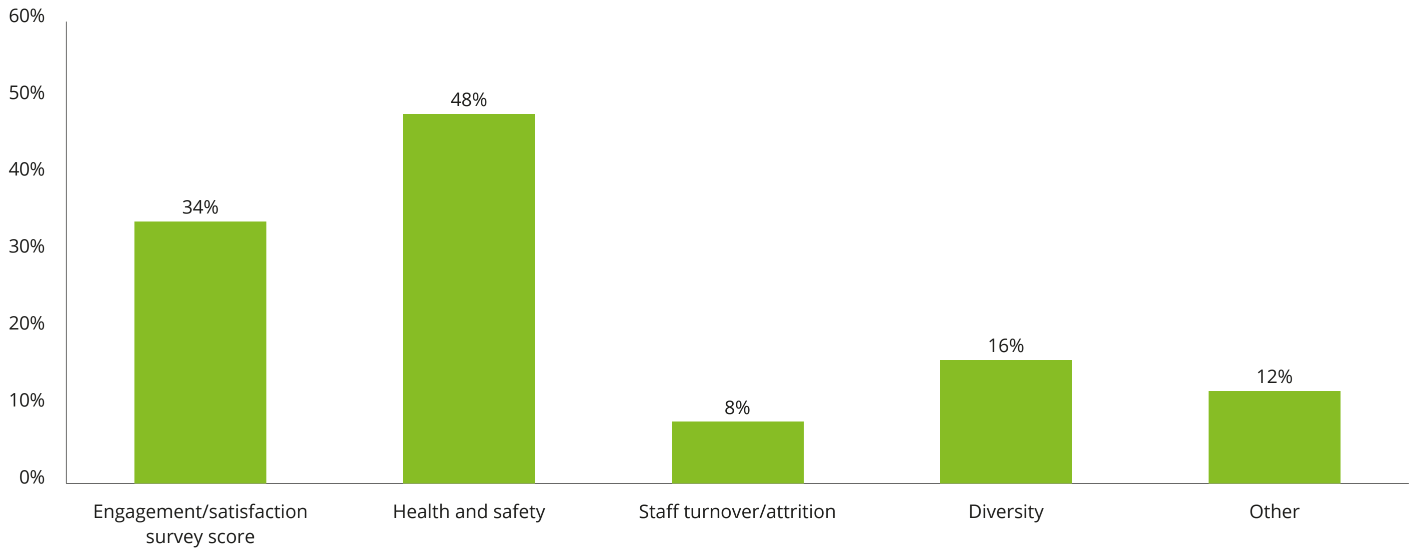
The linkages we are describing – between employee-related KPIs and identification of employees in the business model – are good examples of connectivity within the annual report, which is encouraged throughout the FRC Guidance. It is also a legal requirement for the strategic report to include, within its fair review of the business, analysis using financial and non-financial KPIs to help indicate how effective policies and processes are and to measure progress against strategy.

Health and safety metrics were the most common of these employee-based KPIs. Measurement of these varied from being employee-centric (such as number of accidents recorded) to having more of an operational and implicit financial focus (such as number of lost hours).

Although quoted companies have been required to disclose gender split information since 2014, the focus on diversity-related KPIs (whether gender diversity or other) by some companies was good to see. Most of these KPIs measured gender diversity, either of the whole workforce or else of a sub-section of senior management. Consideration of diversity in the boardroom is explored in more detail below.

Most strategic reports included additional detail and further employee-related metrics that were not necessarily considered 'key' as part of their broader discussion on ESG matters. It is important for companies to identify KPIs and other metrics which are directly relevant to their strategy and business model, and meaningful for their own assessment of performance.

Figure 5. How many companies have employee-related KPIs relating to the following



Most strategic reports included additional detail and further employee-related metrics that were not necessarily considered 'key' as part of their broader discussion on ESG matters.

Move towards global standards for ESG metrics

Many investors and other stakeholders are calling for further comparability between companies, especially on metrics. This is leading to calls for action to develop global standards for ESG metrics. Recently, in response, the five leading sustainability standard setters have published a statement of intent to work together to achieve a coherent and comprehensive corporate reporting system.[5] Investors and others have publicly stated that they wish the IFRS Foundation to establish a sustainability reporting standards board parallel to the IASB.

In the absence of global standards, consistency and comparability can be increased by using common metrics and approaches. The World Economic Forum's International Business Council (IBC) has proposed a common, core set of metrics that cover a range of themes and disclosures on sustainable value creation, linked to the Sustainable Development Goals (SDGs), that can be used within mainstream reporting. The US-based Sustainability Accounting Standards Board (SASB) has published standards covering sustainability accounting metrics on enterprise value creation for 77 industries which are deemed material to that industry group. The metrics cover topics on human capital and the broader workforce.

Adoption of these approaches by companies helps to accelerate moves towards global standards. Further, Larry Fink, CEO of Blackrock, and other investors have called for companies to adopt both TCFD and SASB.

However, when considering disclosure of common metrics, companies should also consider which are material and relevant, to the board's decisions and relevant to the decisions of users.

In our survey, three companies referred to SASB's materiality maps and one referred to both SASB standards and the WEF ESG metrics in relation to improving its own broader ESG risk reporting. However, none of the companies in our sample explicitly referred to either the SASB or the IBC metrics in their annual report. Despite this, we considered that over half of all companies were using employee-based KPIs that were broadly in line with those suggested by SASB or the IBC.

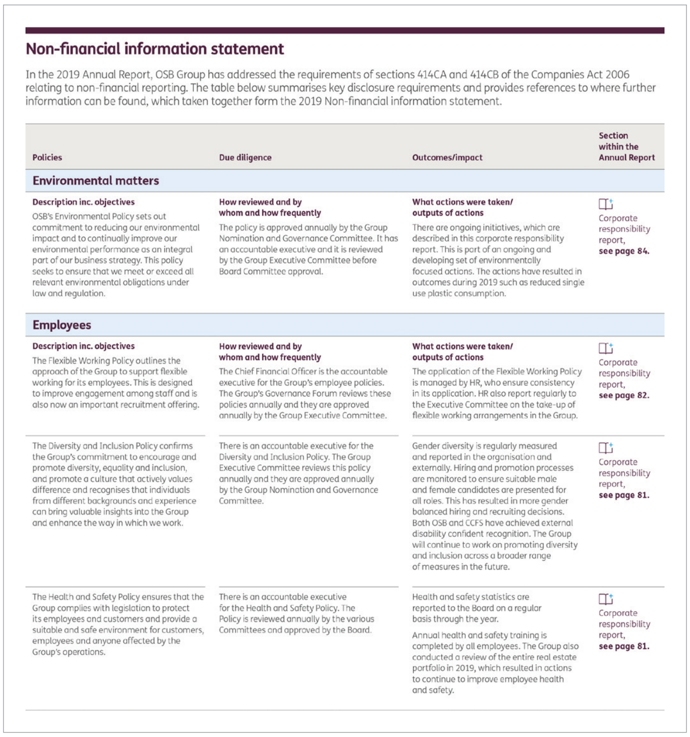
Non-financial information statement

This is the third reporting season that quoted companies with more than 500 employees have been required to include a non-financial information statement (NFI statement) in their strategic report. The NFI statement requires, among other items, a description of policies in relation to certain matters including employees, detail of any due diligence over those policies and the outcome of those policies. The NFI statement continues to be an area of FRC focus, being cited specifically in its letter to Audit Committee Chairs and Finance Directors in October 2019.

Disappointingly, only 88% of reports included an identifiable NFI statement (2019: 72%), despite the FRC stating in its Annual Review of Corporate Reporting 2018/2019 that it will continue to challenge companies whose disclosures in this area appear to fall short of the requirements, which include the requirement to present this information in a separately identifiable statement.

Those statements that were published varied in usefulness, as we have noted in previous years. The most useful NFI statements clearly identify the matters needed to be disclosed, name the relevant policy and provide an accurate and specific cross-reference to the pages where the policy is described.

The NFI statement disclosed by OneSavings Bank plc included significant detail, including descriptions of multiple policies, an overview of relevant due diligence undertaken, the outcomes of the policy and a cross-reference to further information in the report.



Non-financial information statement

In the 2019 Annual Report, OSB Group has addressed the requirements of sections 414CA and 414CB of the Companies Act 2006 relating to non-financial reporting. The table below summarises key disclosure requirements and provides references to where further information can be found, which taken together form the 2019 Non-financial information statement.

Policies	Due diligence	Outcomes/impact	Section within the Annual Report
Environmental matters			
Description inc. objectives OSB's Environmental Policy sets out commitment to reducing our environmental impact and to continually improve our environmental performance as an integral part of our business strategy. This policy seeks to ensure that we meet or exceed all relevant environmental obligations under law and regulation.	**How reviewed and by whom and how frequently** The policy is approved annually by the Group Nomination and Governance Committee. It has an accountable executive and it is reviewed by the Group Executive Committee before Board Committee approval.	**What actions were taken/ outputs of actions** There are ongoing initiatives, which are described in this corporate responsibility report. This is part of an ongoing and developing set of environmentally focused actions. The actions have resulted in outcomes during 2019 such as reduced single use plastic consumption.	Corporate responsibility report, **see page 84.**
Employees			
Description inc. objectives The Flexible Working Policy outlines the approach of the Group to support flexible working for its employees. This is designed to improve engagement among staff and is also now an important recruitment offering.	**How reviewed and by whom and how frequently** The Chief Financial Officer is the accountable executive for the Group's employee policies. The Group's Governance Forum reviews these policies annually and they are approved annually by the Group Executive Committee.	**What actions were taken/ outputs of actions** The application of the Flexible Working Policy is managed by HR, who ensure consistency in its application. HR also report regularly to the Executive Committee on the take-up of flexible working arrangements in the Group.	Corporate responsibility report, **see page 82.**
The Diversity and Inclusion Policy confirms the Group's commitment to encourage and promote diversity, equality and inclusion, and promote a culture that actively values difference and recognises that individuals from different backgrounds and experience can bring valuable insights into the Group and enhance the way in which we work.	There is an accountable executive for the Diversity and Inclusion Policy. The Group Executive Committee reviews this policy annually and they are approved annually by the Group Nomination and Governance Committee.	Gender diversity is regularly measured and reported in the organisation and externally. Hiring and promotion processes are monitored to ensure suitable male and female candidates are presented for all roles. This has resulted in more gender balanced hiring and recruiting decisions. Both OSB and CCFS have achieved external disability confident recognition. The Group will continue to work on promoting diversity and inclusion across a broader range of measures in the future.	Corporate responsibility report, **see page 81.**
The Health and Safety Policy ensures that the Group complies with legislation to protect its employees and customers and provide a suitable and safe environment for customers, employees and anyone affected by the Group's operations.	There is an accountable executive for the Health and Safety Policy. The Policy is reviewed annually by the various Committees and approved by the Board.	Health and safety statistics are reported to the Board on a regular basis through the year. Annual health and safety training is completed by all employees. The Group also conducted a review of the entire real estate portfolio in 2019, which resulted in actions to continue to improve employee health and safety.	Corporate responsibility report, **see page 81.**

Figure 6. Which elements of the NFR Regulations relating to employees were identifiable?

All companies that included an NFI statement this year either named or clearly described at least one employee-related policy, often health and safety, or a code of conduct.

For those companies disclosing an NFI statement, we sought to identify relevant policies, due diligence and outcomes of those policies relating to employee matters.

All companies that included an NFI statement this year either named or clearly described at least one employee-related policy, often health and safety, or a code of conduct. A handful of companies continue to name their policies but refer to their website for descriptions of those policies (rather than clearly describing them in their strategic report), despite the FRC explicitly stating that it is not sufficient to refer to information disclosed elsewhere (such as websites) to meet these disclosure requirements.

There was a marked increase in descriptions of due diligence over those policies named or described, likely due to a combination of improved cross-referencing from the NFI statement, (in recognition of the FRC's focus) and disclosures around workforce generally improving or becoming more detailed as a result of the 2018 Code (such as the notable increase in discussions regarding whistleblowing).

Due diligence activities on employee-related policies commonly include monitoring of relevant metrics either by management or at a board level, and board-level review of whistleblowing reports. Assurance is also obtained over related information or processes by some companies, either by internal audit or external assurance in line with recognised standards.

Determining what the outcome is for a particular policy can be difficult if it is not either explicitly cited in the report or obvious (such as accident rate metrics for a health and safety policy). Where companies cited codes of conduct (policy) and whistleblowing mechanisms (due diligence), they rarely stated the outcome of that policy, such as the number of whistleblowing reports made or otherwise acted upon, or number of disciplinary actions relating to the code. One company stated that it was working on a "people dashboard" to collate and manage employee data, implying this was not yet readily available.

Diversity and inclusion

Under the 2018 Code, companies are required to report annually on their diversity policies, including and going beyond gender. Principle J calls for board appointments and succession plans to "promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths." Diversity must also be featured in the annual board evaluation under Principle L. This is explored in several of the more detailed provisions. Notably, Provision 23 asks companies to describe the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives.

In September 2018, the FRC published Board Diversity Reporting, which encouraged companies to treat diversity as an issue of strategic importance and provide more insightful reporting on diversity and inclusion. Although all companies in our survey sample acknowledged the importance of diversity in the organisation, only a third went beyond positive words to explain clearly why diversity was important to their particular strategy.

Anglo American plc (pictured right) draws out why it believes diversity supports the Group's purpose and contributes to its strategy; it also explains how the Group, engages with historical gender imbalance in the mining industry and explains the Group's targets to address that imbalance.

Savills plc (pictured below) explains its strategic approach and details how it focuses on different aspects of diversity and inclusion, going beyond gender alone, its objectives and how they are implemented and examples of activities and progress.

Having the best minds and inclusive leadership are crucial to finding innovative and sustainable solutions to business challenges and to embedding a high performance culture. This means drawing from the widest available talent pool, and leveraging their complementary skills and attributes to achieve breakthrough outcomes.

Our Inclusion and Diversity (I&D) strategy is a critical foundation of our Purpose of *re-imagining mining to improve people's lives*, supporting us in creating a work environment where each of our people is afforded the opportunity to realise their full potential.

Tackling gender imbalance

Historically, in the mining industry, women have been under-represented at all levels, particularly in senior roles. We are steadily redressing that: over the past three years, the proportion of women at senior management levels across the Group has increased from 15% in 2016 to 24% in 2019. Our target is to exceed 25% by the end of 2020 and aim to reach 33% by 2023.

Inclusion and Diversity

We look to create an inclusive culture in which difference is accepted and valued. We believe that our inclusive approach gives us a competitive advantage and underpins the success of our business by giving us the ability to select our people from the highest quality individuals in the widest available pool of talent.

As an organisation committed to diversity in its workforce, we will continue to strengthen our policies, processes and practices to develop our diversity and inclusion plans within the Group's markets and geographies, in alignment with our corporate goals. We will continue to endeavour to improve the representation of women at Board and senior levels within the organisation and to sustain an inclusive culture in which all talent can thrive.

Our Strategic Approach

Our commitment is to promote on merit regardless of any other factors, creating equal opportunities for career progression and ensuring that every single person within the Savills Group has a sense of belonging.

Savills policy is to embrace diversity and provide a platform and a supportive environment for everyone to be the best they can be.

We are committed to developing a culture of inclusivity and diversity within the property profession with six key areas of focus: gender, disability, LGBTQ+, socio-economic, ethnicity and age. We have led on this with our programme in the UK, and our Diversity Group in the UK is now in its fifth year and continuing to develop our programme across the Group. The main objective is to highlight the diversity of our business and ensure that we are communicating clearly and effectively about our people and our clients:

Area of Focus	Objectives	Implementation	Examples of progress on achieving objectives
Age	Encourage a wider age profile within the property industry by focusing on ensuring that appropriate support is available and offered at all stages of an individual's career	▪ Flexible Working ▪ Improving Internal Communication of existing and new policies ▪ Promoting Mentoring and Rewarding Loyalty ▪ Ensuring that policies and support are offered for Working Carers	▪ We support a significant number of people flexibly for different reasons to accommodate personal and professional requirements ▪ In the UK, 'Making your Mentoring programme relevant for the modern workplace' Savills has adopted a flat mentoring scheme for many years, allowing both mentor and mentee to benefit from their involvement. A recent trial within the UK business has also seen employees matched with colleagues in the same division, who are just slightly further along in their careers, to allow for similar experiences to be shared
Disability	Ensure all staff feel included and supported regardless of any disability (discernible or hidden). We want to highlight the benefits of having a business that is aware of and understands the needs of employees, clients, tenants, visitors and all those that interface with Savills that have any form of disability	▪ Raising awareness through supporting internal and external events ▪ Implement compulsory diversity and equality awareness training across the business ▪ Engaging with a number of professional bodies and diversity groups and will ask for their assistance and expertise ▪ Removing the stigma – promote awareness of mental health issues	▪ We are committed to being a Valuable 500 business, which is a pledge to encourage 500 companies across the globe to sign up and agree to be more inclusive in terms of disability ▪ Savills achieved certification as a Disability Confident Committed Employer (Level 2) in the UK
Ethnicity	Increase the ethnic diversity of people working within Savills and the wider property industry by embracing a rich, diverse cultural mix to promote inclusion and engagement between all staff and clients	▪ Ensuring zero tolerance of harassment and bullying ▪ Making equality in the workplace the responsibility of all leaders and managers ▪ Taking action that supports ethnic minority career progression	▪ Savills has signed up to the Race at Work Charter, an initiative designed to improve outcomes for Black, Asian and Minority Ethnic (BAME) employees in the UK ▪ Our US Building Inclusivity and Diversity Group regularly hosts speaker and panel-discussion events for our employees and clients to encourage awareness and constructive dialogue regarding diversity and inclusion. We recently hosted at the Smithsonian Institution's National Museum of African American History and Culture in Washington, DC, was attended by clients and staff. The event included a programme of speakers who shared current initiatives and best practices for raising awareness for diversity and inclusion at their companies
Gender	To create a strategy that provides an equal and fair platform for everyone to be the best they can be	▪ Continue to ensure that our training fully supports our approach to diversity and inclusion ▪ Relaunched our gender equality and unconscious bias training, to further raise awareness of diversity	▪ We are working hard to redress our balance of men and women in more senior roles through a number of initiatives ▪ Our 'Women in Leadership positions', determined in accordance with the Hampton-Alexander Review criteria, was 22.5% as at 31 December 2019. Whilst this progress reflects our commitment to improve diversity, in a sector where historically there has been a shortage of women leaders, we fully acknowledge that we need to remain focused into the medium term on further improving diversity ▪ We will continue to evolve our approach to meet the needs of our clients and people
LGBTQ+	Embrace diversity and provides a platform and a supportive environment for everyone to be the best they can be Improve lesbian, gay, bi and trans (LGBTQ+) inclusion in the work place	▪ Raising Awareness ▪ Recruit and Retain best people	▪ Savills plc and Savills UK improved 137 places in the 2019 UK Stonewall Workplace Equality Index. We hope to continue to improve on this in 2020
Socio Economic	Create a strategy that provides an equal and fair platform for everyone to be the best they can be regardless of their socio economic background	▪ Creating a workplace that provides an equal and fair platform for everyone to be the best they can be regardless of their socio economic background ▪ Increasing diversity of talent pool ▪ Inspiring the next generation to consider property for their career	▪ In the UK, Savills with Schools initiative now in place across 26 regional offices, to date the business has engaged with over 5,000 pupils ▪ Founding sponsor of Rethink Food, providing vertical farming towers in primary schools in the UK ▪ Supporting London based charity, The Big House, which works with care leavers who are at a high risk of social exclusion by providing a platform to participate in the making of theatre

Gender diversity

Since 2010, gender diversity in the boardroom has been a focus of government and regulators, with increasing attention from investors who have established minimum expectations for board roles to be taken by women. The targets are voluntary, however many boards have adopted targets for board diversity. In our survey, half of the companies stated targets for gender diversity on the board, and a handful of these extend the diversity targets to executive board or equivalent levels of senior management.

58% of companies clearly met the 2018 Code requirement to disclose the proportion of women on the executive board and their direct reports; a few others had less specific disclosures about the proportion of women in management, where it was not possible to tell whether the disclosure was meant to answer the Code requirement in Provision 23.

We looked for companies to have both objectives in respect of gender diversity and specific activities that they undertook to work towards those objectives. 28% of companies included disclosure around activities undertaken to increase gender diversity at board level. These activities largely related to succession planning, implementation of gender balanced shortlists and use of recruitment firms that are signed up to the Voluntary Code of Conduct on gender diversity.

36% of companies disclosed activities towards building gender diversity at senior leadership level. In addition to the activities used for the board, this included attention to recruitment processes more broadly, mentoring and career development programmes, and incorporating diversity goals into balanced scorecards for individual evaluations.

In the workforce more broadly, companies talked about implementing diversity leadership groups to identify actions, training on diversity and inclusion, focus on hiring practices and evaluation, mentoring programmes, employee-led diversity networks and other activities to promote the company as a place that welcomes diversity. In all, 74% of companies disclosed a variety of activities, almost all of which focused on a range of aspects of diversity rather than gender alone. Below board level, we noted that many of the activities companies disclosed could be beneficial both for objectives on gender diversity and for other aspects of diversity.

Rightmove plc explained its diversity and inclusion activities, including mentoring, training in conscious and unconscious bias and focus on recruitment activities.

Balance for all

- Offering a range of family-friendly and agile working policies to both men and women. These include workshops to women before, during and after maternity leave to help us retain talent. We also offer workshops to all employees to help consider how best to balance work and family life.
- We have successfully delivered a 'Thoughtful Leadership' programme to tackle both conscious and unconscious bias and have launched a follow-up programme to enhance the learning (detailed in the development and training section).
- To support our commitment to providing a diverse thought culture we have hosted a series of 'Mentoring Circles' with external keynote speakers (detailed in the development and training section).

Addressing imbalance

- We are participants in the 30% Club cross company mentoring programme. This supports our aim to bring more talent diversity into senior manager roles. We have eight females participating from varying career stages. We match this with an equivalent number of mentors from our senior leadership team to mentees from other participating organisations.
- We continuously review all job specifications and our interview process to ensure universal appeal and fair progression for all to ensure we attract the best talent.
- We ask our recruiting partners to provide for a 50/50 shortlist at candidate stage. Where this is not possible, we seek to understand how it can be achieved. We aim for 50/50 gender representation through the interview process.
- Our internal talent pipeline provided role changes and promotion opportunities for 43 people between April 2018 and April 2019, with 42% of these being female.

Ethnic diversity

Companies in the UK have been encouraged over several years not only to implement comprehensive diversity and inclusion policies, but to focus on BAME diversity as well as gender diversity.

There have been two recent initiatives, one being Baroness McGregor-Smith's independent review of issues faced by businesses in developing black and minority ethnic talent, and the other being the Parker Review on diversity in the boardroom, which reported in October 2017, making recommendations in three key areas: increasing the ethnic diversity of UK boards; developing candidates for the pipeline and plan for succession; and enhancing transparency and disclosure. Although under the 2018 Code, companies should in any event report on diversity beyond gender, these reviews offer suggestions for constructive disclosure that provide opportunities for company reports to differentiate themselves on ethnic diversity.

Since the annual reports in our survey sample were published, there has been an urgent focus on addressing historical inequalities, with recognition by businesses and society that systemic change is necessary. The Black Lives Matter movement has been a catalyst.

Although half of companies identified board-level targets relating to gender diversity, only a minority of those companies also identified targets relating to ethnic diversity. Most of those targets echo the Parker Review in aiming for one BAME board member by 2021. 12% of companies provided a disclosure around workforce objectives relating clearly to ethnic diversity although there was little discussion of supporting activities.

Marks and Spencer Group plc explained its target to appoint a director from an ethnic minority background and its goal to widen the pool of available talent to the board, including ongoing consideration of using open advertising.

Appoint at least one director from an ethnic minority background to the Board by 2021.

With regard to the recommendations of the Parker Review Committee, the Board has been committed to achieving ethnic diversity on the Board as well as gender diversity. With the appointment of Sapna Sood in June, this target will be met.

Consider candidates for appointment as non-executive directors from a wider pool including those with little or no previous FTSE board experience.

During the year, the Nomination Committee discussed non-executive director appointments and succession. It worked closely with executive search agencies in compiling long and short lists of candidates from various backgrounds and industries. Candidates were identified, interviewed and measured against pre-determined criteria. Although we do not currently openly advertise our non-executive director positions, we keep this under review.

Principal risks related to employees

The importance of the workforce on the ability of companies to create value is evident, with 90% identifying an employee-related principal risk. Those companies without such a risk were from a variety of industries. Eleven companies (22%) disclosed an employee-related principal risk, which would presumably have a material impact upon the business should it crystallise, although had not identified employees as being a key resource in their business model disclosure (see above), calling into question the completeness of the business model disclosure.

Figure 7. What did employee-related principal risks relate to?

Health and safety	60%	Although a risk for over half of all companies, fewer (48%) disclosed a corresponding metric as a KPI. For the most part these risks refer to employee safety, but some companies also include the safety of their customers or end consumers within the scope of this risk.
Staff turnover/attrition	76%	76% of companies had a risk relating to staff turnover or attrition, often including reference to the ability to retain skilled workers. Interestingly only 8% of companies disclosed staff turnover or attrition as a 'key' performance metric (see above).
Defined benefit pension	4%	Only a couple of companies identified the risk around defined benefit pension schemes to be a principal risk, reflecting a continued downwards trend compared to five years ago (22%).
Workplace culture	14%	The 2018 Code links company culture to the long-term success of the company. Three companies citing this risk are from industries where regulators are particularly focused on ethics, so it was good to see a broader range of companies clearly thinking about the risk that a failure in their culture could have a material impact on the business overall.
Other	38%	Other employee-related principal risks included compliance with relevant laws and regulations and the level of skill of the workforce.

What to watch out for

- [ ] When describing the mechanism used for workforce engagement, be sure to include details or real examples of how the company has considered and actioned (where appropriate) matters raised by the workforce.

- [ ] Consider the connectivity between different disclosures. If employees are a key resource to the business, identify them as such in the business model, explain the actions taken to manage, sustain and develop employees, describe the value created for them, link to any relevant principal risks and any KPIs measuring relevant impact of those risks.

- [ ] Investors are keen to compare companies' performance with one another more easily. In reviewing the KPIs disclosed, consider whether those chosen by the board are in line with industry recommendations and practice.

- [ ] Remember to include the NFI statement and consider how user-friendly and informative it is. Identify the names of relevant policies and cross-refer accurately to specific pages of the annual report where descriptions of those policies, due diligence and outcomes can be found.

- [ ] When discussing diversity, be sure to explain clearly why it is important to company's strategy. This provides more insightful disclosure and avoids the implication of merely paying lip-service to this hot topic.

- [ ] Government, regulators and investors are looking closely at annual report diversity disclosures including whether they extend beyond gender. Investors are using this information to influence voting intentions. It is worth going beyond basic disclosure to give real insight into your company's approach.

- [ ] There are multiple disclosure requirements around employees and the broader workforce in the strategic report, the directors' report and the corporate governance statement. Be mindful of the overlap of content between the requirements and the FRC's principle of a strategic report being concise. Utilise opportunities to remove duplication and cross-refer to another part of the report instead.

Planet

90% acknowledged climate change

64% referred to TCFD

22% made fulsome disclosures in line with TCFD...

... while 42% are working towards compliance

Of the 22% citing climate change as a standalone principal risk, ...

... a quarter did not have a KPI clearly linked to climate change

64% disclosed a target in relation to GHG emissions

40% stated their scope 3 GHG emissions

Investors, regulators and other business stakeholders continue to demand better disclosures on climate change matters and to challenge companies that are not factoring the effects of climate change into their critical accounting judgements.

The FRC's Lab published a report in October 2019, Climate-related corporate reporting, which aims to reflect the views of investors on existing reporting by companies and to help companies move towards more effective and comprehensive reporting. Structured around the, currently voluntary, TCFD framework (which identifies four pillars of disclosure: governance, strategy, risk management and metrics and targets, each discussed in turn below), the Lab's report sets out challenging questions for boards to ask themselves and examples of good practice.

Also in October 2019, in its Annual Review of Corporate Reporting, and in an open letter to all Audit Committee Chairs and Finance Directors, the FRC further emphasised their expectation that boards address and report on the effects of climate change. Citing climate change as one of the defining issues of our time, it highlighted the responsibility that boards have to consider the likely consequences of any business decisions in the long-term and their expectation that they address, and where relevant report on, the effects of climate change. Reporting should set out how the company has taken account of the resilience of the company's business model and its risks, uncertainties and viability in both the immediate and longer term.

Subsequently, in February 2020, the FRC commenced a major review of the extent to which UK companies and auditors are responding to the impact of climate change on business to ensure reporting requirements are being met. Their focus includes evaluating the quality of disclosures under the 2018 Code regarding risk, emerging risk and long-term factors affecting their viability and whether the recommendations in their Lab report have been adopted.

The Financial Conduct Authority (FCA) published a consultation paper in March 2020 proposing to enhance climate-related disclosures by companies with a UK premium listing – suggesting that such companies would report on the TCFD recommendations on a 'comply or explain' basis. In particular, this would require premium-listed companies to include a statement in the annual report setting out:

- whether they have made disclosures consistent with the TCFD's recommendations in their annual report;
- an explanation of 'why' where they have:
  - not made disclosures consistent with some or all of the TCFD's recommendations; or
  - included some or all of the disclosures in a document other than their annual report; and
- where in their annual report (or other relevant document) the various disclosures can be found.

Such a requirement would potentially take effect for accounting periods beginning on or after 1 January 2021, so our focus in this year's survey was centred very much on current levels of alignment with TCFD.

It was encouraging to see 90% of companies referring to climate change within their annual report, with 64% referring to TCFD – a significant increase from only 1 in 5 companies last year. Uptake of reporting in line with TCFD also increased, with 22% making fulsome disclosures in line with TCFD (2019: 4%) while 40% are working towards compliance. Most of those companies reporting in line with TCFD included the bulk of the disclosures within their annual report, with a handful cross-referring to their website or other publications for the information.

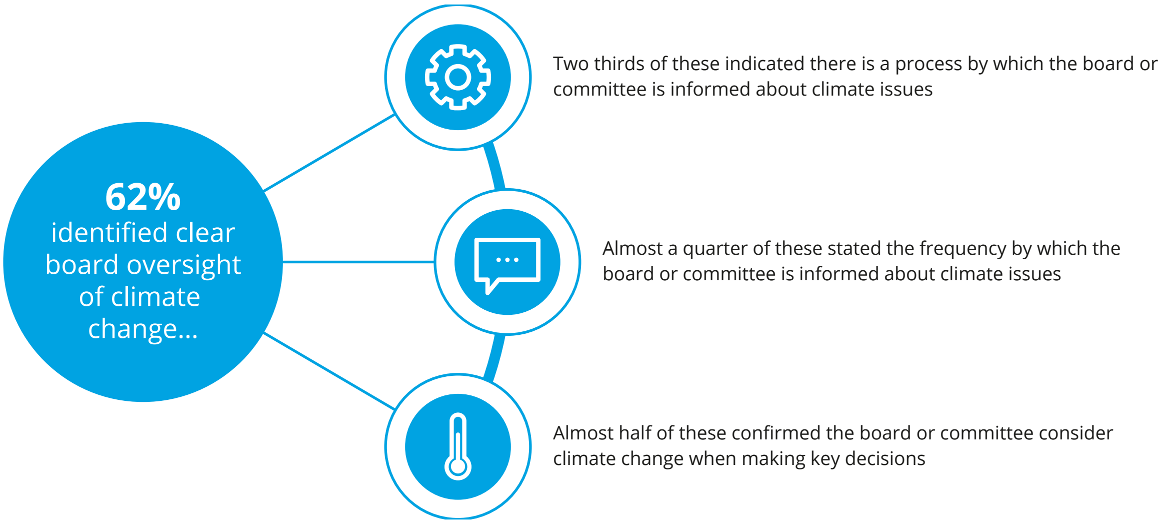
For those that had adopted TCFD and were making clear disclosures in line with the recommendations, the authenticity of climate-related disclosures varied somewhat. Some of the disclosures clearly struck a chord with the broader company strategy, complementing the broader vision or purpose, while some came across as disconnected from the rest of the report, more as if it were a reporting add-on than a fundamental, integrated way of doing business.

It was surprising that a number of reporters in key industries likely to be significantly impacted by climate change (such as aerospace and automobiles) had not made reference to TCFD nor clearly adopted many of the recommendations.

Land Securities Group PLC is an example of where the climate change disclosures were fully integrated into the rest of the strategic report. The company's 'net zero' response to climate change was cited in the opening summary pages as being a key part of the company's broader sustainability aims. The business model identified three material outputs (financial, physical and social) and a separate section in the strategic report was dedicated to the review of each of these. The prime focus of disclosures around "physical space" addressed climate change, demonstrating the integration of the issue within the business. The group strategy included an overview of investment through the life-cycle which cited sustainability as being a key driver. Climate change is also identified as a principal risk, and a related KPI is disclosed with a link to directors' remuneration. Finally, carbon pricing has been incorporated into decision-making, alongside financial cost.

Governance over climate change

A company's response to climate change needs to be led from the top, with disclosures making clear the level of attention given by boards.



Disappointingly, many companies had not clearly taken heed of the TCFD recommendations with respect to the involvement of the finance function. The CFO or finance director of only four companies were clearly involved in the oversight of climate change. This mirrors the TCFD 2019 Status Report which found there is insufficient involvement of finance and risk teams in TCFD reporting. This is critical for information to be robust and reliable if climate considerations are to be appropriately reflected in investment and lending decisions.

Equally disappointing, in the descriptions of board oversight, only 8% described how the board monitors and oversees progress against goals and targets for addressing climate-related issues, despite 42% of companies disclosing a climate-related metric as a KPI (see below).

s172(1) statement

TCFD recommends disclosure around whether the board considers climate-related issues when reviewing and guiding strategy, major plans of action, risk management policies, annual budgets, and business plans as well as setting the organization's performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and disposals. This links closely in with board decision-making disclosure as part of the new s172(1) statement.

24% specifically called out climate change as having been discussed by the board within their s172(1) statement. 6 companies gave examples of board decisions made within their s172(1) statement that referred to climate change. Lloyds Banking Group plc identifies a key board decision concerning tackling climate change, outlining the engagement activities that they undertook prior to making the decisions, and highlighting the long-term implication of those decisions.

KEY BOARD DECISION
TACKLING
CLIMATE CHANGE

Across the globe, action to combat climate change is needed. We support the Government's Clean Growth Strategy and are supporting our customers with a range of initiatives to help them become more sustainable and think about environmental impacts, including access to green finance.

The transition to a low carbon economy impacts us all and subsequently is a fundamental element of our strategy and core to Helping Britain Prosper.

In 2018 following a detailed review by the Board, we introduced a new sustainability metric to our Helping Britain Prosper Plan, signalling our intent and commitment and in January 2020, we announced an ambitious new goal to help reduce the carbon emissions we finance by more than 50 per cent by 2030. Read more about our ambitious goal and other commitments on pages 28 to 31 or in our approach to ESG presentation online https://www.lloydsbankinggroup.com/ investors/financial-performance/

Our engagement process

- In developing our proposals, various stakeholder groups have been engaged including customers, colleagues, shareholders, suppliers, government and regulators
- The annual responsible business materiality study specifically identified environmental sustainability and climate change as a critical issue and as a result further detailed analysis was undertaken by the Group sustainability teams
- The Responsible Business Committee, a sub-committee of the Board, provides direction and oversight, whilst at Executive level, the Group Executive Sustainability Committee (GESC), supported by divisional Governance Forums and working groups, provide oversight
- The Board were briefed on key climate related issues by external industry experts and also engaged on a number of external fronts

Long-term implications

The Board believe we have a responsibility to help drive progress towards a sustainable and resilient UK economy, taking into consideration the needs of different stakeholders and risks to the business, and were comfortable endorsing ambitious plans, given the benefit to the Group and future generations

>£4.9bn
Green finance
Read more about our approach to green finance on page 29

>50% by 2030
We aim to help reduce the emissions we finance by more than 50 per cent by 2030

Link to strategic priorities
Leading customer experience
Maximising Group capabilities

Risk management

TCFD calls for information regarding three main areas of risk management:

1. a description of the processes for identifying and assessing climate-related risks,
2. a description of the processes for managing climate-related risks, and
3. a description of how these processes are integrated into the organisation's overall risk management.

Climate-related risks are inherently more complex and long-term in nature than most traditional business risks, and until recently there has been a lack of clear understanding and measurement capabilities to assess the potential impacts on a company's operations and performance. The Climate Financial Risk Forum published in July 2020 an industry guide to addressing climate-related financial risks. It aims to help financial services firms, of all sizes, understand the risks that arise from climate change, and to provide support on how to integrate these risks into their strategy and decision-making processes.

Many UK companies provide information about their risk management processes, although surprisingly not all of them describe their processes for assessing the potential size and scope of risks. While UK law requires a description of "principal risks and uncertainties", TCFD specifically calls for climate-related issues that could have a "material financial impact" on the company. Only 46% of companies described the process used to determine which risks could have a material financial impact on the company. Those which did not either omitted to describe the process itself or else had not made clear how it assessed which risks might have a material financial impact. Informa PLC describe how every principal risk is assessed for financial viability scenarios, to see if they could have a material financial impact, either on their own or if they materialise together. Land Securities Group PLC describe their risk scoring matrix which considers, among other matters, the financial impact to income and capital values.

With regards to identifying climate change in particular:

12% have a separate process for identifying climate-related risks from their general risk management process

20% explicitly stated that the same process for climate-related risk is followed as for other risks

30% did not specify but had referred to climate-related risks within their discussions of principal or emerging risks, so it can be assumed that the same process is followed

12% described the process used to determine climate-related opportunities which could have a material financial impact

J Sainsbury plc identified that climate change risks were subject to a specific risk review for completeness, before the impact on overall risks assessment was considered.

The level of detail of the description of risk assessment processes varied, but five companies stated that they had relied on climate-specific external sources of data. These ranged from "industry and sectoral relevant benchmark data" to other professional advisors. One bank used its customers' responses to a survey to drive its analysis of transition risk.

Climate-related risks are inherently more complex and long-term in nature than most traditional business risks, and until recently there has been a lack of clear understanding and measurement capabilities to assess the potential impacts on a company's operations and performance.

Strategy

TCFD recommendations outline three disclosures in relation to strategy:

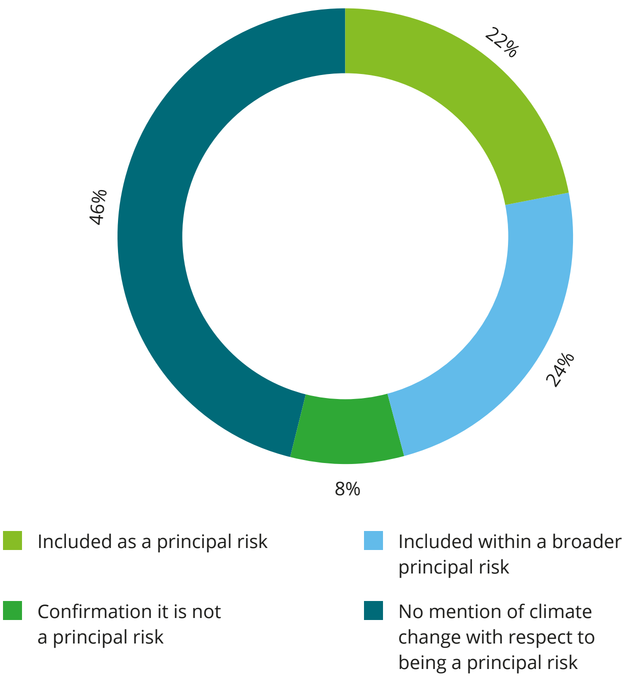
1. Describe the climate-related risks and opportunities identified over the short, medium, and long-term
2. Describe the impact of those risks and opportunities on the company's businesses, strategy, and financial planning
3. Describe the resilience of the company's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario

Beyond the initial identification and description of the risk, this appeared to be an area where companies either struggled to articulate these matters or else had simply not disclosed them.

UK companies are required to describe the principal risks and uncertainties facing the company. Those companies in our sample are also required under the 2018 Code and by law to disclose how they manage and mitigate those risks.

The FRC Guidance confirms that risks and uncertainties included in the strategic report should be limited to those considered by the entity's management to be material to the development, performance, position or future prospects of the entity or where the impact of the entity's activity poses a significant risk.

Figure 8. Is climate change cited as a principal risk?



It specifically calls out risks arising from climate change as being examples of long-term systemic risks which may have a material effect on the entity's ability to generate and preserve value in the long-term. For entities where this is the case the strategic report could explain the potential impact on the entity's strategy and business model if those risks crystallise.

The 2018 Code brought in a new requirement for boards to confirm the procedures in place to identify emerging risks. There is no requirement to identify which risks have been identified as emerging risks, but it appears commonplace for companies to do so. Certain industry groups, such as insurance companies, disclose these as a matter of course already. 28% of companies described climate–related risk as being an emerging risk although unexpectedly 8% had already cited climate change as a principal risk (or part of a broader principal risk) as well. For these, insufficient information was provided to indicate what aspect of climate-related risk was 'emerging'.

TCFD divides climate-related risks into two major categories:

- risks relating to the transition to a lower-carbon economy ("transition risk") and
- risks relating to the physical impacts of climate change ("physical risk").

This terminology has become well established and understood. Of those companies identifying climate-related risks either as principal risks or as an emerging risk, 18% related to transition risk, 18% to physical risk, 55% to both types of risk and for the remaining 9% it was unclear.

Investors and other stakeholders need to understand how climate-related issues may affect a company's businesses, strategy, and financial planning over the short, medium, and long-term. Such information is used to inform expectations about its future performance. Without this clear link to strategy and financial planning, it is easy for additional environmental disclosure to potentially be considered greenwashing.

Only three companies described what they consider to be the relevant short, medium, and long-term time horizons in relation to climate-risk specifically (taking into consideration the useful life of its assets or infrastructure and the fact that climate-related issues often manifest themselves over the medium and longer terms).

Two of these companies then went on to describe the specific climate-related issues for some of these time horizons (short, medium, and long-term) that could have a material financial impact on the company. Persimmon Plc set this out clearly in their TCFD overview:

Strategy	The Board monitors the impact of climate change risk and opportunities on its strategy and business model. It considers the impact over the short (0 to 5 years), medium (6 – 10years) and long (11 – 100 years) term. In the short term (0 – 5 years), we consider the material risk of climate change to be in relation to the transition to a low carbon economy through changing building regulations. On 1 October 2019, the Government set out its plans for the 'Future Homes Standard' including proposed options to increase the energy efficiency requirements for new homes in 2020 as a 'stepping stone' to achieving the new standard. The Future Homes Standard will require new build homes to be future-proofed with low carbon heating and world-leading levels of energy efficiency; it will be introduced by 2025. The industry is currently considering the likely impact of these new regulations. Their implementation may lead to constrained land supply, increased planning delays, increased cost and pressure on materials and require the use of new technology and skills. The physical risks associated with climate change for example, changes in weather patterns and the frequency of extreme weather events, particularly storms and flooding, may increase the likelihood of disruption to the construction process. The availability of mortgages and property insurance may reduce should financial institutions consider the possible impacts relating to climate change. The business considers these risks to be longer term risks. The change in regulations may also in fact be an opportunity resulting from increased demand for low carbon solutions from our customers. Opportunities may also arise from the reduction in operational costs as a result of reducing carbon emissions from our businesses.

More encouragingly, 54% of companies had described the impact of climate-related risks and opportunities on the company's business, strategy, and financial planning (or at least one of these things). This included some companies which were not referring to TCFD within their report, so it is encouraging to see evidence of companies considering some of these matters. The challenge for many of these companies now, having identified risks and opportunities and the potential impact upon their business, is to incorporate the response to these risks into their broader group strategy and decision-making.

Despite the large number of companies identifying the impact of climate change, only four companies described, at least in part, how climate-related issues serve as an input to their financial planning process, the time periods used, and how these risks and opportunities are prioritised.

One financial services company talked of how it looked downwards to the investments it holds and assesses the financial materiality of transition and physical risks across regions, sectors and companies to understand which of these investments will perform well in a low carbon world. This then informs engagement with those investments and, ultimately, the longer term financial planning of the company itself.

In December 2019, the Bank of England issued a discussion paper to standardise climate-related scenario analysis. This aims to test the resilience of the largest banks, insurers and the financial system to different possible climate pathways.

The challenge for many of these companies now, having identified risks and opportunities and the potential impact upon their business, is to incorporate the response to these risks into their broader group strategy and decision-making.

Overall, ten companies (20%) referred to climate-related scenarios used to assess the impact of climate change upon the company, although on occasion it was difficult to see how this exercise had informed the company's strategy and financial planning. Only six of these described what these scenarios were. Some of the descriptions were brief, referring only to the temperature reduction (e.g. 1.5C or 2C). BT Group plc described at a high level the possible risks and impacts under two scenarios.

The 2°C scenario – We looked at the disruptive policies and regulatory changes of moving from today's business-as-usual to a low carbon economy. The main risks for BT of a 2°C scenario include the effect of accelerated and widespread carbon pricing; diesel and petrol vehicle bans; and higher costs for renewable energy if demand outstrips supply.

The 4°C scenario – We considered physical risks, like more regular extreme weather, and big temperature and rainfall changes. In the UK, more storms and floods could lead to more service disruption, damage to our assets (like exchanges) and provide access problems for our engineers. These could all increase our operational costs.

Globally, extreme weather could affect our customers and cause service disruption. It could also make it harder for us to source raw materials from key suppliers who operate in nearly 100 countries.

Under both scenarios we face financial risks by 2030. The most likely impact will be somewhere between the two. But there are also opportunities in a low carbon economy – particularly in how our products, services and infrastructure can help.

Tesco PLC also described two scenarios, based upon those developed by the Intergovernmental Panel on Climate Change (IPCC). After the description they went on to explain their current plans to address risks and opportunities identified in three key areas of their business.

Strategy.

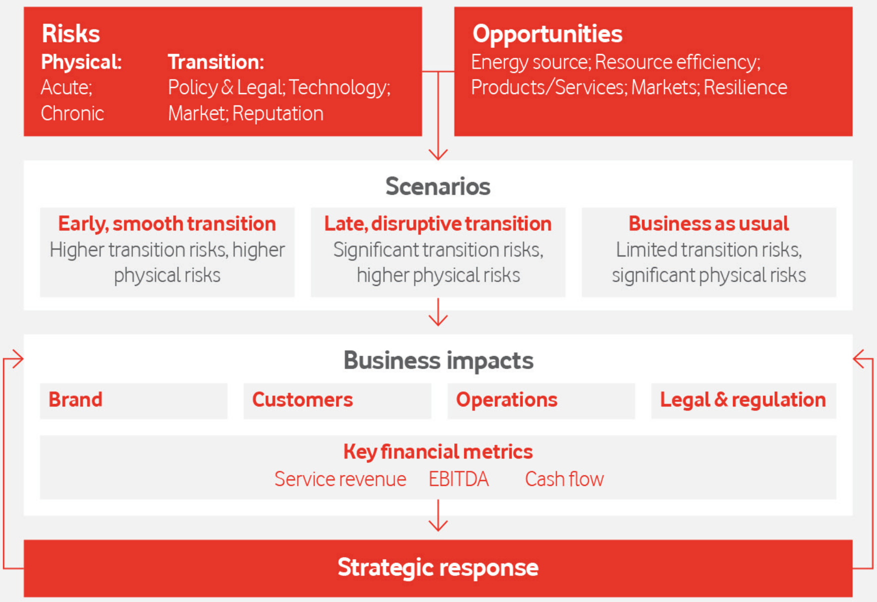
We assessed the risks and opportunities we may face in 2030 under two climate scenarios; a 'Pessimistic' scenario and an 'Optimistic' scenario. The 'Pessimistic' scenario is where the world fails to address climate change, leading to global temperatures continuing to rise well above 2 degrees. This scenario assumes limited policy or regulatory support and looks at physical climate risks. The 'Optimistic' scenario is where the world rises to the challenge of tackling climate change and limits global warming to well below 2 degrees. This low-carbon transition scenario centres on the rapid changes that will be needed by 2030 to cut emissions in line with the Paris Agreement. Our scenarios are based on those developed by the Intergovernmental Panel on Climate Change.

Our scenario analyses assessed Tesco's exposure to physical climate risks such as rising temperatures, changes in rainfall patterns and extreme weather events. Beyond physical risks, we also assessed risks and opportunities arising from a transition to a low-carbon world aligned with the Paris Agreement. These transition risks are a result of market and societal shifts related to agriculture, diets and energy use.

For produce, we focused on agricultural production by country and product. Our assessments indicate some physical risks and opportunities to our produce supply chain. For animal protein, our assessment focused on milk, beef, lamb and chicken. The assessment shows transition risks and opportunities arising from potential policy and societal shifts. To assess climate risks on our property estate, we assessed how our stores and distribution centres might fare under these scenarios.

Vodafone Group Plc used the three scenarios set out by the Bank of England for their analysis, describing each at a high level. They concluded that while the outputs of the scenario analysis will assist in either adjusting existing policies or developing new ones, especially looking at opportunities to improve business resilience and continuity, the overall aim is to provide the board with reasonable assurance of the sustainability of the business in meeting the challenges of an ever-changing global economy.

Our TCFD compliance programme



Bank of England's reference scenarios

Early, smooth transition

- Early, decisive action by society to reduce global emissions
- Coordinated policy action towards low-carbon economy
- Actions sufficient to limit global warming well below 2°C in line with the Paris Agreement

Late, disruptive transition

- Delay in the policy response needed to reduce global emissions
- Severe policy changes required to compensate late start
- Global warming is ultimately limited to well below 2°C

Business as usual

- Governments fail to introduce further policies to address climate change beyond those already known and in place
- Global temperatures increase to above 3°C

4 companies specifically referred to climate change as part of their longer-term viability statement

one stated that the financial impact of climate change had been assessed and concluded it did not impact viability

one referred to it as an example of emerging risks considered in the longer-term assessment of the group's prospects

one called out climate change risk as a specific risk considered as part of stress testing

one confirmed that uncertainties that may arise from climate change were specifically considered in scenarios modelled to assess the longer-term prospects

The TCFD 2019 Status Report concluded that of those companies using scenarios, the majority do not disclose information on the resilience of their strategies. UK quoted companies are required to disclose their assessment of the longer term viability of their business in a stand-alone statement. This implicitly requires consideration of the resilience of the company's strategy, as recommended in TCFD.

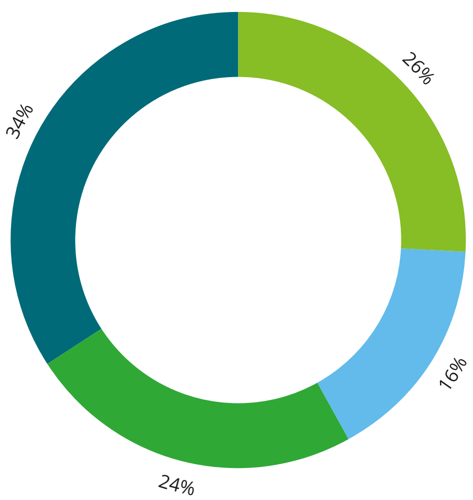
Outside of the longer term viability statement, five companies described the resilience of the company's strategy in the context of climate change, with two of these referring to scenario planning within their description. This mirrors the findings of the TCFD 2019 Status Report, which also acknowledged that companies are still early in the process of using climate-related scenarios internally, evolving their approaches, and learning how to integrate scenarios into corporate strategy formulation processes.

UK quoted companies are required to disclose their assessment of the longer term viability of their business in a stand-alone statement.

Metrics and targets

TCFD recommends disclosure of the metrics used to assess climate-related risks and opportunities in line with the company's strategy and risk management process. When reading the annual reports we looked for a clear link to climate change in relation to these questions, noting that many companies have in previous years stated GHG emissions as a KPI but without any reference to climate change.

Figure 9. Are climate-related metrics disclosed and clearly identified as such?



- Both climate related KPI and other climate related metrics
- A climate related KPI
- Other climate related metrics disclosed (none are KPIs)
- No metrics clearly linked to climate change

For the most part, climate-related KPIs related to carbon emissions, either as a quantified value or else as a percentage reduction against a base level. Some companies also stated energy efficiency or reduction and water usage. Climate-related metrics that were not KPIs tended to be more specific to company operations, although scope 3 emissions, waste and energy efficiency were particularly common.

Including a climate-related metric as a KPI, rather than disclosing it only in the depths of a corporate responsibility part of the strategic report, adds more gravitas to the metric, implying – perhaps – that such metrics are subject to higher levels of management scrutiny and regular board review. As mentioned above, the authenticity of climate-related disclosures varied, with some reporters adopting TCFD without clearly linking impact on climate change to broader company strategy. For example, there seemed to be little correlation between including a climate-related metric as a KPI and the adoption of TCFD; half of companies adopting TCFD (or working their way to compliance) had a climate-related KPI and half did not. A quarter of companies with a climate-related KPI had not indicated they had adopted the TCFD recommendations.

Connectivity with principal risks is also important and demonstrates authenticity of disclosures; of the 22% of companies citing climate change as a principal risk, a quarter did not have a KPI clearly linked to climate change, raising the question of whether and how the risk was being measured.

UK companies have long been encouraged by the FRC to disclose relevant targets for performance, and TCFD also recommends disclosing key targets used to manage climate-related risks and opportunities.

The chairman of Hammerson plc stated in his opening statement: "Targets [in respect of climate change] which are set within easy reach miss the scale of what we all have a responsibility to achieve." This echoes the importance of climate change as a key business issue and the significance of work needed to be done to meet key targets identified by the IPCC.

Irrespective of whether they had been clearly linked to the issue of climate change, it was good to see that 64% disclosed a target in relation to GHG emissions. Many of these targets referred to "net zero" by 2030, 2045 or 2050, with some companies aiming higher than that and striving to be carbon negative by 2030.

Similarly, targets for climate-related metrics other than GHG emissions were common. Hammerson plc incorporated both carbon and non-carbon elements (resources and water) within a broader target of being what they term "net positive" by 2030 (reducing carbon emissions, water demand and resource-use to less than zero).

For all of the climate-related metrics and targets identified above, only 39% of those companies explained how they all fit into their strategic approach; 19% did so for at least some of the metrics. Without that link between measurement of performance against strategy, it is unclear why the metrics are important and what the impact upon the company's business is.

64% disclosed a target in relation to GHG emissions, with a further **14%** indicating that they were in the process of establishing a target

46% disclosed targets for climate-related metrics other than GHG emissions, with a further **14%** in the process of establishing a target

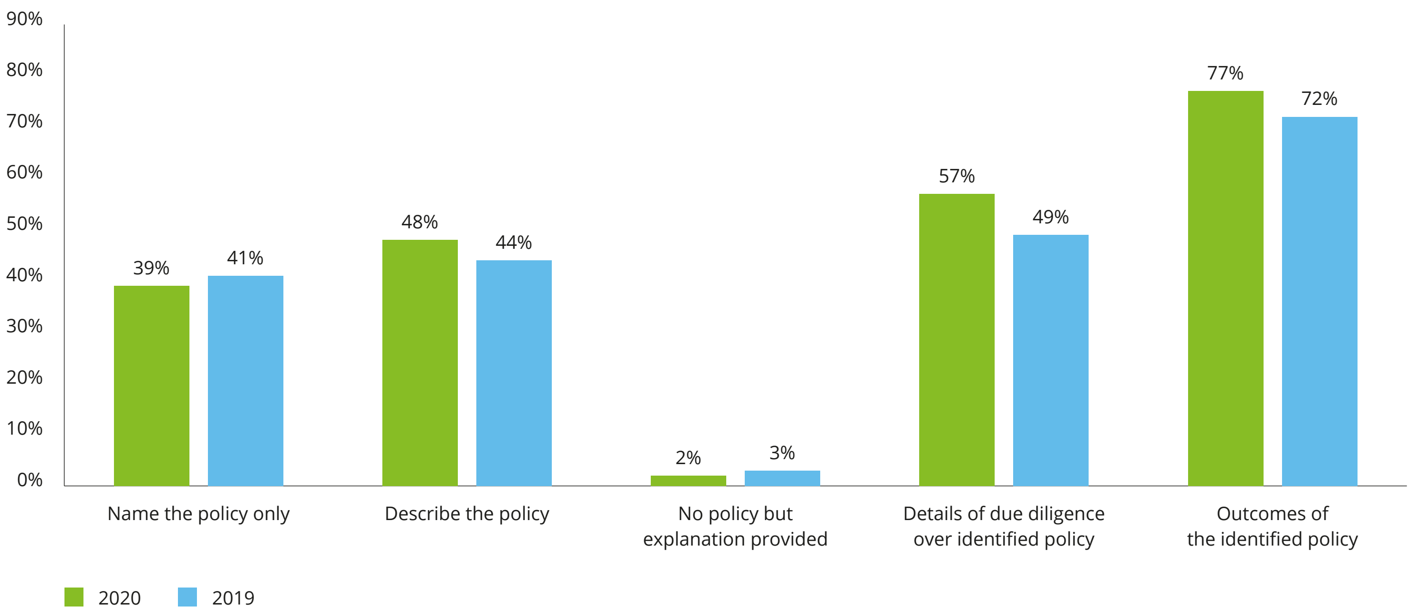
28% did not have any metrics or targets which had clearly been linked to climate change

Non-financial information statement

As noted in the People section, above, the FRC has stated that it will continue to challenge companies whose disclosures in this area appear to fall short of the requirements. It was therefore encouraging to see a marginal increase of identifiable policies relating to the environment (which is broader than simply climate change), whether described or only named, and progress in disclosing due diligence and outcomes. Environmental policies covered a variety of matters although carbon emissions, waste and water were commonly cited. Some companies had combined Safety, Health and Environmental (SHE) policies and systems over which external assurance or accreditation was gained.

Of those companies for which we could not identify relevant policies, there was a handful which had climate-related KPIs or had included climate change within their principal risks. In these instances it appeared to be the lack of clarity and signposting of the non-financial information statement (or even a lack of statement) which hindered communication of relevant policies rather than the company necessarily overlooking the matter of the environment.

Figure 10. Which elements of the NFR Regulations relating to environment were identifiable?



Disclosure of GHG emissions and SECR

All quoted companies are required to disclose scope 1 and 2 GHG emissions within their directors' report. 80% of companies considered the disclosures to be of strategic importance and so located them within the strategic report, instead.

TCFD recommends, and the UK Government strongly encourages, the disclosure of scope 3 emissions as well, being those emissions that arise as a consequence of the activities of the company but occur from sources not owned or controlled by the company. These emissions include employee travel and commuting, and the extraction and production of purchased materials.

40% went further than the legally required disclosures and stated their scope 3 emissions. These were from a variety of industries and included a few which had not made any indication of adopting TCFD.

The new SECR regulations became effective for periods commencing on or after 1 April 2019. For quoted companies SECR extends current GHG reporting by the inclusion of energy consumed (as well as GHG emissions), stating the proportion of total energy consumed and GHG emissions which related to UK activities (as opposed to global activities) and describing the principal actions taken (if any) on increasing energy efficiency.

It was encouraging to see 10% of companies comply with the new requirements, adopting them earlier than required. Of the four companies in our sample in scope of SECR, two had not clearly identified the proportion of emissions and energy consumed relating to the UK and offshore.

A further 30% adopted part of the new requirements voluntarily, either stating the total energy consumed or else outlining some of their actions taken on increasing energy efficiency. The most useful of these were those which demonstrated how the actions fitted into their broader environmental strategies – such as Hammerson plc's boxes scattered among the review of the business, detailing different energy-saving aspects of their "Net Positive" strategy – or else those which demonstrated the link between financial investment (and subsequent savings) and environmental benefit, such as BT Group PLC.

Hammerson plc

Net Positive

Our smart metering roll out is now completed at all but one of our UK flagship destinations . This is giving us live visibility of sub-metered utility demand at each asset, complete with alerts that enable the onsite teams to see and respond to spikes in demand.

This important investment is transforming the use of energy data across the portfolio and is already delivering cost savings for our tenants.

MORE **Further information on Sustainability on page 36**

Net Positive

We installed a 900kWh photovoltaic (PV) array at Les Terrasses du Port which recently became operational. It is predicted to generate 1,446MWh of electricity annually, approximately 20% of landlord demand at the asset. Costing €1.4 million, the system will save €120,000 p.a. at current electricity prices.

BT Group PLC

Decarbonise our buildings: This year we invested £45.3m in energy management projects in the UK, which cut operating costs and contributed to a global energy reduction of 65GWh. These investments have saved us £343m since 2009/10.

Unite Group PLC also linked their energy efficiency efforts back to financial impact, although without the quantification, explaining that energy consumption constitutes not only one of the most significant sources of carbon emissions but also one of their largest operating costs.

Climate change within the financial statements

An important consideration for climate-related risk upon a company, like many risks, is the impact on the financial statements. Particularly in relation to climate change and the need to transition to the low-carbon economy, there is an inherent potential cost both of action and inaction. Climate-related risks and opportunities and financial performance are interconnected, and there should be consistency between the narrative descriptions around climate change in the strategic report and the impact demonstrated in the financial statements. Investors have increased calls for companies to account for and disclose the impact of climate change in financial statements, arguing that they see this as essential to their analysis of risk and returns over time.

The call for further disclosure in the financial statements

Collective action by investors is well co-ordinated. Climate Action 100 + now has more than 370 investor signatories, representing over 35 trillion dollars of assets under management. They are targeting a list of over 160 companies that they say represent up to 80% of global industrial emissions. This includes action where they believe companies have not appropriately addressed climate change in their reporting. In the letters sent to the chairs of audit committees of the targeted companies, investors are expressing their concerns that material climate considerations may be overlooked. They say this could mean that both performance and capital are potentially overstated. They also emphasise that uncertainty around decarbonisation is not a reason to delay accounting and reporting adjustments today.

The IASB's In Brief article on IFRS Standards and Climate-related Disclosures looks at some of the potential financial reporting implications of climate change and the relevant IFRS Standards which address these, all in the context of applying materiality judgements. In particular, key estimates and judgements and the cash flow forecasts that underpin recognition and measurement of assets and liabilities are impacted by climate change considerations. This is a focus of the FRC's ongoing thematic review around climate change disclosure.[6]

It was disappointing to see the chasm between the communications in the strategic report of climate-related impact and that in the financial statements.

There was little link between narrative commentary and financial statement disclosures, with only two companies referring explicitly to climate change impacts in their financial statements. Both were in respect of impairment testing. One had built in, where it considered appropriate, the impact of climate change into their assumptions used in the value in use calculations. The other company had calculated the fair value less cost of disposal of certain assets, with cash flow forecasts being part of this.

Those cash flow forecasts included long-term price assumptions derived from median curves which included certain data points such as the impact of climate change.

One further company, Drax Group plc, set out clearly their purpose of "enabling a zero carbon, lower cost energy future" and the Group CEO's review referred to a post balance sheet decision to close their coal units. This was also cited in the financial statements as a post balance sheet event, but the main detail of accounting considerations was located in the directors' report:

Post balance sheet events

On 26 February 2020, following a comprehensive review of operations and discussions with National Grid, Ofgem and the UK Government, the Board determined to end commercial coal generation at Drax Power Station in 2021 – ahead of the UK's 2025 deadline. The Group will shortly commence a consultation process with employees and trade unions with a view to ending coal operations in September 2022. Under these proposals, commercial generation from coal will end in March 2021 but the two coal units will remain available to meet Capacity Market obligations until September 2022.

The Group currently anticipates incurring one-off closure costs of between £25 million and £35 million in the period until closure and initially expect to provide in full for these costs during 2020, where appropriate. In assessing the financial impact, the Group will also consider the useful lives, residual values and potential impairment of certain assets at Drax Power Station. The timing for completing this impairment review is uncertain as these assets remain an integral part of the site and a detailed closure plan needs to be finalised. The carrying amount of affected assets was approximately £240 million at 31 December 2019, comprising coal-specific assets with useful lives up to 2025 and other assets with useful lives up to 2039. In addition, the Group held coal inventory at 31 December 2019 with a carrying amount of £103 million, which the Group expects to recover in full over the period to closure.

There was little link between narrative commentary and financial statement disclosures, with only two companies referring explicitly to climate change impacts in their financial statements.

Another impact on the financial statements and, more directly, upon the allocation of capital is the consideration of carbon pricing. TCFD recommends companies disclose their internal carbon prices. Two companies set out their strategy to achieve their climate targets whereby the strategy includes the use of internal carbon pricing, although it was not clear whether such pricing had directly impacted anything in the financial statements in the current period. Land Securities Group PLC noted how using a carbon price can strengthen decision making and capital allocation.

3. Use an internal shadow price of carbon

To support our net zero ambitions, we calculate an internal shadow price of carbon, so we can consider the carbon cost as well as the financial cost when making investment decisions.

We established our internal price of carbon by estimating how much we're spending on carbon reduction projects currently, and how much more we would need to achieve our 2030 goals. We balance this with figures reflecting the fact that making early design decisions with a low cost increase can have significant carbon-saving potential. Our figure is in line with the Commission on Carbon Pricing's recommendation for a carbon price level consistent with the Paris Agreement, and aligned to guidance from the UN Global Compact.

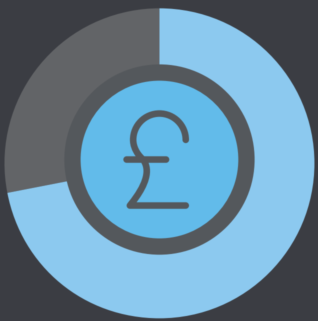
Importantly, our shadow carbon price is not a tax, but a way to strengthen our decision making, and to highlight carbon risks associated with key decisions. The risk may be an increase in the market price of carbon offsets, or the possibility of being forced by regulations to enter a carbon-emissions trading scheme.

What to watch out for

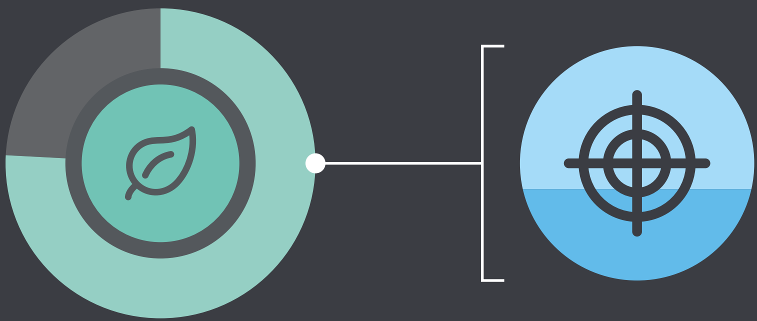
- ☐ The integration of a company's response to climate change risk within its broader strategy and processes, which is fundamental to driving action, should be reflected in the disclosures in the annual report.
- ☐ If the processes in place for identifying, assessing and then managing climate-related risks are separate from the broader risk management process, this should be explained.
- ☐ Where climate-related risk is a principal or emerging risk, the s172(1) statement provides an opportunity for boards to indicate how they have responded to the risk and, where relevant, explain how the risk has influenced their decision-making.
- ☐ When describing climate-related risk and explaining the company's strategic response to it, be sure to outline which issues impact the short, medium, and long-term, as well as the time horizons of each.
- ☐ Where climate-related risks are deemed 'principal' or otherwise significant, the connection between the risk and the metric in place to measure the impact on or the outcomes from the company should be communicated.
- ☐ Under the new SECR regulations, remember to disclose the proportion of total GHG emissions and energy consumed in the UK and offshore area – a few of the early reporters appear to be missing this.

Another impact on the financial statements and, more directly, upon the allocation of capital is the consideration of carbon pricing.

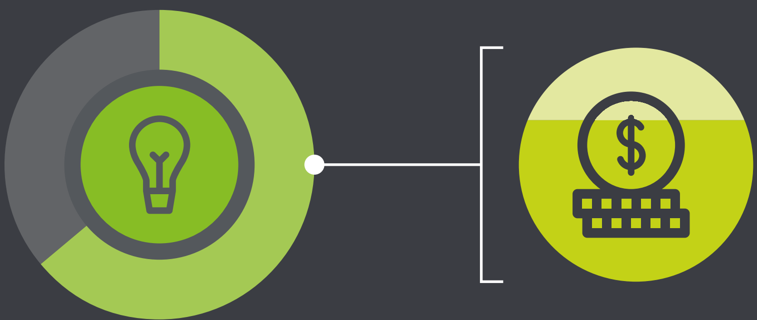
Profit



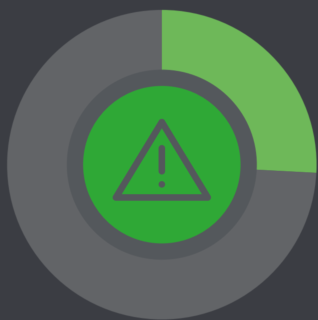
72% disclosed or described a dividend policy



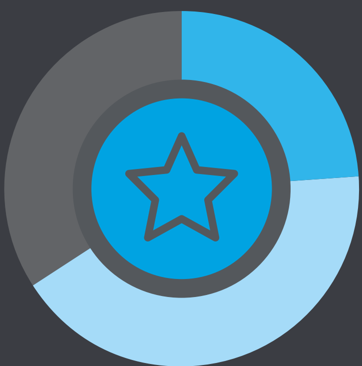
76% indicated that elements of directors' remuneration related to broader ESG factors, with 39% of those quantifying some or all targets



Of the 64% of companies that disclosed the assumptions underlying their viability statement, 69% made assumptions about the availability of funding or refinancing



Only 26% of companies clearly described the procedures in place to identify emerging risks



24% considered Brexit to be a principal risk, while a further 42% included Brexit within a broader risk

Under the triple bottom line concept of "people, planet, profit", 'profits' go beyond the financial value created by a company, and encapsulate the broader economic value generated, such as through taxes, job creation, and contribution to wider economic health. Companies operate within a wider economic ecosystem, impacting on and benefiting from economic and social prosperity in myriad ways. But society is also the source of capital for all organisations and therefore business can only thrive by ensuring the social contract is maintained, without which the sources of value that it depends on may not be sustained.

Companies operate within a wider economic ecosystem, impacting on and benefiting from economic and social prosperity in myriad ways.

In this way company purpose and company profit become inextricably linked. Profits are crucial for a company to serve all of its stakeholders over time. The company purpose guides the culture and provides a framework for decision-making, helping to sustain long-term financial returns.

In this section we consider this perspective by looking at value creation, capital allocation, remuneration in relation to ESG factors, and a company's resilience and long-term viability.

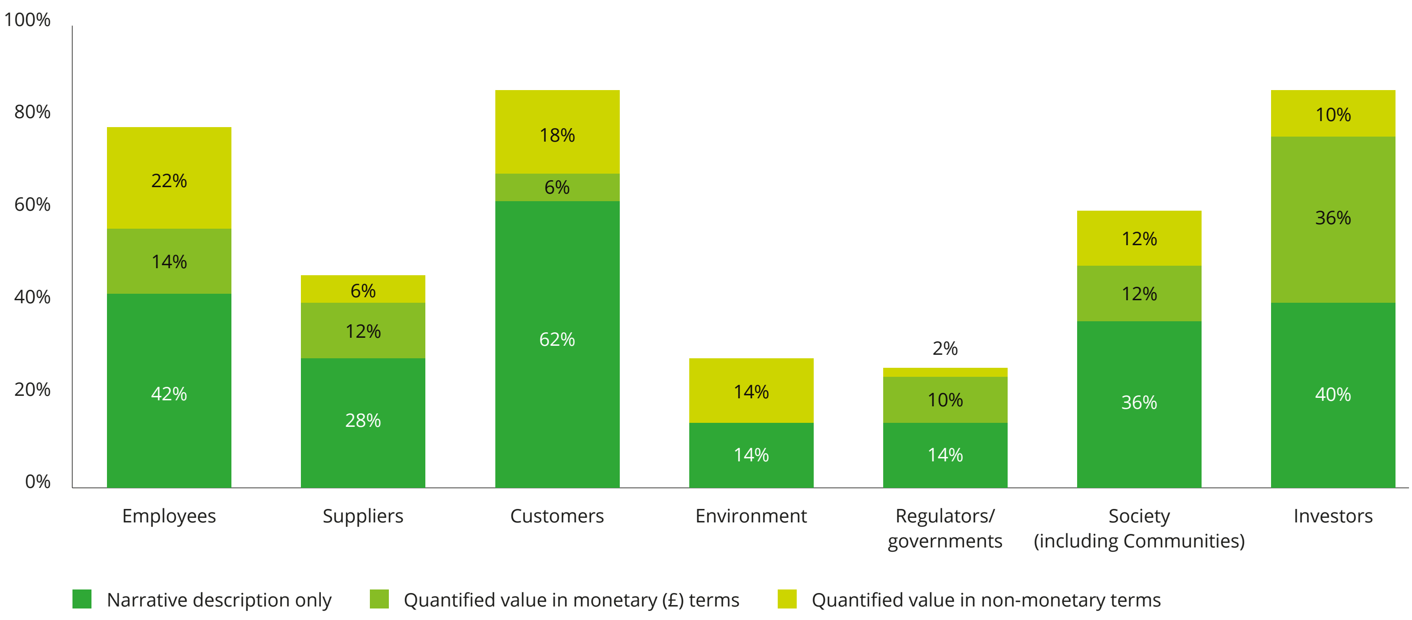
Value creation

Value is created by a business for its shareholders (for example, through dividends) and for a range of other stakeholders. This is essential in order to ensure long-term success and resilience, as these stakeholder relationships themselves can in turn affect the company's ability to create value for itself.

The FRC Guidance expects that the description of a business model should explain how the company generates and preserves value over the longer term and to be consistent with the company's purpose, although there is no requirement to quantify the value created. It is useful to do so, however, as a description of value created demonstrates what the outcomes or impacts of the business were in the year and whether this is in line with their objectives and targets. Companies can indicate how these then feed back into the business model as 'inputs' or otherwise key sources of value upon which the business depends. This dynamic between impacts the company has and its dependencies provides further insight into the resilience of the business model. Figure 11 summarises the extent to which reporters quantify value creation for stakeholders in their business model. Three companies did not clearly address value creation in their business model.

Perhaps unsurprisingly, value creation for investors, customers and employees were the most referred to. Value for investors tended to be defined in terms of strong financial returns in dividends or through a broader reference to earnings (such as earnings per share). Customer value tended to refer to strong customer service or experience. Net promoter scores (demonstrating customer satisfaction) were also common. Those companies which monetised value for customers (expressed as the value of R&D spent on developing products for customers, or the value of orders for the year) also provided a description of how their products benefited customers.

Figure 11. Is value creation discussed in the business model for the following stakeholders?



Value created for employees ranged from simply providing a job (quantifying the number of jobs in the period), to the value of wages and salaries paid, to more company-specific value creation in terms of career progression and training received.

Value created for suppliers varied from the strength of relationship to the value of orders placed with suppliers, with one retailer citing a supplier satisfaction score. Those companies that cited value created for the environment ranged from those describing their sustainable products and practices which enhance the environment to those companies describing 'value created' as a reduction in a negative impact by referring to improved environmental metrics, such as reducing GHG emissions, energy consumption or waste-to-landfill. Value created for governments or regulators tended to be described as either taxes paid (for those quantifying the value) or else a description of conducting business in line with relevant laws and regulations.

Most descriptions of value created for society or local communities (regardless of whether they were quantified) were in relation to provision of local jobs and charitable fundraising. The more informative reports in this area looked beyond merely how profits are donated to charitable causes, articulating how their operations in themselves create social value. Whitbread plc highlights in its business model the importance of choosing the right location for its hotels (considering both recruitment and broader impacts on the community) and as an outcome describes its operations as playing a key part in local communities. Elsewhere in the strategic report it describes how engagement with local communities forms a vital part of this decision-making. G4S plc linked their description of social and economic benefits they bring to the communities in which they operate to the realisation of some of the UN's Sustainable Development Goals (SDG). For example, their ordnance clearance and mine risk education contracts facilitate the safety of local communities and the opportunity for communities to rebuild their lives by returning land to productive use, achieving various SDGs, including "Peace, justice and strong institutions".

Recognition of the company's impact on and value created for broader stakeholders than shareholders is now commonplace in business model disclosures. Preparers should be careful to ensure they consider the connectivity between the business model – arguably the heart of the strategic report – and other key disclosures such as the new s172(1) statement (which also calls for discussion of the board's consideration of impact upon broader stakeholders), principal risks and KPIs measuring the impact.

Capital allocation

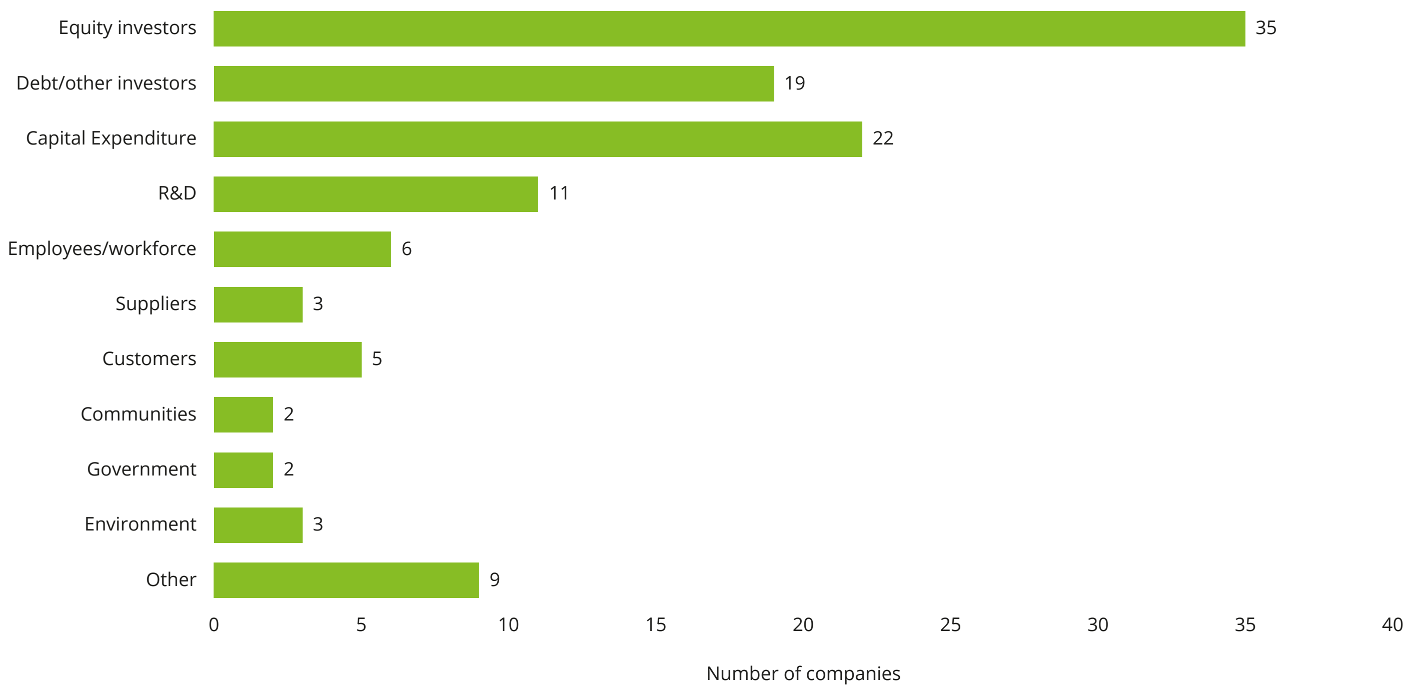
The way companies allocate financial capital and determine and communicate their dividend policy and practice are a specific area of focus for investors[7] and are high on the political agenda, particularly against the backdrop of COVID-19. Investors are challenging companies on the issue as they perceive a lack of transparency about how companies allocate surplus capital between dividends, investment (such as R&D), capital expenditure, investment in skills and training and other significant areas such as pension contributions or deficit reductions. Many institutional investors regard capital allocation decisions as being among the most important responsibilities of directors and a key area for shareholder engagement with boards because they are seen as playing a vital role in determining a company's ability to be successful in the long-term.

The FRC Guidance specifically calls out decisions around capital allocation and dividends to be a key example for boards to refer to in their s172(1) statement, as these typically impact the long-term prospects of the business. Linking these disclosures to the s172(1) statement demonstrates how the board is considering the likely long-term consequences of their decisions.

74% of companies provided an insight into capital allocation. We were looking here for specific discussion (even brief) of how capital is allocated more broadly rather than passing references to "investing in our people" or "investing in IT" without either quantifying this or providing a more in-depth description. This captured information both about how capital had been allocated in the past and how it might be allocated in the future. A number of companies referred to having a "disciplined approach to capital" or reference to a capital allocation policy which was then not clearly articulated or explored further.

Description of an overall policy and approach to allocation of capital across all strategic priorities is useful as a starting point. Further insight can be gained through discussion of capital allocation in the context of delivering on purpose and value creation for those stakeholders or matters included in the purpose. Indeed, this can provide evidence of purpose in action and stop it looking like a mere soundbite on the opening pages of the annual report. Ideally disclosures should address matters such as how decisions on capital are consistent with purpose and the narrative on broader value creation, how directors consider the balance of long-term versus short-term when allocating capital, what the trade-offs are against the various value drivers, and how investment is made in sources of competitive advantage. Such detail would also provide insight into how resilient the business model is (see below).Bringing these disclosures together in one place in the annual report can help present a fuller and more connected picture.

Figure 12. Within the capital allocation discussion, which stakeholders or matters were referred to?



Almost all disclosures about capital allocation referred to shareholders, usually with regards to dividends or share buy-back schemes. References to capital expenditure and debt were also commonplace. Many "other" matters were acquisitions or disposals. References to broader stakeholders were less common, and certainly the detail was much more limited, without much quantification of capital. Half of the disclosures about capital allocated to employees were in relation to pension contributions and management of deficits.

Based upon our understanding of the company, taking into consideration its purpose, business model, and strategy, we considered 32% of companies providing an insight into capital allocation had covered all material or the most significant stakeholders. For the remaining 68% we observed omissions of broader stakeholders which implied a narrower focus that was not consistent with the company's stated purpose, strategy or description of value creation.

Consistent with findings on the general discussion of capital allocation, whilst 54% quantified their allocation of capital, this tended to be in relation to dividends, debt repayment or capital expenditure. Some companies, where relevant, quantified their pension contributions, but otherwise there was little detail on the quantification of capital allocation in respect of other stakeholders.

The FRC Guidance suggests including a quantified analysis of allocations of free cash flow to enable users of the accounts to understand how discretionary resources have been allocated between shareholders, other stakeholders and retained in the company. This was provided by KAZ Minerals PLC in the context of their approach to sustainability.

Economic value generated and distributed

$ million	2019	2018
Direct economic value generated		
Revenues	2,266	2,162
Economic value distributed		
Operating cash costs[1]	670	659
Employee wages and benefits[2]	219	184
Payments to providers of capital[3]	277	256
Taxes paid[4]		
Kazakhstan	324	321
Kyrgyzstan	11	9
Russia	–	–
United Kingdom	–	3
Community investments[5]	22	9
Economic value retained	743	721

1 Operating cash costs as disclosed in the Financial review (page 41), being the difference between revenues and EBITDA adjusted to exclude total employee costs (see note 9 to the financial statements) and social spend, which are shown separately in the table above.
2 Employee wages and benefits are the Group's total labour costs and associated social taxes (see note 9 to the financial statements).
3 Payments to providers of capital represents interest paid on borrowing facilities and dividends to shareholders during the period (see consolidated statement of cash flows on page 130).
4 Taxes paid for each region is reflected in the payments to governments table on page 49 (see Financial review) and is the total taxes paid adjusted to remove employee and employers' payroll taxes, which are reflected within employee wages and benefits for each region and excludes social spend, reflected as community investments.
5 Community investments represents the social payments as reflected in the payments to government table on page 49.

Other reporters, such as Rotork plc, included similar quantified information in their business model where they identified value created.

Creating value in 2019

Customers
We develop solutions that improve our customers' productivity.

£692m
Order intake

17
New product launches

Employees
We create an environment where each and every employee is able to be their best.

£188m
Amount paid in wages, salaries, social security etc.

275
Sales people trained in value selling

Suppliers
We have a reputation for integrity, fair dealing and ethical behaviour.

£240m
Spend with external materials suppliers

300+
Supplier audits completed

Governments & communities
We engage positively with the community and offer support through donations and volunteering.

£33m
Corporation tax (cash paid)

3
Global charity partners

Shareholders
We have a strong track record of creating shareholder value and have increased our dividend each year for nearly 20 years.

£52m
Dividends paid to shareholders

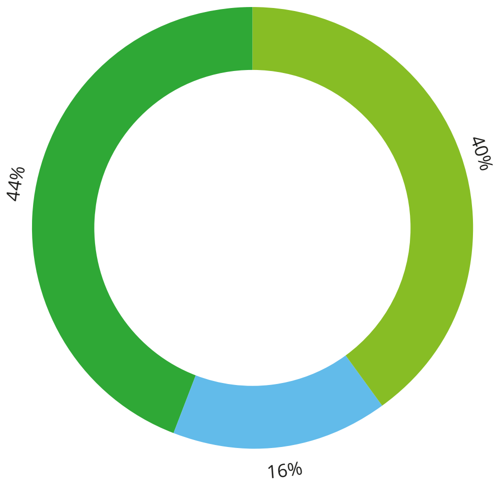
38%
Total shareholder return

More on page 52

Distributions

Investors have been calling for more insight and transparency around dividend policy, with some wanting to see an audited figure for distributable reserves within the annual report. In particular, the Investment Association has called on all listed companies to improve the transparency of their approach to paying dividends, recommending that they include their distribution policy with their annual report. The UK Government is yet to mandate any specific capital allocation or dividend disclosures, but it has stated that if sufficient progress is not made it will consider whether to mandate the disclosure of an audited distributable reserves figure.

Figure 13. Is the level of distributable profits disclosed?



With 44% of companies not clearly indicating the level of distributable reserves available, there is still work to be done by some companies to meet investors' expectations in this area.

72% disclosed or described a dividend policy. These ranged from detailed explanations, to concise although relatively unclear descriptions of a "progressive dividend policy". The FRC Lab's report on disclosure of dividend policy and its subsequent implementation study identify the key aspects that investors want to see in this area and provide a number of good examples.

G4S plc clearly identify the key considerations by the board before proposing a dividend and also state the impact of COVID-19 upon their most recent decision (see the Pandemic section, below).

Dividend

In assessing the dividend, the board considers:

- future investment requirements;
- the Group's pension obligations;
- net debt to Adjusted EBITDA;
- the availability of distributable reserves in the parent company; and
- reward to shareholders.

As announced on 23 March 2020, notwithstanding the Group's strong liquidity and robust business continuity plans, the board considers that the uncertainty relating to Covid-19 and its impact on economic activity in our key markets has increased substantially since the date of the Group's preliminary full year results announcement. In these circumstances, the board will not be proposing the payment of a final dividend in respect of the full year 2019 at the forthcoming Annual General Meeting. Once the adverse impact of Covid-19 has abated, it is the board's intention to restore the dividend, taking into account the board's objective of attaining dividend cover of 2.0x and thereafter pursuing a progressive dividend policy. For the year ended 31 December 2019, the interim dividend was 3.59p (DKK 0.2905) per share (for the year ended 31 December 2018, the interim dividend was 3.59p; DKK 0.2969 and the total dividend was 9.70p; DKK 0.8290).

OneSavings Bank plc defined its dividend policy in the directors' report and also provided a table within an "appendix" in the annual report which showed the basis of the calculation of the proposed final dividend.

Results and dividends

The results for the year are set out in the Statement of Comprehensive Income on page 162. Our dividend policy for 2020 remains a payout ratio of at least 25% of underlying profit after taxation to ordinary shareholders. The Directors recommend the payment of a final dividend of 11.2 pence per share on 13 May 2020, subject to approval at the AGM on 7 May 2020, with an ex-dividend date of 26 March 2020 and a record date of 27 March 2020. This is in addition to the 2019 interim dividend of 4.9 pence per share paid during the year (2018: 14.6 pence total dividend).

2. Calculation of 2019 final dividend

The table below shows the basis of calculation of the Bank's proposed final dividend for 2019:

	2019 £m	2018 £m
Statutory profit after tax	**158.8**	139.6[1]
Less: Coupons on AT1 Securities classified as equity	**(5.5)**	(5.5)
Tax on coupons	**–**	1.5
Statutory profit attributable to ordinary shareholders	**153.3**	135.6
Add: CCFS pre-acquisition profits	**92.5**	–
Add back: CCFS pre-acquisition exceptional items	**15.7**	–
Add back: CCFS pre-acquisition integration costs	**5.2**	–
Tax on CCFS pre-acquisition integration costs	**(1.6)**	–
Add back: Group's exceptional items	**15.6**	9.8
Add back: Tax on Heritable option	**2.6**	(2.6)
Add back: Amortisation of fair value adjustment	**21.6**	–
Add back: Inception adjustment	**(3.3)**	–
Add back: Amortisation of intangible assets acquired	**1.3**	–
Release of deferred taxation on the above amortisation adjustments	**(7.0)**	–
Less: gain on Combination	**(10.8)**	–
Add back: ECL on Combination	**3.6**	–
Pro forma underlying profit attributable to ordinary shareholders	**288.7**	142.8
Total dividend: 25% of pro forma underlying profit attributable to ordinary shareholders	**72.2**	35.7
Less interim dividends paid:		
CCFS (pre-acquisition)	**(10.3)**	
OSB	**(12.0)**	(10.5)
Proposed final dividend	**49.9**	25.2

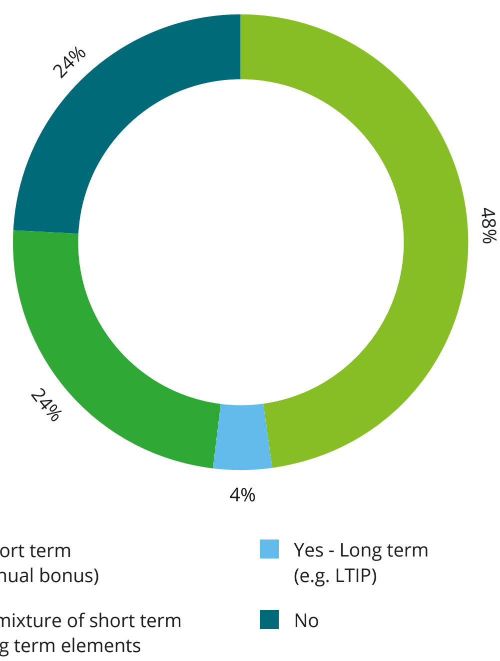
1. In 2019, the Group restated the prior year comparatives to recognise interest expense and taxation on the £22m Perpetual Subordinated Bonds previously classified as equity.

Directors' remuneration

The broader value created by a company in achieving its purpose often drives the variable elements of directors' remuneration as a means of incentivising directors to succeed in their role. The extent to which directors are taking capital out of a company is also an important part of broader capital allocation. Shareholders of quoted UK companies must approve the directors' remuneration policy and directors' remuneration is addressed in a separate part of the annual report.

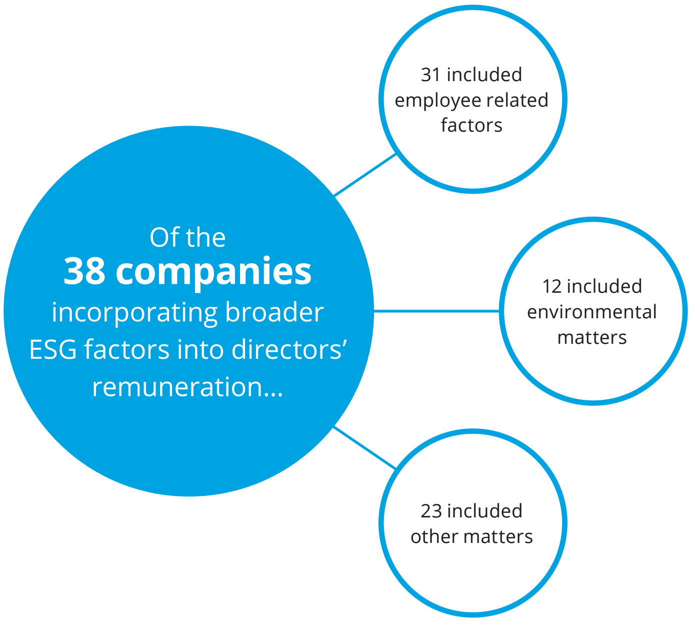
We sought to understand the extent to which ESG factors that are material to value creation over time and which are explicitly referenced as part of a director's duty in s172 are embedded in performance management and incentives. The connection between remuneration and broader company strategy, particularly the consideration of broader ESG matters, was not always clear.

Figure 14. Are there any elements of directors' remuneration relating to performance of broader ESG factors?



We looked at the most recent remuneration policies disclosed in the annual report. It was encouraging to see that 38 companies (76%) had incorporated broader ESG factors into the remuneration policy to some degree. However, not all companies were forthcoming with the types of measures that will be used in the coming year to assess performance of broader ESG factors. Where they are included, over half provided broad themes without specific measures cited (on occasion noting this was due to commercial sensitivity and would be published after the event next year; in general there was more detail in the policies for the year gone by), while 39% provided quantified targets for some or all of the measures.

The "other" matters covered in remuneration policies were often linked to customer metrics and outcomes, with some companies citing culture, regulatory compliance or other strategy-specific metrics. It was also interesting to note that those companies linking elements of remuneration to environmental matters were from a wide variety of industries, including telecommunications and food and drink, not just those that might traditionally be thought of as 'polluting'.



The proportion of directors' remuneration depending on these broader ESG performance metrics varied considerably from company to company, as may be expected, with some having as little an impact as 5% of bonus and some as much as 50% of directors' bonus; the range for longer term incentive schemes was broadly 10% to 33%.

OneSavings Bank plc set out their Business Balanced Scorecard which clearly indicated which metrics (not all of them KPIs for the group) were driving directors' remuneration, and the outcome in the year. They outlined the KPIs per category and weighting of each category for the following year, although acknowledged the targets would not be published in advance as they are commercially sensitive.

2019 performance against the Business Balanced Scorecard

		Targets[1]					
Category	**Key performance indicator**	**Threshold (25%)**	**Budget (50%)**	**Max (100%)**	**Actual result**	**Outcome CEO**	**Outcome CFO**
Financial (50%)	Underlying PBT	£192.9m	£196.9m	£204.9m	£199.1m	33.44%	33.44%
	All-in ROE	21.4%	22.4%	24.4%	23.2%		
	Cost to income ratio	31.0%	30.0%	28.0%	30.4%		
	Net loan book growth	16.2%	17.2%	19.2%	20.1%		
Customer (15%)	Customer satisfaction	45	50	60	67	11%	11%
	Broker satisfaction	27.5	30	35	26.6		
	Complaints	0.8%	0.5%	0.1%	0.1%		
Quality (15%)	Overdue actions	3	2	0	1	11.45%	11.45%
	Arrears	1.25%	1.0%	0.5%	0.96%		
	High-severity incidents	4	3	1	0		
Staff (10%)	Diversity[2]	27.0%	28.0%	30.0%	30.9%	10%	10%
	Employee engagement[3]	3	4	6	7		
Personal (10%)	Vary by executive – see section below					10%	10%
Total						75.89%	75.89%

1. Targets – based on a sliding scale between threshold, target and maximum.
2. Diversity – based on the gender diversity of the senior leadership team.
3. Employee engagement – the employee engagement score represents the number of categories which showed improvement versus the prior year.

Resilience of the business model

Capital allocation decisions, distributions made and the remuneration of executive directors provide insight into the board's perspective on the success of the business. Investors and other stakeholders increasingly expect to understand the connection between capital allocation and forward looking statements that reflect the board's views of the sustainability of the business model over the longer term. This is especially relevant in relation to investment required to enable a company to transition to a low-carbon business model.

The proposed Resilience Statement

The Brydon Report echoes the above view and considers that information about the resilience of the business is information that is critical to stakeholders. Reporting on resilience is expected to provide "more information about the likely survival of the company into an indeterminate future." The report proposes that the board makes a Resilience Statement covering three future time periods:

- A short-term statement over a period of about a year with a high degree of certainty, subject to audit (the equivalent of the current going concern period).

- A medium-term statement over a longer period detailing stress-testing or scenario-testing and explaining the directors' conclusions on that, not subject to audit but with the possibility of the directors obtaining other assurance (some of the most informative current viability statements include similar disclosure around stress-testing or scenario-testing).

- A long-term statement about business resilience describing long-term risks and the directors' analysis of the resilience of the business to those risks, not subject to audit or assurance.

As we conducted this year's survey, we focused on disclosures in the front half around sustainability of the business model and adequate disclosure of the directors' stress or scenario testing of the company's business model as part of the viability statement.

Last year, 13% of companies included disclosure around the resilience of the business model in the viability statement. This year seven companies did so – a similar number. However, the picture was quite different when we considered whether there was discussion of the resilience or sustainability of the business model elsewhere in the annual report, pushing the total number of those providing disclosures to 70%. The sharp increase is perhaps driven by Provision 1 of the 2018 Code, which includes a disclosure requirement for the board to describe the sustainability of the company's business model.

Persimmon Plc incorporates a discussion of the sustainability of the business model in the future prospects section of its viability statement, covering market positioning, strategy and fundamentals:

Key Factors in assessing the long term prospects of the Group:

1. The Group's current market positioning

- Strong sales network from active developments across the UK providing geographic diversification of revenue generation
- Three distinct brands providing diversified products and pricing deliver further diversification of sales
- Imaginative and comprehensive master planning of development schemes with high amenity value to support sustainable, inclusive neighbourhoods which generate long term value to the community
- Disciplined land replacement reflecting the extent and location of housing needs across the UK provides a high quality land bank in the most sustainable locations supporting future operations
- Long term supplier and subcontractor relationships providing healthy and sustainable supply chains
- Flexible cost structure to allow the effective response to changes in market conditions
- Increased investment to support higher levels of construction quality and customer service through implementation of the Group's customer care improvement plan
- Strong financial position with considerable cash reserves and with additional substantial working capital credit facilities maturing March 2024

2. Strategy and business model

- Clear strategy to support continued investment in sustainable, inclusive residential development opportunities for the long term benefit of local communities and other stakeholders throughout the UK
- Focusing on constructing new homes for our customers to the high quality standards that they expect and helping to create attractive neighbourhoods
- Strategy recognises the Group's ability to generate surplus capital beyond the reinvestment needs of the business
- Positioning the business to retain appropriate flexibility to mitigate the impacts of the cyclicality of the UK housing market is a key element of the Group's strategy
- Substantial investment in staff engagement, training and support to sustain operations over the long term
- Approach to land investment and development activity provides the opportunity to successfully deliver much needed new housing supply and create value over the long term
- Differentiation through vertical integration achieving security of supply of key materials and complementary modern methods of construction to support sustainable growth in output
- Simple capital structure maintained with no structural gearing

3. Principal risks associated with the Group's strategy and business model include:

- Risk of the impact of disruption to the UK economy resulting from the departure of the UK from the EU
- Market risk related to reduced consumer confidence due to regional economic uncertainties
- The risk of a reduction in mortgage funding availability and/or affordability due to reduced lender risk appetite and/or regulatory change
- Team, skills and talent related risks regarding retention and change management

See pages 58 to 63 for the full list of principal risks together with detailed descriptions.

The longer term viability statement

Much of the information called for as part of the suggested medium-term resilience statement should already be captured in a high quality longer term viability statement. Provision 31 of the 2018 Code explains the requirements:

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

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

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

All companies we surveyed prepared the viability statement over a 3 – 5 year period, with 84% looking out for three years (2019: 82%).

All companies we surveyed referred to the nature of the analysis they undertook to support the statement and all described performing one or more of modelling, stress testing, sensitivity analysis or scenario planning; some described a quite detailed modelling approach. 20% of companies had also performed reverse stress testing as part of their analysis.

Smith & Nephew provided high-level detail on the scenarios they modelled, including some numerical detail of how this was reflected in the stress testing of the business plan. They also explained the link to strategy and to principal risks (where they covered elements of their mitigation strategies).

2019 Scenarios modelled

Scenario 1 – Pricing and reimbursement pressures	
Pricing and reimbursement pressures (Principal Risk) – leading to a major loss of revenues and profits.	**Action taken:** We have modelled additional annual price erosion of 1% from 2020.
Link to strategy – Achieve the full potential of our portfolio	**Link to principal risks** – Pricing and Reimbursement
Scenario 2 – Operational risk	
Execution risk – our inability to launch new products losing significant market share to the competition.	**Action taken:** We have modelled revenue growth for China at 50% of the plan over the three-year period.
Key supplier disruption – resulting in our inability to manufacture or supply a few key products for a full year.	**Action taken:** We have modelled an interruption to receiving goods from a key supplier for a period of one year.
Temporary loss of key production capability – resulting in our inability to manufacture several key products for two years.	**Action taken:** We have modelled the loss of strategic production machinery, resulting in the loss of production and sales of several key products for two years from 2021.
Product liability claim – giving rise to significant claim or loss.	**Action taken:** One-off significant loss occurring due to a new product defect.
Link to strategy – Become the best owner. – Transform the business through enabling technologies. – Achieve the full potential of our portfolio.	**Link to principal risks** – Supply – New Product Innovation, Design & Development Including Intellectual Property. – Commercial Execution. – Business Continuity and Business Change.
Scenario 3 – Finance, legal regulatory and compliance risks	
Regulatory measures – impacting our ability to continue to sell key products.	**Action taken:** We have modelled the complete loss of revenue from a key product effective beginning of 2020 for two years and returning back in lower volumes in 2022.
Tax or treasury failure – giving rise to a significant fine or loss.	**Action taken:** We have assumed a one-off significant fine or loss resulting from a tax compliance or treasury operations issue in 2021.
Link to strategy – Become the best owner.	**Link to principal risks** – Legal and Compliance. – Quality and Regulatory. – Finance.
Scenario 4 – Cybersecurity	
Inability to issue invoices or collect money for a period of time.	**Action taken:** We have modelled one of our key regions being unable to invoice for a month in 2021 due to an IT disruption.
Link to strategy – Transform the business through enabling technologies.	**Link to principal risks** – Cybersecurity.
Scenario 5 – Mergers and acquisitions	
Failure to integrate newly acquired business effectively to achieve expected growth.	**Action taken:** We have modelled a scenario of zero growth in a recently acquired business.
Link to strategy – Achieve the full potential of our portfolio.	**Link to principal risks** – Mergers and Acquisitions.
Scenario 6 – Political and economic	
Political and economic risk – for example, political upheaval, which could cause us to withdraw from a major market for a period of time.	**Action taken:** We have modelled a loss of revenue in our Middle East markets due to global conflict for twelve months.
Link to strategy – Become the best owner.	**Link to principal risks** – Political and Economic.

> Much of the information called for as part of the suggested medium-term resilience statement should already be captured in a high quality longer term viability statement.

We considered that almost half of companies disclosed their analysis in sufficient detail to provide investors with an understanding of the nature of the scenarios they had explored and 58% of those included clear conclusions on each scenario. 36% of companies included at least some detail on possible mitigating activities. The most detailed disclosure in our sample for any individual scenario was from Next plc on the COVID-19 pandemic.

Sales Scenarios

We have modelled three scenarios for full price sales as set out below. The first scenario assumes a shorter pandemic duration. The second and third are spread out over 24 weeks. It is important to stress that no one knows, and the phasing shown below is pure guesswork. Our gut feeling is that the -10% scenario is too optimistic, and we believe the -25% scenario is overly pessimistic. The week by week progression does not make much difference to our cash resources and the number to focus on is the total quantum of lost sales rather than the timing.

Full price sales versus last year	Scenario -10%	Scenario -20%	Scenario -25%
Weeks 1 & 2	- 45%	- 45%	- 45%
Weeks 3 & 4	- 90%	- 90%	- 100%
Weeks 5 & 6	- 45%	- 90%	- 100%
Weeks 7 & 8	- 25%	- 65%	- 75%
Weeks 9 & 10	- 25%	- 65%	- 75%
Weeks 11 & 12	- 25%	- 45%	- 60%
Weeks 13 & 14	-	- 45%	- 60%
Weeks 15 & 16	-	- 25%	- 40%
Weeks 17 & 18	-	- 25%	- 40%
Weeks 19 & 20	-	- 10%	- 25%
Weeks 21 & 22	-	- 10%	- 25%
Weeks 23 & 24	-	- 10%	- 10%
Decline for affected period	**- 42%**	**- 45%**	**- 53%**
Rest of year	0%	0%	0%
Full year	**- 10%**	**- 20%**	**- 25%**

Cost Assumptions

The paragraphs below set out the way in which we have modelled the major heads of cost.

Stock We have assumed that we can cancel out of somewhere between 10% and 20% of the lost sales, saving the cost value of the stock. The later in the year the sales are lost, the greater our opportunity to cancel orders.

Clearance rates We have assumed that we will not achieve any additional markdown sales by clearing additional surplus stock. This is potentially overly conservative.

Variable costs As sales reduce, the demand for labour in our warehouses, stores and call centres would reduce. We have assumed that for warehouses and call centres, costs are 20% variable. So if Online sales drop by -10%, costs would only fall by -2%.

Retail store wages are assumed to be 30% variable to Retail sales. We believe this can be achieved mainly through not requiring staff to work more than their contracted hours and, in the short term, we would not replace leavers. In the event of a prolonged closure period, and in the absence of any Government assistance, we may have to take more radical action on wages, but we have not factored this into the model.

Online distribution costs, many of which are contracted out to a third-party on a per parcel basis, are assumed to be 65% variable.

Head office Most Head Office functions are vital to the long term future of the business and we have assumed that wages remain broadly fixed.

Bad debt We have not assumed any change in bad debt rates or payment profile though in reality payments may be a little slower than expected and bad debt may increase.

Rents We have assumed that rents and all other fixed costs are not variable.

64% of companies, an increase from 51% last year, chose to disclose qualifications or assumptions underlying their assessment. Predictably given the course of 2020, 69% of these companies made assumptions about the availability of funding or refinancing. A further 16% included assumptions either explicitly or implicitly about the future impact of COVID-19, including the length of lockdown. Although most of the companies in our survey did not have a full picture of the outcomes of the pandemic at the time they reported, it is clear that risk was risk recognised in the business environment. This compares to assumptions about availability of funding or refinancing being disclosed by only 23% of companies in 2019.

64% of companies, an increase from 51% last year, chose to disclose qualifications or assumptions underlying their assessment.

Risk management – emerging risks

Provision 28 of the 2018 Code introduces the requirement to perform a robust analysis of emerging risks in addition to principal risks for the first time. This is the first year in which companies have been required to provide disclosure in this area, which should include a description of the procedures that are in place to identify emerging risks. This is intended to help understand the approach the board takes to risks that are on the horizon and may be critical to business resilience in years to come.

Describing the procedures in place to identify emerging risks has not been done effectively by the majority of companies. We considered that only 26% of companies included a disclosure in the annual report that clearly covered this point. Disclosures that met the requirement referred to procedures such as horizon scanning, bottom-up strategic planning processes, executive board workshops, review of the macroeconomic or industry-specific landscape, in each case focused on the identification of emerging risks.

ITV plc described a recent review of its risk management framework, including emerging risks, together with ongoing horizon scanning, dialogue with the business and wider market and economic movements:

> **Principal risks**
> The recent review of our risk management framework included refreshing our principal risks and updating the way they are presented and defined. We took a blank sheet, top down approach with stakeholders across the business to better define existing risks and also identify potential emerging risks. The Divisional Boards and Management Board then took part in a series of externally facilitated workshops to assess and prioritise these risks. The outcome of this exercise is our refreshed principal risks, which have been reviewed and approved by the Board.

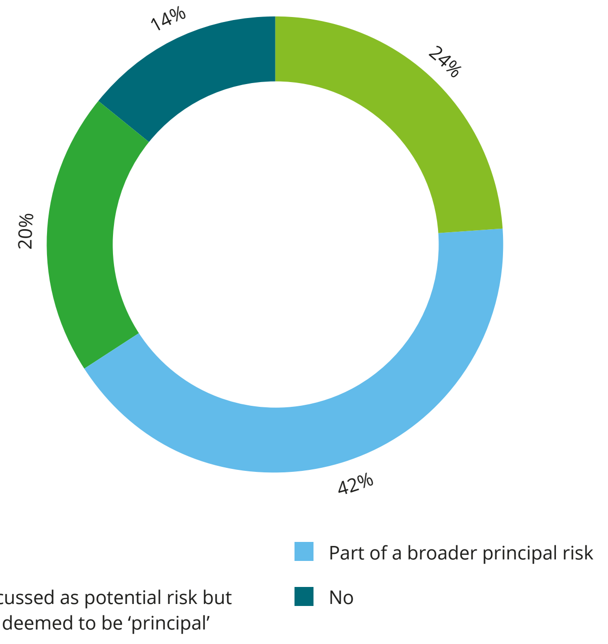
> **Emerging risks**
> We define emerging risks as uncertainties which originate from known or previously unconsidered sources, but which are not clearly understood, visible or possible to fully assess. These risks could impact over a longer period and have the potential to significantly impact our business model and/or operations.
>
> Emerging risks are identified by the business on an ongoing basis and are escalated through risk management processes and reporting. ITV's Group Risk team supports the business in identifying and highlighting emerging risks to the Board. They do this through undertaking horizon scanning, maintaining ongoing dialogue with the business and keeping up to date with wider market and environment movements.
>
> As part of our efforts to redefine our principal risks this year, we also considered emerging risk areas. We have undertaken exercises to analyse emerging risk areas in order to determine whether they should be promoted to principal risks and monitored as part of our existing risk management processes. Where the risks have not been assessed as principal risks they have been categorised as emerging risks, have been reviewed by the Board, and will continue to be periodically reported and reviewed internally.

Some companies did discuss emerging risks but with a lens of management or mitigation, which is also useful and informative but does not respond to the Code requirement to describe the procedures in place to identify emerging risks.

Risk management – Brexit

Brexit was described by many companies last year as an "emerging risk". Many companies continue to include Brexit within a broader principal risk (42%) or else call out Brexit as a principal risk in its own right (24%).

Figure 15. Is Brexit included as a principal risk?



More generally, Brexit remains a hot topic and a driver of uncertainty for many companies. 40% referred to Brexit within their longer term viability statement, while 74% mention Brexit elsewhere in their strategic report outside of the risk section. Boards are talking about it too, with 62% mentioning Brexit in their corporate governance statements, often as part of a list of key matters discussed by the board or else in the audit committee reports in relation to risk. One retailer has set up a dedicated governance steering group to discuss the group's plans and approach to manage the impact of Brexit.

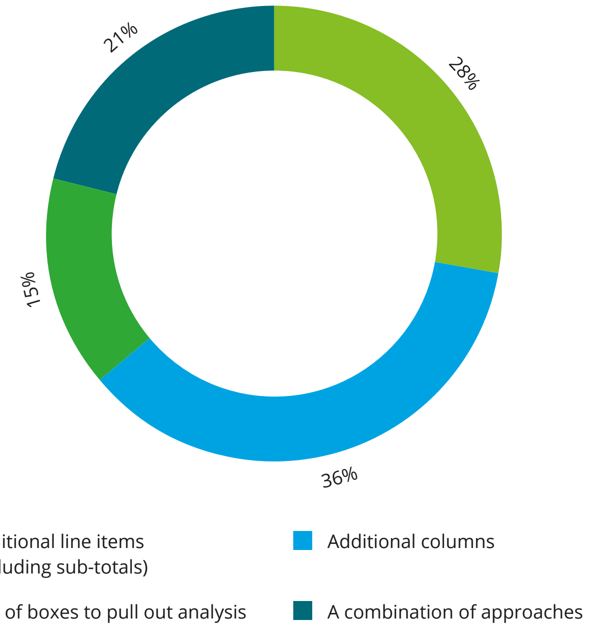
28% referred to Brexit within the financial statements, although in a small number of cases this was negative confirmation of the lack of anticipated impact.

Alternative Performance Measures (APMs)

The use of APMs continues to be commonplace by UK reporters, with many preparers believing that they serve a useful purpose in telling a company's story. APMs have been an area of focus by the FRC over recent years, being the third most commonly raised substantive issue in their 2018/2019 monitoring activity. The FRC recommend adherence to the ESMA guidelines and expect compliance.

78% of companies presented adjusted measures of profitability on the face of their income statement.

Figure 16. How are non-GAAP measures presented on the face of the income statement?



The use of additional columns (whereby typically a 'before exceptionals' column of results is presented, followed by a column of 'exceptional' figures with a third column showing the statutory total results) remains the most common way to present non-GAAP measures. The IASB's recent exposure draft on general presentation and disclosure introduces the term "management performance measures" (MPMs), broadly being subtotals of income and expenses used in financial statements that complement totals or subtotals in the IFRS Standards, and communicate to users management's view of an aspect of an entity's financial performance. The exposure draft proposes that presentation of MPMs on the face of the income statement would be restricted, with the use of columns to present MPMs prohibited entirely. Further data on the use of APMs can be found in Appendix 1.

What to watch out for

- ☐ When describing capital allocation policies or processes, consider how to stretch beyond providers of financial capital and capital investment to include discussion of other key stakeholders, how capital is allocated to address their needs, and how this fulfils the company purpose.
- ☐ Consider the consistency of and connection between those stakeholders identified in the business model as key relationships or resources, those described as for whom value is being created and those discussed by the board in explaining how they have discharged their duty under s172.
- ☐ Investors are calling for detail around dividend policies and the level of reserves available for distribution. Be sure to include this in a clear and meaningful way.
- ☐ Ensure there is clear linkage in the strategic report between the company's performance and directors' remuneration; investors are looking beyond financial measures alone to drive remuneration and seeking to understand how broader ESG factors are taken into account.
- ☐ When describing the work the board has performed on the viability statement, include enough granular information on the nature of testing and the scenarios assessed for investors to determine whether they consider the work sufficiently robust.
- ☐ Remember to include a good analysis to explain the directors' view of the sustainability of the business model, in line with Code requirements and regulator requests – the viability statement or business model disclosures may be a natural place for this.

Pandemic

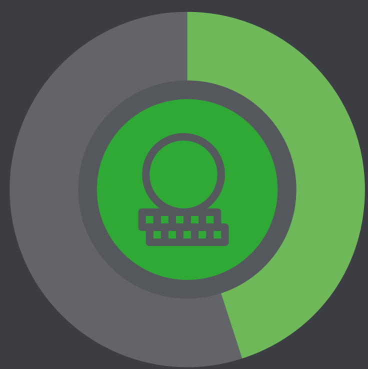
Although 100% discussed the impact of COVID-19, 55% presented a distinct section of their report to summarise their response

85% referred to COVID-19 in their s172(1) statement

All companies mentioned COVID-19 within their principal risks

No companies disclosed material uncertainties relating to going concern or a significant judgement related to that conclusion

85% acknowledged the impact of COVID-19 when discussing dividends



45% disclosed impacts of COVID-19 as exceptional in their income statement

The impact of the COVID-19 pandemic has been significant for companies across all industries and jurisdictions. In this section we look at some of the emerging trends in annual reporting for a sample of 20 FTSE 350 March year-ends. In July of this year the FRC also published their own thematic review of the financial reporting effects of COVID-19, building on the guidance they had published earlier in the year. Of course, as the situation regarding the pandemic continues to evolve and regulators issue further pronouncements and guidance, reporting trends may also continue to evolve and companies should monitor this carefully.

It was perhaps surprising that despite the uncertainty caused by COVID-19 and the relaxation of filing deadlines, on average the companies surveyed had their annual reports approved 58 days after their year-end. This was in fact a day quicker than the average FTSE 350 company approval in our prior year survey. Companies may have felt that delaying proceedings would not help to resolve the uncertainty they faced and that fulsome and transparent disclosure of forecasts, estimates made and judgements they had taken was the best way forward.

Unsurprisingly, all companies surveyed included discussion of COVID-19 and how their businesses had responded to the pandemic. BT Group PLC was an example of a company that made effective use of a COVID-19 'icon' to identify disclosure in both their narrative and financial reporting related to the pandemic. 55% of those surveyed elected to present a distinct section within their annual report pulling together different elements of the company's response, often with cross-references to where further detail could be found. Such sections were often presented as double page spreads and went on to describe companies' interactions with various stakeholders, including employees, customers, suppliers and society at large.

Governance and board response

As with the other hot topics examined in this publication, a company's response to the COVID-19 pandemic will ultimately be led by the board of directors. A number of companies set out their governance framework for dealing with the pandemic, including the role of different teams and committees in addition to the board of directors.

Severn Trent plc set out in their report their COVID-19 Governance Framework, including what the board's role was within that.

Our COVID-19 Governance Framework

Key

↑ Informs ↑ Reports

1. The Board oversees the Strategic Incident Team's response to the COVID -19 pandemic. The Board receives at least weekly updates on progress and stakeholder impacts.
2. The Strategic Incident Team leads the Company's COVID-19 response and oversees the Tactical Incident Team. The Strategic Incident Team considers how current and developing scenarios will impact in the medium term and plans an effective response to ensure the continued resilience of our operations.
3. The Tactical Incident Team is focused on ensuring that the Company maintains normal business operations, mitigates risks to core services, protects the health and wellbeing of our people and protects the health of our customers.
4. Internal controls and processes are continually reviewed and updated to enable efficient delivery throughout, and beyond, the pandemic. Read more about our system of internal control on page 94.
5. Stakeholder impacts, and wider societal benefits, are considered at all levels of our COVID-19 response, including the consequences of our decisions on them. Our stakeholder engagement process enables us to carefully consider all the relevant factors and select the best course of action. Read more about our approach to stakeholders in our s.172 statement on page 28 and stakeholder engagement section on page 24.

It was perhaps surprising that despite the uncertainty caused by COVID-19 and the relaxation of filing deadlines, on average the companies surveyed had their annual reports approved 58 days after their year-end.

All companies gave some level of insight into what the board specifically had done, although in some it appeared to be largely limited to how the board had been kept updated by management or committees during the course of the pandemic.

OUR RESPONSE TEAMS

Board

The Board has led the business's Covid-19 response – it has directed senior leadership to consider all scenarios associated with the pandemic, reviewed and considered potential response options, and set expectations for M&S's approach with each of its stakeholders and the community at large. The Board has called upon the M&S Crisis Management and Government Relations Teams to review and update them on the government's social-distancing requirements, business support measures, and policies affecting M&S as a listed business, and directed them on how to respond accordingly. Since the World Health Organization declared the virus a pandemic, the Board has had additional meetings by phone or online at least weekly to monitor the Company's ongoing response.

Operating Committee (OC)

As M&S's senior leadership team with responsibility for the day-to-day operation of the business, the OC has overseen the business's Covid-19 response under the guidance of, and as directed by, the Board. From reviewing immediate cost reduction plans to preserve liquidity, to consulting with BIG to determine colleague furloughing proposals, the OC has continued to take operational decisions in line with the Board's strategic approach, ensuring that the Board can remain focused on the long-term strategic issues and decisions associated with the pandemic.

Disclosure Committee (DC)

The DC exists to monitor the presence of inside information, ensuring that the Company adheres to the Market Abuse Regulations and fulfils its obligations as a listed Company to announce inside information as soon as possible. The DC has been instrumental in reviewing the financial impacts of the virus on the business as these become clearer alongside the potential price sensitivity of this information on the Company's listed securities, so that market announcements can be made promptly.

Business Involvement Group (BIG)

BIG is the mechanism by which the colleague voice is heard by the Board and senior leadership and has therefore ensured that colleagues are consulted and kept informed at every stage of the business's response. The National BIG Chair has attended CMT meetings throughout the crisis.

Crisis Management Team (CMT)

The CMT is a standing body with representatives from all areas of the business: Business Continuity; Corporate Communications; Clothing & Home; Food; International; Sourcing; HR; IT; Dotcom; Retail; Property; Legal; Insurance; Internal Audit; Finance. It has been responsible for determining and directing the actions required to minimise impact on the business's operations, and has provided the OC and Board with regular updates on its progress, which included the immediate closure of all Outlets stores and Clothing & Home sections of full-line stores in response to the UK's lockdown measures, and implementing social distancing and safety measures in all distribution centres and stores to ensure their continued operation. It has met regularly, often daily, to ensure that the business is reacting to the crisis in a timely manner.

Government Relations Team (GRT)

Initially, the GRT closely followed the government's position in relation to the virus, ensuring that the Board was well informed of all changes. As the pandemic progressed, the GRT's role has evolved to liaising directly with government departments to help shape virus-related policies impacting M&S as a retailer and as a listed company.

OUR RESPONSE IN NUMBERS

Board meetings	12
CMT meetings	51
Colleague announcements	70
Market updates	2
Value of product and cash donations	£928k
Charity T-shirts sold	65k
Meals donated to Neighbourly	1.29m
Charity bags for life sold	405k

* Figures as at 14 May 2020.

Marks and Spencer Group plc provided a description of each of the various response teams they had in place as a result of COVID-19.

The amount of detail provided on board-level action varied. All companies gave some level of insight into what the board specifically had done, although in some it appeared to be largely limited to how the board had been kept updated by management or committees during the course of the pandemic. Those companies may have felt that it was implicit within the broader discussions on how the company had responded to the pandemic that the board had led the company's response during that time. Other companies made it clear that the board specifically had engaged with various stakeholder groups during the course of the pandemic, as described below.

Purpose, stakeholder engagement and decisions

As noted in the recent BlackRock Investment Stewardship report, "because COVID-19 poses an existential threat for many companies, it is also straining the social contract between companies and their employees and other stakeholders". In uncertain times strong relationships with stakeholders are more important than ever in preserving a company's business model and sustaining its resilience.

Events such as the pandemic may even lead the board to reassess the company's purpose to ensure it strengthens the social contract. Vodafone, for example, provided disclosure on 'developing a new social contract' in response to COVID-19.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Developing a new 'social' contract (continued)

COVID-19: Our rapid, comprehensive and coordinated response to support society...

Vodafone is committed to doing its utmost to support society during this period of uncertainty and change. As a provider of critical connectivity and communications services enabling our digital society, we announced a five-point plan to help the communities in which we operate.

1 Maintain network service quality

In assisting governments and citizens, it is essential that we are able to maintain a minimum level of resilience and quality of service on our networks. This ensures essential connectivity and communications services, enabling citizens who are staying at home to continue to work, learn, socialise and be entertained. This was our first priority.

- As customers work from home to an unprecedented degree using video conferencing over fixed broadband, uplink data (from the customer to our network) increased by as much as 100% in some markets. Download traffic has increased by 44% in aggregate.
- Overall, mobile data usage increased by around 15% across Europe, peaking at 30% in Spain and Italy. In Africa, where there is limited fixed broadband, mobile data usage increased by around 20%, reaching 40% at its peak in South Africa.
- In response, we brought forward planned network upgrades, adding four Terabits per second of additional capacity to our networks during March and April. In our cable and fibre networks, we upgraded the number and size of interconnection points with other operators and by the end of April had increased our capacity by 60%.
- Our engineers continue to play an essential role when equipment at premises needs attention. In Germany, our 5,000 customer engineers managed to decrease repair times by around 40%, aided by the ability of customers to make immediate appointments and reduced travel times.

2 Provide network capacity and services for critical government functions

We are offering hospitals additional network capacity and services such as video conferencing and unlimited, fast connectivity for healthcare workers. This allows remote consultations, removing the need for non-essential travel to hospitals and has allowed updates and best practices to be shared between hospitals and clinical staff.

- In Italy, Vodafone has provisioned vital connectivity for new hospitals in Cuasso, Varese and the new Fiera Milano hospital in Milan.
- Vodafone UK has provided emergency coverage for temporary new hospitals including the 4,000 bed Nightingale Hospital at London's Excel Centre and similar facilities in Manchester, Cardiff and Glasgow.
- Vodafone Romania has installed new mobile sites for temporary military hospitals in Bucharest and Constanta.
- In South Africa and Lesotho, Vodacom has provided 20,000 and 1,000 devices respectively to Ministries of Health departments for field workers engaged in testing and related data collection.
- To guarantee connectivity for patients, Vodafone Spain has provided 30,000 SIMs with 60GB of data to hospitals and care centres for the elderly – ensuring that people who are affected by COVID-19 in nursing homes, residences or small hospitals can stay connected to their families.
- In Italy, Vodafone has donated more than 1,200 smartphones and tablets to hospitals, foundations and non-profit organisations to enable patients to remain in touch with relatives.
- In the UK, Vodafone has announced that 125,000 NHS workers who are existing customers will benefit from 30 day's free unlimited mobile data.
- Vodafone Germany and Corevas have repurposed and offered for free their EmergencyEye technology which was previously used to provide detailed virtual health assessments via smartphone – removing the need for patients to leave the house and lowering the risk of infections as a result.

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- In Kenya, Safaricom Foundation's Safari Smart mobile service is helping to disseminate information on infectious diseases, including COVID-19, providing more than 275,000 users with information on the signs and symptoms of the virus.
- Vodafone's Foundations in the Czech Republic and Hungary are working with their respective health ministries to provide official COVID-19 information in real-time through additional features on their Life-Saving app. The app has already reached 1.3 million Czech users and more than 500,000 users in Hungary.

Facilitating E-learning for students

With schools also now being shut, we are offering free access to government educational resources, and any other educational resources that are recommended by the national educational authorities and academic institutions.

3 Improve dissemination of information to the public

Recognising the importance of timely and accurate information to the public, we are offering all governments the ability to disseminate critical information via text alerts and providing free access to health and education sites.

- In the UK, we have zero-rated the cost for mobile users to visit the nhs.uk domain and equivalent pages in Scotland, Wales and Northern Ireland for the duration of the crisis.
- In South Africa, our ConnectU Platform provides free services on health, jobs, education, safety and security, and Government services to the public.
- In Germany, we have zero-rated digital education web pages and the official COVID-19 virus website of Robert Koch Institute and hospitals.

4 Facilitate working from home and help small and micro businesses within our supply chain

The economic repercussions of this pandemic could be significant and long lasting. To mitigate these effects, we need to help those that can to work from home. For businesses of all sizes, but particularly SMEs, we are providing remote working solutions, advice and best practice information on how to use those services in the most effective way.

- Vodafone employees alone, for example, are hosting 40,000 virtual video meetings and generating over six million call minutes every single day thanks to a rapid expansion of capacity to all of the digital tools we use.
- We are supporting Vodafone Business customers to digitalise their own companies rapidly. We have enabled as many as 2.5 million employees to work from home, many for the first time.
- We have announced faster supplier payment terms to micro and small enterprises who may have liquidity problems.
- We have provided special remote working solutions for businesses and SMEs, in particular:
  - Vodafone Hungary are offering business packages to micro and SME business customers without any loyalty contract.
  - Vodafone markets including Spain, Italy, South Africa and Kenya are offering unlimited data and special offers to SMEs for a limited period.

...ensuring vital connectivity to keep families connected, to enable businesses to operate, students to learn, healthcare to be delivered and Governments to provide critical services.

5 Improve governments' insights in affected areas

Data insights are essential to understand the effectiveness of lockdowns and the spread of the virus. Wherever technically and lawfully possible, we are assisting governments in developing insights based on large anonymised data sets.

This work falls into three broad categories: mobility 'insights', data and AI-driven modelling and contact tracing apps:

- **Mobility 'insights':** we are providing governments and public administrations with access to the mobility dashboards (live in Spain, Italy, Greece and Portugal). This mobility data is particularly useful to see if quarantine and lockdown measures have been effective and are being observed. In Italy, we used our Vodafone Analytics platform to provide Lombardy's regional government with heat maps showing how population movements changed before and after containment.
- **Data & AI-driven modelling:** We have leveraged our experience of tracking the spread of infectious diseases, like malaria in Africa, using big data and artificial intelligence techniques. We developed an epidemiologist model, in collaboration with academics from the University of Southampton and Imperial College.
- **Contact tracing apps:** We are assisting governments as they look to exit quarantine/lockdown measures, through the development of contact tracing smartphone apps. We are a member of the pan-European research consortia the Pan-European Privacy-Preserving Proximity Tracing ('PEPP-PT') that has created an open-source technology standard and Software Developer Kit to develop a contact-tracing app that works in a privacy-protected manner.

Additional actions

- In response to COVID-19 Vodafone has given direct contributions and services in-kind totalling approximately €100 million, reaching 78 million customers.
- The Vodafone Foundation has also donated €9 million in cash grants, gifts in-kind and from employee donations via the community fund.
- During the COVID-19 crisis, M-Pesa is a strong alternative to cash, offering a no-contact payment solution. Working with regulators, M-Pesa has implemented a number of measures across our African markets including enabling free person to person transactions, increasing transaction and balance limits, and flexible customer registration and on-boarding.

85% of companies made reference to COVID-19 in their directors' s172(1) statements, either directly or through cross-referencing, again often linking to disclosure on stakeholder engagement.

In their thematic review on COVID-19 the FRC stated that they expect narrative disclosures to be provided explaining how relationships with employees, customers, suppliers and others have been maintained during the pandemic.

Biffa plc provided a summary of how they had engaged with their various stakeholders during the pandemic, with cross references to where further information could be found.

Stakeholder Management

All of our stakeholders were affected in some way by the COVID-19 crisis. Our swift action and clear engagement with all stakeholders has enabled Biffa to endure these challenging circumstances in the best way possible, whilst ensuring we have continued to support these stakeholders and act fairly at all times:

Employees – our internal effort to protect our people was our top priority. From adapting staff benefits where relevant, utilising the Coronavirus Government Retention Scheme, creating an internal response team, utilising our employee app to proactively engage with our teams, offering wellbeing support and other engagement methods including letters, appreciation videos and much more.

Customers – we actively worked with customers to minimise service disruption and support them where possible. We have also enjoyed good levels of new business wins.

Shareholders – we sought to engage proactively with shareholders, participating in numerous calls with them as well as briefing broker sales teams, and releasing three RNS announcements in relation to the crisis. Our share price reaction has been consistent with our sector and the FTSE 250 overall.

Suppliers – we are extremely grateful to the many long-standing suppliers who have supported our operations through the crisis. We worked proactively with key suppliers to agree rebates, payment deferrals and discounts where appropriate.

Government and Regulators – we proactively engaged with the Government and Regulators and other industry operators to pull together as an industry, helping to develop industry guidelines and best practice in response to the crisis.

Communities – our key workers are providing an essential service to businesses and households. We were overwhelmed by the support we received from our customers and members of the public (in the form of hand-written notes, pictures and social media posts) who have expressed their gratitude for our front line workers.

You can read more on:

Principal risks on pages 34 to 38

Viability statement and going concern on page 39

How the Board Engages with Stakeholders on page 47

As discussed earlier in this publication, companies often describe their people as their most valuable asset. It therefore came as no surprise that all companies surveyed discussed the specific impact of the pandemic on their employees. These disclosures typically went beyond straightforward matters such as how remote working had enabled them to continue trading, to also include information such as:

- whether employees had been furloughed and whether redundancies were anticipated in the short term;
- changes to policies on holiday pay;
- findings from staff surveys;
- charitable initiatives launched; and
- training and other support provided.

Land Securities Group PLC provided an up-front summary in their report of how they had engaged with and prioritised the needs of different stakeholders during the pandemic, including employees, and how they had responded.

Our people

— The health and wellbeing of our people has always been our priority. All of our office-based staff were encouraged to work from home from 16 March.
— We have made changes to our policies, notably our holiday policy to ensure that staff don't miss vital family holiday time and that our business can manage the resourcing demands placed upon it.
— Our trained mental health first aiders have worked tirelessly to support all members of staff, using a range of external resources, toolkits and guides for remote working and those with caring responsibilities in the home.
— Our Senior Management have acted swiftly to provide extraordinary levels of communication via weekly videos, emails, internal intranet and regular telephone and video conferences ensuring that every staff member has some form of regular, daily contact with their line manager or team.
— For those staff whose work has been severely disrupted, we have created a skills hub for them to offer their time to teams with increased demand, thereby ensuring no one is unproductive or isolated during the lockdown.
— We are offering support to our people who continue to work in our assets.

Read more in Our stakeholders on pages 16-17

85% of those surveyed acknowledged COVID-19 when discussing their dividend policy or the dividends they were proposing. Whilst some companies indicated that despite COVID-19 they were in a strong enough position to still propose dividends, others indicated that COVID-19 had led to them deciding not to propose any dividend in the current year.

National Grid plc were an example of the former, having explicitly referenced the stress testing they had performed against a number of COVID-19 scenarios ahead of deciding to recommend a dividend in line with their usual policy. More general findings on dividend-related and capital allocation disclosures can be found in the 'Profit' section of this publication.

As described earlier in this publication, the best s172(1) statements include examples of decisions made by the directors in fulfilling their duties under s172. However, not all companies explicitly presented examples of decisions the board had taken in response to COVID-19, as distinct from those that management had taken as part of their s172(1) statements. It may have been that the directors believed that it was implicit within the broader narrative as to which decisions they had ownership of. The most common 'decision' where it was presented as clearly owned by the Board related to employee matters, such as a decision not to place employees on furlough.

Risks, going concern and viability

All companies surveyed included COVID-19 within their principal risks, either as a stand-alone principal risk having various effects, as a factor impacting various existing principal risks or through a combination of both these approaches. The best disclosures provided company-specific insight into the potential impacts of the pandemic and, again, information on stakeholder engagement was often incorporated into discussions of mitigating activities.

Vodafone Group plc commented also on their consideration of impact of COVID-19 on their systems of internal controls.

> Internal controls systems
>
> We have reviewed our financial controls and have concluded that except for a limited number of changes required as a result of remote working, primarily in relation to the form of physical evidencing of approval, the ongoing operation of our financial controls is substantially unaffected by COVID-19 restrictions. This is in part a function of the tools and processes that have allowed remote access working for finance teams. We also performed a re-assessment of the Internal Audit plan for FY21 to ensure priorities were re-aligned with areas of higher risk in the current COVID-19 impacted operating environment.

Longer term viability statements continued to look out over a time period of four years on average – no companies had changed their lookout period as a result of COVID-19 despite all the uncertainty created by the pandemic. 40% included information on assumptions they had made related to COVID-19, such as the length of the lockdown period or when they foresaw trading returning to normal levels. Additionally, 85% also indicated that they had undertaken additional stress/sensitivity testing in response to the pandemic. 35% of those companies indicated which factors they had flexed as part of their stress testing without quantification and 29% gave some form of quantification of the factors they had flexed under the different scenarios tested.

Burberry Group plc provided an example of disclosure relating to how the scenarios had been updated for the impact of COVID-19, including information on their reverse stress testing.

> **SCENARIOS**
>
> A range of downside scenarios resulting from the potential impact of COVID-19 have been developed. These scenarios were informed by a comprehensive review of the macroeconomic downside scenarios using third party projections of scientific, epidemiological and macroeconomic data for the luxury fashion industry:
>
> - The Group central planning scenario is based on a significant reduction to FY 2019/20 revenues reflecting a protracted period of lockdown and the resultant store closures and footfall declines across key regions, with a gradual improvement in FY 2021/22 and FY 2022/23.
> - As a sensitivity, this central planning scenario has been flexed to reflect a further 15% downgrade to revenues throughout the three-year period and the associated consequences for EBITDA and cash. Management consider this represents a severe but plausible downside scenario appropriate for assessing going concern and viability. This was designed to test an even more challenging trading environment as a result of COVID-19 together with the potential impacts of one or more of the Group's other principal risks.
> - For the purposes of a liquidity stress test, we flexed our central planning scenario. This test assessed a £1.6 billion (61%) revenue downgrade from FY 2019/20 in FY 2020/21, a gradual improvement in FY 2021/22 to a £0.6 billion revenue downgrade from FY 2019/20 and then flat growth in FY 2022/23. We have used this to perform reverse stress testing to understand the funding headroom limits.
>
> The reverse stress test includes the following:
>
> - A significant short-term decrease in FY 2020/21 revenue compared to the central planning scenario caused by reinfection in Mainland China and a second lockdown or a delay or slower recovery in EMEIA or Americas as well as a long-term decline in travelling consumers resulting from prolonged travel restrictions.
> - A longer-term decrease in revenue during the three-year period caused by a macroeconomic downturn depressing consumer demand.
> - Foreign exchange volatility impacted by changes to macro-economic forces.
> - The impact of one or more of the principal risks arising from one-off events, represented by a £100 million reduction in annual profit and cash, for example: business or supply chain interruptions within Burberry and its vendors as the business recovers from the pandemic, a cyber-attack resulting in significant loss of data, or additional duty costs associated with the UK's withdrawal from the European Union.

All companies surveyed made reference to the impact of COVID-19 in explaining their conclusion that it was appropriate to adopt the going concern basis of accounting. 50% of audit reports in the companies surveyed included a key audit matter relating to going concern, but no companies in our sample disclosed a material uncertainty relating to the use of the going concern assumption. Furthermore, no companies disclosed the use of significant judgement in forming their conclusion regarding going concern under IAS 1 paragraph 122. The FRC's thematic review reminded companies of this disclosure requirement, which could apply even where there is ultimately no material uncertainty.

Financial statements

All companies made reference to COVID-19 in their financial statements, although there was typically less information compared to that presented in the narrative reporting.

Not all companies surveyed disclosed discrete financial impacts recognised in the financial statements as a result of COVID-19. Of those that did, impairments of non-financial assets under IAS 36 *Impairment of non-financial assets* and expected credit losses relating to receivables under IFRS 9 *Financial Instruments* were the most common items. 45% disclosed an impact of COVID-19 in a note setting out 'exceptional items' or similar, although these amounts typically also included other non-COVID related amounts, consistent with the companies' normal accounting policies regarding such items.

The presentation of such exceptional items on the face of the income statement varied between using columns, boxes and additional line items. However, in line with the FRC's guidance relating to COVID-19, no companies were seen to present pro-forma alternative performance measures in their income statements containing 'missing' amounts such as lost revenue as a result of COVID-19.

At a time when forecasting of future performance is perhaps more difficult than ever, users cannot expect consistent assumptions to be applied and as such the disclosures required by IAS 1 on critical judgements and key sources of estimation uncertainty become more important than ever. The most commonly cited sources of estimation uncertainty impacted by COVID-19 were determining recoverable amounts of assets under IAS 36 and estimating expected credit losses under IFRS 9. However, a variety of other areas of estimation uncertainty were also repeatedly identified as having been impacted by COVID-19, including inventory provisioning and the valuation of unquoted pension scheme plan assets.

The FRC has reiterated that it expects sensitivity analysis or details of a range of possible outcomes to be provided for areas subject to significant estimation uncertainty, going on to state that it expects the number of such disclosures to increase in light of the pandemic. In some cases companies only seemed to provide sensitivity information where it was already required by a standard other than IAS 1, such as IAS 36.

It is worth remembering that IAS 36's specific requirements regarding sensitivities require, that for CGUs with significant goodwill, if a reasonably possible change in a key assumption would give rise to an impairment, the amount by which that assumption would have to change to erode the headroom needs to be disclosed. This is subtly different from disclosing the impact of changing a key assumption by plus or minus X%. In the majority of instances of those companies testing goodwill balances for impairment, estimates of CGUs' recoverable amounts continued to be based on value in use rather than fair value less costs of disposal.

At a time when forecasting of future performance is perhaps more difficult than ever, users cannot expect consistent assumptions to be applied and as such the disclosures required by IAS 1 on critical judgements and key sources of estimation uncertainty become more important than ever.

Taking into account the significant uncertainty regarding the outcome of COVID-19 and its impact on retail operations and the global economy, as well as other factors impacting the net realisable value of inventory, management consider that a reasonable potential range of outcomes could result in an increase or decrease in inventory provisions of £20.0 million in the next 12 months. This would result in a potential range of inventory provisions of 24.1% to 30.6% as a percentage of the gross value of inventory as at 28 March 2020.

Looking beyond IAS 36, and in line with FRC's call, Burberry Group plc (pictured above) provided an example of sensitivity information in connection with inventory provisioning, going beyond the requirements in IAS 2 *Inventories*.

Despite estimates of expected credit losses also regularly being cited as a key source of estimation uncertainty impacted by COVID-19, very few companies provided insight into how it had impacted their methodology for measuring such allowances.

United Utilities Group plc provided an example of disclosure on the impact COVID-19 has had on their allowance for expected credit losses for trade receivables, including some sensitivity information.

Despite estimates of expected credit losses also regularly being cited as a key source of estimation uncertainty impacted by COVID-19, very few companies provided insight into how it had impacted their methodology for measuring such allowances.

What to watch out for

- ☐ Make it clear what actions the board has taken in response to COVID-19 and the impact it has had on different stakeholder relationships.
- ☐ Provide clear disclosure on the assumptions used and judgements made in concluding on the use of the going concern assumption and the longer-term viability statement.
- ☐ Provide sensitivity analysis or details of ranges of possible outcomes relating to areas of significant estimation uncertainty.
- ☐ Avoid splitting amounts recognised in the financial statements on an arbitrary basis between portions that relate to COVID-19 and those that relate to business as usual.
- ☐ Ensure appropriate consistency, linkage and cross-referencing of COVID-19 disclosures across the annual report.

Appendix 1 – Additional findings from 100 companies

This appendix presents various statistics from surveying the larger sample of annual reports that includes 100 UK companies spread across the whole of the FTSE and is largely consistent with that used in previous years' surveys, as described in Appendix 2.

Reporting mechanics

	2020	2019
Average speed of annual report approval (days)	74	64
Fastest approval of an annual report (days)	36	30
Average report length (pages)	185	172
Average proportion of report comprising narrative reporting (as opposed to financial statements)	62%	61%
Average remuneration report length (pages)	21	18
Average length of accounting policies disclosure (where presented as a discrete section)	9	8

Key performance indicators

Companies clearly identifying their KPIs	85%
Average number of KPIs	10
Average number of non-financial KPIs	3
Companies with KPIs but no non-financial KPIs	16%

Categories of non-financial KPIs disclosed (of those presenting such metrics):	
Health & safety (employees or customers)	42%
Customer related (excluding H&S)	41%
Employee related (excluding H&S)	52%
Environmental, including climate change	39%

Principal risks and uncertainties

Average number of principal risks	11
Highest number of principal risks	34

Categories of risks disclosed:	
Workplace culture	8%
Cyber – data protection and cyber crime	85%
Cyber – Failure of IT systems	56%
Inability to keep up with technological change	35%
Defined benefit pension	14%
Tax	24%
Brexit (including as part of a broader risk)	57%

Other narrative reporting findings

Companies referencing materiality for narrative reporting as a whole	2%
Companies referencing materiality for CSR matters	20%
Materiality disclosures that gave detailed insight (for narrative reporting as a whole or CSR)	50%
Companies referring to the United Nations' Sustainable Development Goals	41%

Alternative performance measures on the face of the income statement

	2020	2019
Companies presenting APMs on the face of the income statement	74%	66%
Collective terms, where used, for measures stripped out of profit (number of companies):		
Exceptional	15	23
Adjusting	9	13
Non-recurring	1	1
Other	22	22
Items stripped out to arrive at APM (number of companies):		
Restructuring/reorganisations	36	35
IAS 36 impairment	37	28
IFRS 9 impairment	5	2
Other IFRS 9 related items	19	3
Amortisation of intangibles	35	28
Acquisition (IFRS 3) costs	24	26
IFRS 2 expense	11	7
Method of presenting APMs on the face of the income statement (number of companies):		
Extra column	22	–
Box in income statement	16	–
Box below income statement	3	–
Extra lines in P&L	19	–
More than one of the above	14	–

IAS 1 critical judgements and key sources of estimation uncertainty

Judgements clearly distinguished from sources of estimation uncertainty	77%
Average number of critical judgements	2%
Average number of key sources of estimation uncertainty	3%
Companies with no critical judgements	14%
Companies with no key sources of estimation uncertainty	2%

IFRS 16 Leases

Companies with critical judgements or key sources of estimation uncertainty relating to IFRS 16	24%
Common examples included identification of leases, determination of the lease term and arriving at an incremental borrowing rate	
Right of use assets presented separately on the face of the statement of financial position	37%
Companies with leases of intangible assets accounted for under IFRS 16	0%
Companies presenting a 'net debt' metric	54%
Net debt metrics included lease liabilities	52%
Net debt metrics excluded lease liabilities	28%
Companies presenting net debt with and without lease liabilities	20%

Other financial statement disclosures, including Brexit

Brexit referred to in going concern disclosures	4%
Brexit referred to in critical judgements and key sources of estimation uncertainty	8%
Brexit referred to in IAS 36 impairment disclosures	9%
Evidence of reverse factoring apparent from disclosures	9%
Companies with IAS 36 sensitivity disclosures appearing open to challenge in terms of correctly disclosing the amount by which key assumptions would have to change to eliminate 'headroom'	26%

Appendix 2 – Survey methodology

For many years the Annual report insights series has presented the findings of a survey of 100 annual reports of UK companies with a premium listing of their equity on the London Stock Exchange, both within and outside of the FTSE 350. This year we have adopted a different approach to facilitate a deeper look into key areas where regulators and investors are increasing their focus.

Purpose, people, planet and profit chapters

In four key areas – purpose, people, planet and profit – the publication presents the findings of a survey of 50 UK companies with a premium listing of their equity on the London Stock Exchange. The population comprises 21 FTSE 100 companies and 29 FTSE 250 companies across a range of industries. All companies had financial years ending between 31 December 2019 and 31 March 2020 and had more than 500 employees, and were therefore required to disclose both an NFI statement and s172(1) statement and were in scope of the 2018 Code. As many of these companies as possible were included within the sample used in the previous survey.

Pandemic chapter

A large number of the annual reports surveyed for the four previous chapters that were approved in February or early March 2020 made little or no reference to COVID-19. As such, in this section we look at some of the emerging trends in annual reporting regarding COVID-19 for a sample of 20 FTSE 350 March year-ends.

Appendix 1 of consolidated publication – additional findings

This appendix presents various statistics from surveying the larger sample of annual reports that includes 100 UK companies spread across the whole of the FTSE. 91 of the 100 companies are the same as those used in the previous year's survey. The population comprises 20 FTSE 100 companies (2019: 19), 39 FTSE 250 companies (2019: 37) and 41 companies outside the FTSE 350 (2019: 44). Investment trusts, other than real estate investment trusts, are excluded from the sample due to their specialised nature. The reports analysed are for financial years ended between 28 September 2019 and 31 March 2020.

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

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

Glossary of terms and abbreviations

Term	Definition
2018 Code, or the new Code	The 2018 UK Corporate Governance Code
Acc Regs Sch. 7	Schedule 7 of *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)*, as amended
the Act	UK Companies Act 2006, as amended
BEIS	The Department for Business, Energy and Industrial Strategy
BEIS Q&As	A set of frequently asked questions published by BEIS regarding *The Companies (Miscellaneous Reporting) Regulations 2018 (SI 2008/860)*
Brydon review	An independent review by Sir Donald Brydon into the quality and effectiveness of audit
Climate Action 100 +	An investor initiative encouraging large corporate greenhouse gas emitters to take necessary action on climate change
ESG	Environment, social and governance matters
ESMA Guidelines	Guidelines on Alternative Performance Measures (APMs) for listed issuers published by the European Securities and Markets Authority (ESMA). Since original publication, ESMA has published several questions and answers on the guidelines to promote common supervisory approaches and practices in the implementation of them
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FRC Guidance	The FRC's Guidance on the Strategic Report published in July 2018
FRC Lab	The Financial Reporting Lab was launched in 2011 to provide an environment where investors and companies can come together to develop pragmatic solutions to today's reporting needs. Latest reports can be found here.
FRC's Annual Review of the UK Corporate Governance Code	See this link
FRC's Annual Review of Corporate Reporting 2018/2019	See this link
GHG	Greenhouse Gases
IASB	International Accounting Standards Board
IBC	The World Economic Forum's International Business Council
Investment Association	A trade body and industry voice for UK investment managers
IPCC	Intergovernmental Panel on Climate Change, the United Nations body for assessing the science related to climate change
KPI	Key performance indicator
NFI Statement	the Non Financial Information Statement as required by s414CB of the Act
NFR Regulations	*The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (SI 2016/1245)* which implement the EU Non Financial Reporting Directive into sections 414CA and 414CB of the Act
Parker Review	An independent review by Sir John Parker into the ethnic diversity of UK boards
R&D	Research and development
s172	Section 172 of the Act which sets out certain directors' duties
s172(1) statement	The statement required by s414CZ of the Act, under which the directors must explain how they have fulfilled their duty under s172(1) of the Act
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals, a set of targets set out by the United Nations
SECR	Streamlined Energy and Carbon Reporting, as set out in *The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SI 2018/1155)*
TCFD	Task Force on Climate-related Financial Disclosures
TCFD recommendations	Recommendations as set out by the TCFD which promote voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders
TCFD 2019 Status Report	An overview of current disclosure practices as they relate to the TCFD recommendations
WEF	The World Economic Forum

Endnotes

1. https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans
2. https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter
3. https://www.iasplus.com/en-gb/publications/corporate-governance/s172-1-first-reporters
4. As required by Acc Regs Sch. 7: 11(1)
5. The statement of intent signed by CDP, CDSB, GRI, IIRC and SASB can be found at: https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf
6. https://www.frc.org.uk/news/february-2020-(1)/frc-assesses-company-and-auditor-responses-to-clim
7. For further information see the FRC's Financial Reporting Lab's report on Disclosure of dividends – policy and practice (Nov 2015) and the two implementation studies, all available at https://www.frc.org.uk/investors/financial-reporting-lab/publications

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