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A clear vision

Annual report insights 2016

The full details

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Executive summary

Maintaining a clear vision

The objective of making reports and accounts clear and concise is becoming harder to achieve. And despite everyone's best efforts the size of annual reports and accounts grows inexorably year on year. Every year this survey shows that reports are getting longer, this year by an extra eight pages.

The focus should be on producing better information rather than simply more of it. This is not an easy ask against the ever growing demands for more disclosure. For example 2015 reports had to include a full list of subsidiaries and other associated companies rather than just their principal ones and for 2016 this statutory requirement is further supplemented with the disclosure of registered office addresses, no doubt resulting in yet more pages of data in the annual reports.

The tide shows no sign of turning. Investors want more transparency on tax and dividend policy for example. The FRC's thematic review on tax and its Financial Reporting Lab's on dividend policy are starting to focus companies' attention on these two areas of public and investor interest. 38% of companies in our survey chose to provide information on distributable reserves in their financial statements, but thus far only 10% included detailed information on tax governance in their strategic report. As more companies are engaging in the broader debate around the social licence to operate we are seeing more examples of companies explaining the broader contribution they make to society and the broader impact they have, with 49% including a cross reference to where further corporate responsibility (CR) information could be found, compared to the 34% who did so in 2015.

Integrated reporting

<IR> by focusing on the long-term value creation is often seen as a useful framework to explain a company's broader contribution and impact. 71% of companies in our survey are now telling their value creation story compared with 54% in the previous year; furthermore 33% discussed how they were creating value for a variety of stakeholder groups. UK companies are using the principles and ideas of <IR> to innovate rather than following the IIRC framework dogmatically. For example, the number of companies presenting information similar to <IR> capitals when discussing their business model is up from 53% to 70% in the year and 23% provided a meaningful discussion of corporate culture, an area where the FRC are currently undertaking a project.

Eight companies in our sample described their report as an integrated report, but regardless of whether they were described as such we certainly found good examples of integrated thinking shining through. Authenticity is what really puts clear blue water between one report and another.

Changing course over the past year

There was much change over the past year. On the accounting side many parent companies bade farewell to old UK GAAP, in most cases transitioning across to FRS 101, the IFRS-based reduced disclosure framework. And the 2014 Corporate Governance Code and its accompanying guidance on risk and internal controls was the main change to take effect, including the new statement on longer-term viability.

Most companies went for a three year lookout period, but only 48% of companies gave detail on qualifications to, or assumptions made in their analysis. Alongside this companies had to provide a new statement that directors had made a robust assessment of principal risks. 85% did so, but disappointingly out of these 12% did not provide a description of risk management processes that would corroborate this assertion; also, only 63% disclosed how risk appetite had been incorporated into their risk assessment process.

Recognising the risks surrounding cyber security

Cyber security was clearly seen as a risk on the near horizon. 79% of FTSE 100 companies surveyed discussed the board's approach to dealing with this threat, though smaller companies took a more sanguine view, with 59% of FTSE 250 and only 12% of those outside the FTSE 350 including such a discussion.

The effects of Brexit

Only 16% of companies in the survey had identified a potential Brexit as a principal risk in their last annual report (being 2015 year-ends). With the referendum decision and the FRC reminders of the need to update the assessments around principal risks and uncertainties we should see a somewhat different picture in 2016. Reports will be expected to reflect the ability to navigate possibly difficult and choppy waters.

Looking to the horizon

Along with Brexit there are many issues for preparers to navigate both in the immediate future and in the years ahead. Alternative Performance Measures (APMs) feature greatly in UK reports and the biggest step-change for 2016 year-ends will be the ESMA Guidelines on this. Historically the UK regulator has been perhaps more accepting than some other regulators of their presence, but with the ESMA Guidelines now fully effective the FRC has made it clear that they will consider material non-compliance with those Guidelines when assessing whether the strategic report complies with the law and thus is fair, balanced, and comprehensive. We looked at the presence of APMs in the summary sections, which is often indicative of companies' use of APMs. Of those presenting APMs in the summary section, 72% failed to give equal or greater prominence to corresponding GAAP measures, 63% failed to provide clear reconciliations and 13% failed to provide comparative figures.

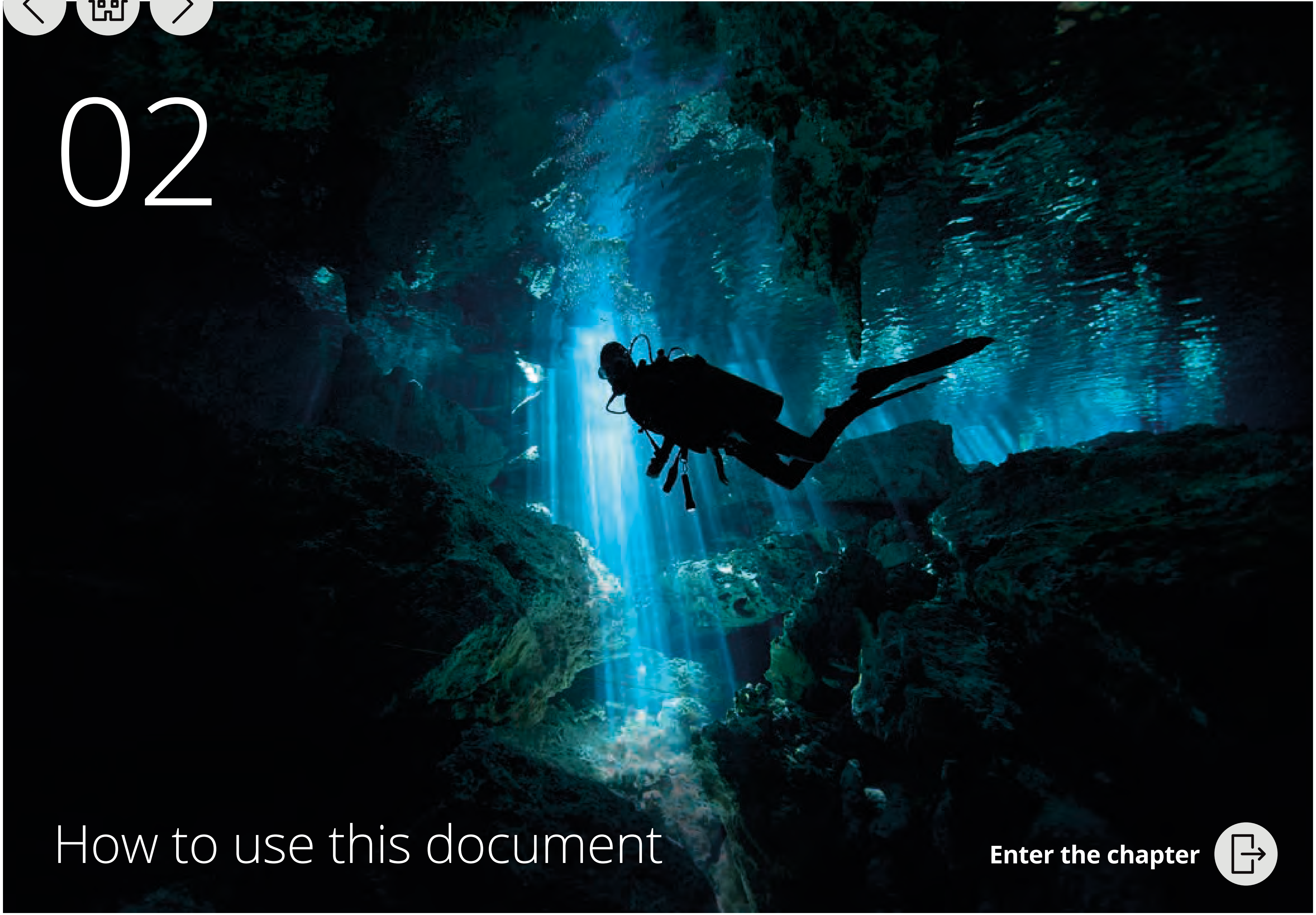
And there is also change ahead on the audit committee front as companies look to apply the 2016 Code and the revised accompanying guidance, although it is not effective until periods beginning on or after 17 June 2016. The survey shows that only 12 companies give the ratio of audit to non-audit fees. This is now a recommendation of the Guidance on Audit Committees, and only 35 companies had a relatively full description of their non-audit services policy. Where it was clear from the report that the auditor provided significant non-audit services, in only 28% of cases was there a clear description of the safeguards in place, despite the fact that this has been a recommendation for some time and is at least hinted at in the wording within the Code.

There will also be a focus on internal audit as a result of renewed attention in the new Guidance on Audit Committees. Only 41% of our sample of companies described clear reporting lines to the audit committee and so demonstrated independence from management. And only 34% described the internal audit plan being set with reference to the principal risks of the business, as is recommended by the Guidance on Risk Management, Internal Control and related Financial and Business Reporting.

With three important new IFRS standards on the way, IFRS 9 on financial instruments, IFRS 15 on revenue and IFRS 16 on leases, further disclosures about their expected impact will have to be made. Regulators and investors will be looking for quantification of the impact and, as a minimum, entity specific and detailed qualitative disclosures.

Setting a safe course ahead

Now is the time, ahead of the reporting season, to make sure everything is properly ship-shape and sea-worthy. This report has been designed with that objective clearly in view. Its insight and examples aim to help preparers develop a clear vision for their own annual reports and to help the annual report continue as the anchor of communication with investors, delivering a clear vision of a business to its readers.



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How to use this document

This publication has been written with the overriding aim of providing you, the user, with insight into current best practice in annual reporting so that you can take advantage of this knowledge and make your own report as effective as possible. It has a specific focus on areas of regulatory change, as well as those that have been highlighted by regulators and investors where companies can do better – chapter 3 and the introductions to each chapter provide an overview of these. Therefore, whether you are an audit committee member, a company secretary or a finance director; work in investor relations or the finance department, there is something in here for you.

The publication is based upon an extensive survey of the annual reports of 100 UK listed companies – see appendix 1 for details. As a result it is packed with insight into historical trends that will allow you to benchmark your own report against our sample, along with plenty of examples of good practice identified from companies across the FTSE.

In our accompanying guide ***Planning your report*** we have distilled the key pitfalls to avoid, regulatory developments to watch out for, ideas for making your report stand out and ways to ensure that it is clear and concise.

What are the benefits of a good annual report?

As one of the most important opportunities for a company to communicate with its stakeholders, the quality of its annual report helps to shape a company's reputation. And reputation is something that companies ignore at their peril – according to the 2016 UK Reputation Dividend Report[1], corporate reputations represented 38% of the FTSE 100's market capitalisation and 25% of the FTSE 250's. Therefore, the bottom line is simple – a good quality annual report can increase the value of a company. But there are other reasons to produce a high-quality report as well.

- As well as attracting investment, a strong annual report will provide good publicity with other stakeholders too, whether it be employees, customers, suppliers or society at large.

- The directors are responsible for preparing an annual report, including the financial statements, and are required by the UK Corporate Governance Code to state that they consider the annual report and the accounts, taken as a whole, to be "fair, balanced and understandable". A strong report will therefore reflect well on the quality of a company's governance.

- Prizes are awarded by a number of bodies for the best annual reports, bringing with them further prestige and good publicity.

- The Financial Reporting Council's Conduct Committee monitors the quality of corporate reporting in the UK and investigates reports that it thinks may be defective. For obvious reasons it is desirable to avoid criticism from the regulator and the bad publicity this can bring.

Which parts of this document are most relevant to me?

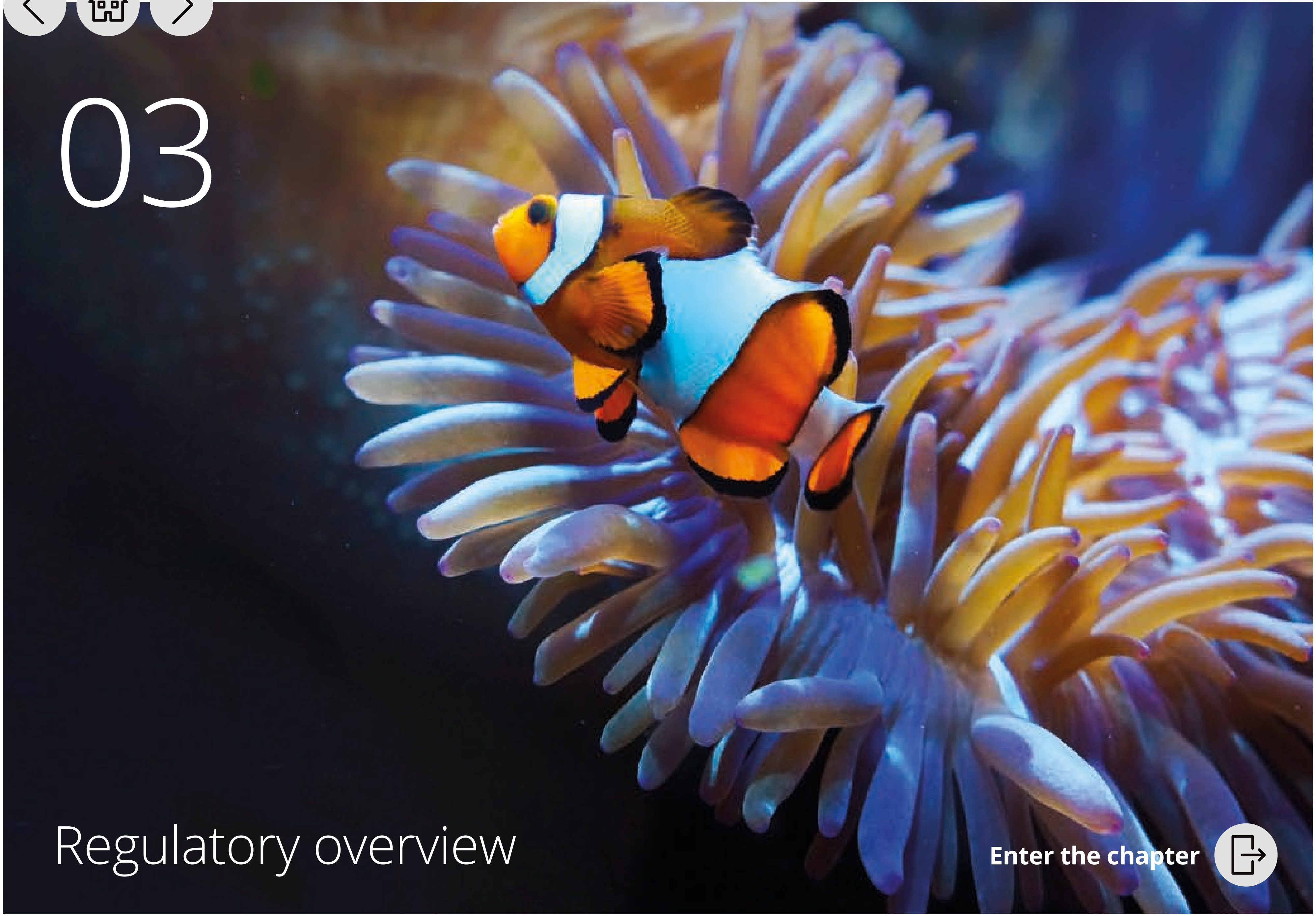
The table overleaf will help you to identify those areas of the publication likely to be of most interest to you. As well as our thoughts and findings, all of the chapters listed below contain links to further guidance and examples of good practice taken from real life annual reports.

One of the focus areas of our surveying this year is the extent to which companies are applying the principles of integrated reporting. However, rather than having a separate chapter on this, our findings have been integrated into each of the chapters that make up the report.

The publication is based upon an extensive survey of the annual reports of 100 UK listed companies. As a result it is packed with insight into historical trends that will allow you to benchmark your own report against our sample, along with plenty of examples of better practice identified from companies across the FTSE.

1 http://www.reputationdividend.com/files/7814/5441/0391/UK_2016_Reputation_Dividend_report.pdf

Theme	Chapter	What is examined?
Background information	**3.** Regulatory overview	An overview of recent and future changes in the requirements that UK listed companies are subject to, as well as regulatory hotspots.
Annual report as a whole	**4.** Overall impressions	Trends in overall report structure, from the length of the report and its various sections to the speed of reporting timetables and the cohesiveness of the report as a whole.
Narrative reporting	**5.** Summary material	How companies set the scene with an introductory summary section, covering the presentation of both financial and narrative information and the ways of linking this effectively to the rest of the report. A particular focus area this year is the presentation of alternative performance measures in the summary material.
	6. Strategic report	Disclosures in the strategic report, including the business model, objectives, strategy, presentation of business performance. Also covers corporate responsibility information such as diversity information, anti-bribery and corruption policies and human rights issues.
	7. Key performance indicators	The types of measure identified as KPIs, how they are presented and the quality of linkage to other areas, such as directors' remuneration.
	8. Principal risks and uncertainties	The effect of the adoption of the 2014 UK Corporate Governance Code on risk reporting. Also examines the risk areas commonly identified as principal, the level of detail given and ways of presenting the information effectively, including linking it to other parts of the annual report.
	9. Going concern and viability statements	The assessment and reporting of going concern and the way in which companies have complied with the requirements regarding the new viability statement.
Corporate governance	**10.** Corporate governance	The quality of disclosure given by companies regarding their compliance with the 2014 UK Corporate Governance Code, including explanations for areas of non-compliance.
	11. Nomination committee reporting	The work of the nomination committee, including the consideration given by companies to succession planning and consideration of corporate culture.
	12. Audit committee reporting	Insight into best practice around audit committee reporting, in particular the discussion of significant issues the committee has considered in connection with the financial statements and oversight of the external audit relationship.
Financial statements	**13.** Primary statements	The way in which companies present information in their primary statements, in particular the use of non-GAAP measures.
	14. Notes to the financial statements	Key findings from reviewing the notes to the financial statements, including ideas for making them clearer and more concise by improving accounting policy disclosures and ensuring consistency with narrative reporting.



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Regulatory overview

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Regulatory overview

When preparing their annual reports, UK listed companies have to follow requirements and guidance from many different sources. These require or suggest not just what should be included in the report but also how it should be presented. Some of the most significant requirements arise from:

- the Companies Act 2006 and supporting statutory instruments (the Act);
- the Listing Rules (LR);
- the Disclosure Guidance and Transparency Rules (DTR);
- the UK Corporate Governance Code (the Code); and
- International Financial Reporting Standards (IFRSs).

Companies also need to pay attention to regulatory pronouncements from bodies such as the Financial Reporting Council (FRC), the Financial Conduct Authority (FCA) and the European Securities and Markets Authority (ESMA). While not mandatory, application of the International Integrated Reporting Council's (IIRC) Integrated Reporting (<IR>) Framework is also becoming more prevalent.

This chapter sets out a brief overview of the key developments that management teams will need to bear in mind when preparing their annual reports for 2016 and beyond, as well as highlighting current areas of regulatory focus[2]. More detail on these is given in the introduction to each of the chapters of this document. The information contained in this publication is not exhaustive – other publications produced by Deloitte, such as ***GAAP: UK reporting*** and ***GAAP: Model annual report and financial statements for UK listed groups***, provide comprehensive information on all of the requirements, with the latter publication presenting a model annual report for a UK listed group. In addition, information on the latest developments, including news articles, thought pieces and supporting resources, can be found on Deloitte's one-stop-shop for all accounting, governance and regulatory matters – www.ukaccountingplus.co.uk. Where specific developments have been discussed below we have included hyperlinks to the associated pages on UK Accounting Plus, which include Deloitte publications designed to help you understand how these changes will affect you.

The big picture

The demands placed on companies in relation to their corporate reporting by regulators and investors continue to evolve. To assist companies in addressing these changing demands, the FRC continues to issue helpful guidance as part of its Clear & Concise Reporting initiative, as well as through the work of its Financial Reporting Lab. In recognition of the particular challenges faced by smaller listed companies when trying to produce high quality annual reports, the FRC is also currently in the middle of a project specifically aimed at improving smaller listed and AIM company reporting.

The centrepiece of the Clear & Concise project is the FRC's Guidance on the Strategic Report (the 'FRC Guidance'), issued in 2014, which is referred to throughout this publication. This document sets out a wealth of guidance for companies on how to communicate effectively within their strategic report, as well as how to link it meaningfully to other parts of the report. In December 2015, the FRC published Clear & Concise: Developments in Narrative Reporting, which examined the impact of the FRC's Clear & Concise initiative in general and the FRC Guidance in particular. It concluded that companies are taking on board the objectives of the FRC's Clear & Concise initiative and the overall quality of corporate reporting has improved since the introduction of the strategic report, although opportunities for further improvement still exist.

Since we published our last annual report insights survey, the Financial Reporting Lab has issued two new publications:

- Disclosure of dividends – policy and practice (November 2015), which responds to the significant interest expressed by investors in the quality of disclosure made by companies about their planned dividend payments and the resources available for this purpose; and
- The Components of Digital Reporting (June 2016), which examines some of the key findings from the previous Lab report Digital Present (May 2015) and links these to its upcoming Digital Future project.

2 Areas of regulatory focus have been identified from a variety of sources, but in particular the FRC's Corporate Reporting Review Annual Report 2015

At the time of writing, the Lab is also currently undertaking projects in the following areas:

- Business model reporting – a project exploring several characteristics of business models including how various groups define a business model, the way in which business model disclosures are prepared, how investors use business model disclosures and what good business model reporting looks like; and

- Digital Future: Data – a project that will look at how the use of technology to communicate corporate reporting to the investment community might evolve, by investigating the effect of technology trends and the potential transformation of reporting formats.

In June 2015 the FRC began the second phase of its Smaller listed and AIM company reporting project with the publication of its discussion paper Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies. This set out the FRC's findings from the first (data gathering) stage of its project and its proposals to address the challenges faced by smaller listed and AIM-quoted companies. In June 2016 the FRC published Update on the discussion paper: Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies, which provides an overview of the feedback received to the Discussion Paper and summarises the FRC's progress against the proposals that it contained. Throughout our survey we highlight areas where, from our survey data, it appears that companies outside the FTSE 350 struggle in their reporting.

As well as the work of the FRC to improve corporate reporting in the UK, the impact of Integrated Reporting (<IR>) on the UK reporting landscape continues to grow. Since the publication of the <IR> Framework in December 2013, companies have gradually began to adopt more and more of the principles set out in the Framework when putting together their annual reports, recognising the value that this gives to investors. In support of the Framework, the IIRC has published various research reports highlighting the practical outcomes of adopting <IR> in its Creating Value series. The most recent reports in this series are:

- Integrated Reporting and investor benefits, published in December 2015, which highlights the increasingly compelling evidence on the value of <IR> for investors

- The value of human capital reporting, published in June 2016, which highlights the value of reporting on human capital, sharing some of the developments and experimentation taking place in this area.

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UK corporate reporting – timeline of key changes

Effective for periods commencing on or after*:

1 January 2015	1 January 2016	June/July 2016	1 January 2017	1 January 2018	1 January 2019
CMA FTSE 350 audit tendering changes	New Accounting Regulations and corresponding changes to UK GAAP	17 June – New EU Audit Regulation and 2016 UK Corporate Governance Code, including auditor rotation rules	EU non-financial reporting directive	New IFRS for financial instruments	New IFRS on lease accounting
New UK GAAP		3 July – ESMA Guidelines on Alternative Performance Measures*		New IFRS on revenue recognition	

*The ESMA Guidelines are effective for documents issued on or after 3 July 2016, regardless of the accounting period.

Other significant initiatives

Other significant initiatives

- **FRC's Clear & Concise initiative and Smaller listed and AIM company reporting project**
- **IIRC Integrated Reporting Framework**
- **IASB disclosure initiative**
- **IASB conceptual framework project**
- **Financial Reporting Lab projects on business models and digital reporting**
- **IASB project to develop a new insurance standard**

Narrative reporting

This past year, the most significant development in narrative reporting was the changes to risk reporting requirements brought about by companies adopting the 2014 UK Corporate Governance Code. While some companies made only the minimum changes necessary to their reports in order to comply with the new requirements, others took it as an opportunity to revise their risk reporting more substantially.

Existing requirements

Other than for small companies, which are exempt, the main component of the narrative section of an annual report is the strategic report, which was introduced in 2013 by section 414A of the Companies Act 2006. Companies are also required by section 415 of the Act to include a directors' report, although since the introduction of the strategic report this contains mainly basic compliance disclosures.

The strategic report is required to include:

- a fair review of the company's business, including (for quoted companies) elements such as a description of the company's business model, its strategy and information about corporate social responsibility (see chapter 6 for more details);

- to the extent necessary for an understanding of the development, performance or position of the company, analysis using financial and, where appropriate, non-financial key performance indicators (KPIs) (see chapter 7 for more details); and

- a description of the principal risks and uncertainties facing the company. There have been some noteworthy developments in risk reporting this year, as a result of companies adopting the 2014 version of the UK Corporate Governance Code (see chapter 8 for more details).

Many companies have also chosen to present the new longer-term viability statement and revised going concern disclosures required by the 2014 Code as part of their strategic report (see chapter 9 for more details).

The FRC Guidance includes a lot of information for companies on how to present the content requirements of the strategic report most effectively. The <IR> Framework also gives guidance on reporting requirements that will be helpful to UK companies. However, the <IR> Framework goes further than this, introducing the concept of 'Integrated Thinking' – challenging and enabling companies to 'live their story' rather than merely tell it. <IR> is discussed in more detail throughout this report – look out for the <IR> boxes.

New requirements

The most significant new narrative reporting requirement that listed companies will have to deal with in their 2016/17 annual reports is ESMA's Guidelines on Alternative Performance Measures[3]. These Guidelines apply to a variety of documents but, in particular, include within their scope the narrative sections of annual reports (but not the financial statements themselves). Although they are described as 'Guidelines', ESMA has stated that they expect compliance with them to be enforced by national regulators. In a UK context the FRC has issued ESMA Guidelines on Alternative Performance Measures: Frequently Asked Questions[4], which indicate that they will be considering material inconsistencies with the ESMA Guidelines as part of the activities of their Conduct Committee i.e. reviews of company annual reports. Deloitte has produced a practical guide to the ESMA Guidelines[5] to assist preparers in complying with the new requirements.

The Guidelines apply to documents published on or after 3 July 2016, so are already in force. They set out a framework for the presentation of Alternative Performance Measures (APMs), also known as non-GAAP measures, aimed at promoting their usefulness and transparency. In particular, they require that:

- APMs should be defined and the basis of calculation set out;

- APMs should be reconciled to the most directly reconcilable line item, subtotal or total presented in the financial statements;

3 http://www.iasplus.com/en-gb/news/2015/06/esma-apm
4 http://www.iasplus.com/en-gb/news/2016/05/frc-apm
5 http://www.iasplus.com/en-gb/publications/uk/need-to-know/2016/ntk-apms

1 2 3 4 5 6 7 8 9 10 11 12 13 14 Appx. 1 Appx. 2 Contacts Resources

- APMs should not be displayed with more prominence, emphasis or authority than the most directly comparable measure defined by the entity's financial reporting framework;

- APMs should be accompanied by comparatives for the corresponding previous period; and

- APMs should be consistent over time, with changes in or the cessation of use of an APM explained.

Our findings on the presentation of APMs are discussed in chapters 5 (in relation to use of APMs in summary material) and 7 (in relation to the presentation of KPIs).

Areas of regulatory focus
The following areas of regulatory focus have been identified in relation to narrative reporting.

- Making the report (being both the narrative and the financial statements) **clear and concise**. Measures such as removing immaterial information and making effective use of cross-references to avoid duplication can help preparers meet this challenge. Companies should consider whether initiating a 'Clear and Concise review' would be beneficial.

- Presentation of **non-GAAP measures** is likely to be a significant focus area given the new requirements introduced by the ESMA Guidelines. In addition, the identification of items excluded from non-GAAP measures (often described as 'exceptional items') is also likely to be an area of continued focus – see the financial statements section of this chapter for more detail.

- The business review included within the strategic report should be **fair, balanced and comprehensive**. This includes balancing analyses that use non-GAAP measures with analyses that use unadjusted metrics, ensuring discussions of performance and position are suitably comprehensive and not omitting 'bad news'. Companies should also ensure that they cover all relevant aspects of both financial position and performance in this review.

- Identification of **principal risks and uncertainties**. Companies should ensure that the risks and uncertainties disclosed are genuinely principal and make sure they discuss how risks are managed or mitigated.

- Identification of **key performance indicators (KPIs)**. Companies should consider whether ratios that are discussed prominently in the strategic report should be identified as KPIs, and that where non-GAAP measures are identified as KPIs the information required by the ESMA Guidelines is given.

- The **linkage and consistency** of the information included in the 'front half' and 'back half' of the annual report. Companies should ensure that there is cohesion between the information reported and effective linkage throughout the annual report. For example, consistency would be expected between the items identified as part of capital when discussing capital management in the front and back halves of the report. Similarly, the description of reconciling items in a company's tax note should be consistent with discussions in the strategic report.

- Compliance with the Companies Act requirements regarding **employee numbers** and **greenhouse gas emissions**. The Act is quite prescriptive regarding the content of these disclosures so companies should ensure that they are providing the correct information.

On the horizon
The only forthcoming change to narrative reporting is the UK implementation of the EU Directive on disclosure of non-financial and diversity information. Various consultations on other additional reporting requirements for companies (Closing the Gender Pay Gap[6] and Improving Large Business Tax Compliance[7]) have concluded that the information they are proposing should be provided in a separate document, rather than as part of a company's annual report. However, where issues in this regard are material to the business, companies will need to consider whether disclosure should also be provided to meet the above requirements of the strategic report.

6 http://www.iasplus.com/en-gb/news/2015/07/consultation-gender-pay-gap

7 http://www.iasplus.com/en-gb/news/2015/07/tax-strategy-consultation

2016 is also the first year that companies will need to be publishing a slavery and human trafficking statement, as required by the Modern Slavery Act 2015[8]. This is a statement outside of the annual report, although again companies should also consider whether this needs to be mentioned in the strategic report (34% of the companies we surveyed this year did – see chapter 6).

The EU Directive on disclosure of non-financial and diversity information has yet to be transposed into UK law, despite EU law requiring it to become effective for financial years beginning on or after 1 January 2017. It will apply to all companies that are:

a. public-interest entities, as defined by EU law (which includes all companies with debt or equity listed on a regulated market, such as the LSE main market); and

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

For large listed companies, it will build on existing diversity disclosure requirements so that such companies will also be required to provide information on their diversity policy, covering age, gender and educational and professional background in their corporate governance report.

Also, it will introduce a specific requirement to disclose information on anti-corruption and bribery matters, including related policies. The government consulted on its implementation in the UK in February 2016[9] but is still deliberating on how to address the comments received.

Corporate governance

This past year the revised 2014 version of the UK Corporate Governance Code (the '2014 Code') and supporting Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[10] became effective, bringing in changes to the requirements around governance reporting as well as the changes to risk reporting and the new viability statement discussed earlier in this chapter.

Existing requirements

Listed companies are required by the Listing Rules to make certain disclosures about corporate governance in their annual reports. Companies with a premium listing are required to state how they have applied the main principles set out in the UK Corporate Governance Code (the Code), in a manner that would enable shareholders to evaluate how the principles have been applied, and a statement of compliance with all relevant Code provisions, identifying provisions that have not been complied with and providing reasons for this non-compliance. During the period covered by this year's survey companies had to report on their compliance with the 2014 Code, which is supported by the associated FRC documents Guidance on Risk Management, Internal Control and Related Financial and Business Reporting and the 2012 version of the Guidance on Audit Committees, both of which recommend various disclosures for inclusion in the annual report.

The main components of a company's corporate governance report are:

- a report on how the company has applied the main principles of the Code, including or cross-referring to the internal control statement and the statement of compliance with the Code, often with an introduction from the chairman (see chapter 10 for more details);

- a report on the work of the audit committee, in particular its oversight of the preparation of the financial statements and the significant issues considered, as well as its oversight of the auditor relationship, including effectiveness, tendering requirements and non-audit services (see chapter 12 for more details); and

- reports from the other significant board committees, in particular the nomination committee (see chapter 11 for more details) and the remuneration committee.

Quoted companies reporting under the Act are also required to include a directors' remuneration report. The remuneration report must contain a statement by the chair of the remuneration committee telling the story of the year in respect of remuneration. Following this the report is split into a policy report (not subject to audit) and an annual report on remuneration (some elements of which are subject to audit). The policy report is subject to a binding shareholder vote every three years, or whenever the policy is to change. The annual report on remuneration is subject to an annual advisory vote and includes a 'single figure' directors' remuneration table. The GC100 and Investor Group has published guidance on these requirements, which was updated in August 2016[11].

8 http://www.iasplus.com/en-gb/publications/corporate-governance/governance-in-brief/gib-modern-slavery-act

9 http://www.iasplus.com/en-gb/news/2016/02/bis-non-financial-reporting-directive

10 http://www.iasplus.com/en-gb/news/2014/09/frc-publishes-2014-code

11 http://uk.practicallaw.com/2-632-2324

Some companies have also chosen to present the new statements on the robust assessment of principal risks, longer-term viability, and the revised going concern disclosures required by the 2014 Code as part of their corporate governance report, although the majority have presented these as part of their strategic report (see chapters 8 and 9 for more details).

New requirements

There are no new governance reporting requirements that companies need to address until they adopt the revised 2016 Corporate Governance Code, which applies for periods commencing on or after 17 June 2016 (so not applicable to December 2016 year-ends) and is discussed below. However, companies will need to ensure that they have the necessary processes and procedures in place by the commencement of this period, for example in relation to auditor rotation and non-audit services.

Areas of regulatory focus

In relation to governance there are several areas of regulatory focus at the moment.

- The **quality of explanations** given where a company does not comply with one or more provisions of the Code. In a letter to investors sent in May 2016, ahead of the 2016 shareholder meeting season, the FRC reminded investors that companies should "set out the background to the matter, provide a clear rationale for the action being taken and describe any mitigating activities" when departing from Code provisions. It also encouraged investors to challenge companies where they believe explanations are inadequate.
- The level of detail given in the audit committee report, including in relation to **significant financial reporting issues** considered by the committee, how the committee has assessed the **effectiveness of the external audit** and **safeguards on non-audit services**. This year in particular, disclosure around auditor rotation is likely to be a key focus area.
- **Succession planning** and **corporate culture**, which are discussed in more detail in the next section.

On the horizon

2016 Corporate Governance Code

For financial years commencing on or after 17 June 2016, the 2016 Corporate Governance Code replaces the 2014 Code. However, the changes are minimal, with only a few amendments to section C.3.

- The audit committee as a whole will be required to have competence relevant to the sector in which the company operates.
- The Code provision on audit tendering for FTSE 350 companies is removed, as it is superseded by the Competition & Markets Authority Order and other regulations.
- The audit committee report will be required to provide advance notice of plans to retender the external audit.

At the same time a revised version of the FRC's Guidance on Audit Committees also becomes effective, updated to include guidance on the committee's new responsibilities. A new ethical standard for auditors is also introduced, which places some additional restrictions on the non-audit services that can be provided by the external auditor.

With the UK implementation of the revised EU Auditing Directive also completed by 17 June 2016, the changes that this introduces regarding auditor rotation and tendering will also come into force for periods commencing on or after that date. All listed companies are now required to tender their audit at least every 10 years, with a change of auditor required at least every 20 years.

Succession planning

The FRC is currently undertaking a project on succession planning, with a Discussion Paper[12] published in October 2015 and a feedback statement[13] on this in May 2016. The discussion paper explored six areas that the FRC considers to be important to succession planning:

- how effective board succession planning is important to business strategy and culture;
- the role of the nomination committee;
- board evaluation and its contribution to board succession;
- identifying the internal and external 'pipeline' for executive and non-executive directors;
- ensuring diversity; and
- the role of institutional investors.

The feedback statement summarises the responses received to the FRC's proposals. In particular, there was some support for further guidance, particularly in relation to the role of the nomination committee and on reporting on succession planning. The final outcome of this project is expected to be changes to the FRC's Guidance on Board Effectiveness, made in conjunction with the outcome of its Corporate Culture project.

Corporate Culture

The FRC has recently published the results of its study on corporate culture[14]. This was a joint project undertaken together with various other organisations aimed at gathering practical insight into corporate culture and the role of boards; understanding how boards can shape, embed and assess culture; and identifying and promoting best practice. No changes to the Code are planned as a result of this project, however the FRC will use the observations in this report, and any feedback received, to update its Guidance on Board Effectiveness, in conjunction with the outcome of its succession planning project.

Remuneration reporting

The Executive Remuneration Working Group, established by the Investment Association, has recently issued a report[15] which provides ten recommendations "to rebuild trust in executive pay structures in the UK". One of its recommendations includes a proposal to the FRC that the Corporate Governance Code should be amended to reflect what is already seen as 'best practice' in determining executive remuneration.

Financial statements

No major changes in IFRSs came into force for the reports covered by our survey this year, nor will they in the reporting season ahead. However, other than for the September year-end companies in our sample, this past year has seen the transition of company-only reporting from old UK GAAP to IFRSs or one of the new UK GAAP frameworks, principally FRS 101.

Existing requirements

Listed groups are required to prepare consolidated accounts under IFRSs as adopted by the EU and this will remain the case for the foreseeable future, despite the outcome of the referendum on the UK's membership of the EU. Listed entities that are not parent companies, such as many investment trusts, can also choose to prepare financial statements using FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Financial statements consist of two main sections:

- the primary financial statements, comprising the income statement, statement of comprehensive income, statement of financial position, statement of changes in equity and statement of cash flows (see chapter 13 for more details); and
- the notes to the financial statements (see chapter 14 for more details).

12 http://www.iasplus.com/en-gb/news/2015/10/frc-dp-board-succession-planning

13 http://www.iasplus.com/en-gb/news/2016/05/frc-feedback-statement-dp-board-succession-planning

14 http://www.iasplus.com/en-gb/news/2016/07/frc-report-corporate-culture

15 http://www.iasplus.com/en-gb/news/2016/07/erwg-executive-pay

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The separate financial statements of a 'qualifying entity' can be prepared under FRS 101 *Reduced Disclosure Framework*, which closely reflects IFRS accounting but with reduced disclosures. If eligible, this may be an attractive option for many parent companies' separate financial statements and for their subsidiaries. Another option is to apply FRS 102 with reduced disclosure. At the moment, to apply FRS 101 or FRS 102 with reduced disclosures a company must notify its shareholders in writing and they must not object to its use, although the FRC is currently consulting on the removal of this requirement.

New requirements

To the right is a list of the new IFRS requirements coming into force for financial years ending between September 2016 and August 2017 (depending in some cases on whether IFRSs as endorsed by the EU or as issued by the IASB are being applied). Hyperlinks to further information are included in the table.

For periods commencing on or after 1 January 2016, changes to the Accounting Regulations come into force, which alter various disclosure requirements of the law, primarily for small companies. However, two changes that will be relevant to listed companies are:

- the requirement to disclose the registered office of all subsidiaries and other significant investments, further expanding the requirement to disclose the names of all such entities that was introduced this year; and
- where a parent prepares group accounts and takes the exemption from publication of its individual profit and loss account, its individual profit or loss for the year must be disclosed on the face of the balance sheet, rather than in the notes as was previously permitted.

Title	Per IASB IFRSs, mandatory for accounting periods starting on or after:	Per EU-endorsed IFRSs, mandatory for accounting periods starting on or after:
Annual Improvements to IFRSs: 2011-13 Cycle (Dec 2013)	1 July 2014	1 January 2015
Annual Improvements to IFRSs: 2010-12 Cycle (Dec 2013)	1 July 2014*	1 February 2015
Amendments to IAS 19 (Nov 2013) – Defined Benefit Plans: Employee Contributions	1 July 2014	1 February 2015
Amendments to IAS 1 (Dec 2014) – Disclosure Initiative	1 January 2016	1 January 2016
Annual Improvements to IFRSs: 2012–2014 Cycle (Dec 2014)	1 January 2016	1 January 2016
Amendments to IAS 27 (Aug 2014) – Equity Method in Separate Financial Statements	1 January 2016	1 January 2016
Amendments to IAS 16 and IAS 41 (Jun 2014) – Agriculture: Bearer Plants	1 January 2016	1 January 2016
Amendments to IAS 16 and IAS 38 (May 2014) – Clarification of Acceptable Methods of Depreciation and Amortisation	1 January 2016	1 January 2016
Amendments to IFRS 11 (May 2014) – Accounting for Acquisitions of Interests in Joint Operations	1 January 2016	1 January 2016
Amendments to IFRS 10, IFRS 12 and IAS 28 (Dec 2014) – Investment Entities: Applying the Consolidation Exception	1 January 2016	1 January 2016

*Amendments to IFRS 2 *Share-based Payments* and IFRS 3 *Business Combinations* apply prospectively to transactions occurring on or after this date. All other amendments apply to annual periods commencing on or after 1 July 2014.

Areas of regulatory focus
In relation to financial statements, significant areas of regulatory focus at the moment include the following.

- Identification of **exceptional items**. Various issues in relation to the identification of items as exceptional have been highlighted by the FRC, including:
  - lack of or poorly designed accounting policies and inconsistent application of them;
  - recurring or immaterial items identified as exceptional;
  - failure to appropriately identify financing and tax items as exceptional;
  - lack of symmetry between good and bad news;
  - inability to reconcile measures presented; and
  - failure to present comparative information.

  As discussed in the narrative reporting section, the presentation of non-GAAP measures such as 'profit before exceptional items' in the front half of the annual report is likely to be an area of regulatory focus with the ESMA Guidelines coming into force this year.

- Disclosure of **accounting policies**. Companies should make sure that they provide clear, company-specific policies for all material transactions and balances, bearing in mind their business model when doing this. Companies should not be afraid to remove irrelevant or immaterial accounting policy disclosures from their reports and should not give extensive detail on new IFRS requirements that will have little or no effect on future financial statements.

- Other opportunities to make the financial statements more **clear and concise**. Some issues that companies could look out for include large tables of immaterial information that could be removed or replaced with a brief piece of narrative, the possibility of aggregating small items in the primary statements, unnecessary repetition that could be replaced by a cross reference and disclosures from prior years that are no longer needed.

- **Revenue recognition**. Companies should ensure that their policies reflect their specific circumstances rather than being boilerplate. In particular, where companies have long-term contracts, sufficient explanation of how the percentage of completion of these is determined is very important. With the effective date of IFRS 15 ***Revenue from Contracts with Customers*** now on the horizon, the FRC and ESMA[16] have both issued statements setting out their expectations around pre-adoption disclosures.

- Clarity and completeness of **critical judgements**. Companies should ensure that they state explicitly what the judgements made are, rather than just repeating the company's accounting policy or providing a general reference to judgements being included in accounting policies. They should also ensure that a clear distinction is made between critical judgements and key sources of estimation uncertainty, even where they relate to the same item. Companies should also be aware of opportunities to match the narrative used to discuss these with the significant financial reporting issues discussed in the audit committee report.

- Discussion of **key sources of estimation uncertainty**. Companies should make sure that all of the significant uncertainties that exist are highlighted in this disclosure, in particular any that have been considered as significant by the audit committee. Companies should also remember the need to provide supporting information such as sensitivities in relation to estimation uncertainties.

16 http://www.iasplus.com/en-gb/news/2016/07/esma-ifrs-15

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- Correct accounting for **business combinations**. Care should be taken when doing this to determine whether the transaction is a business combination at all and, if so, which entity is the acquirer for accounting purposes. This will not always be the legal acquirer. Also, companies should ensure they exercise sufficient diligence in identifying and valuing intangible assets acquired in a business combination, rather than just assuming that any excess paid above the fair value of previously recognised assets of the acquiree represents goodwill. Care should be taken to identify any contingent payments that should be accounted for as remuneration expenses. Companies should also ensure they meet all of the disclosure requirements of IFRS 3, particularly in relation to post balance sheet business combinations.

- Calculation and disclosure related to **impairment assessments**. Companies should ensure that discount rates are up to date and remember that they need to be pre-tax. The identification of CGUs and allocation of goodwill to CGUs can also be subject to scrutiny. Other potential issues include use of a single pre-tax discount rate for multiple cash-generating units (CGUs) with different risk profiles (and where cash flows are not risk adjusted) and failing to give sufficient information about the assumptions made in determining value in use. Finally, companies should ensure that any required sensitivity disclosures are clear in setting out the situations in which impairments could arise.

- Accounting issues relating to **pension schemes**, primarily defined benefit schemes. The FRC has highlighted several issues – these are:

  – the sufficiency of disclosure regarding governance of pension plans and the applicable regulatory framework;

  – whether companies have correctly identified and described the effect of minimum funding requirements and any restrictions on recognising a surplus;

  – the sufficiency of sensitivity disclosures for actuarial assumptions; and

  – the usefulness of maturity profile information for defined benefit obligations.

- Disclosures relating to **provisions, contingent liabilities and contingent assets** are another area of challenge, with clear identification of the reasons for movements in provisions and disclosure about uncertainties relating to timing or amount of outflows sometimes missed. Companies should also be wary of including a significant class of 'other' provisions without explanation or stating that disclosure have not been made because they would be seriously prejudicial. Finally, ensuring consistency between the front and back halves in terms of contingent liabilities discussed is important.

- **Financial instruments disclosures**, especially the detail given in disclosures concerning items in level 3 of the fair value hierarchy. Companies should ensure that level 3 disclosures are sufficiently detailed and robust and provide sufficient quantitative information about significant unobservable inputs. Companies should also ensure that credit risk disclosures cover all financial receivables.

- **Tax accounting** is another current hot topic, with some potential issues being:

  – including only current tax in the effective tax rate reconciliation;

  – inappropriate aggregation of reconciling items or unclear description of them;

  – inadequate justification to support recognition of deferred tax assets that are dependent on future profitability – this is particularly relevant for loss-making businesses; and

  – lack of clarity around the treatment of tax on share-based payments.

The FRC is currently undertaking a thematic review of tax reporting by FTSE 350 companies[17], which is expected to conclude in the near future.

17 http://www.iasplus.com/en-gb/news/2015/12/frc-disclosure-tax-risks

- Misclassification of items in **cash-flow statements** and inappropriate netting of cash flows continue to crop up in the FRC's reviews of accounts, although they are less prevalent than in the past. Companies should also pay attention to the classification of unusual or non-recurring cash flows, as it may still be correct to classify them as operating items.

- Disclosure issues relating to **intangible assets**, in particular the treatment of research and development expenditure, amortisation method and the distinction between internally generated and acquired intangibles. The need to separately identify individually significant intangible assets should also not be overlooked.

- **Capital management** disclosures should include a clear identification of what is managed as capital, including quantitative data, and this should be consistent with the narrative reports. Capital management policies should also be clear and company-specific.

- Judgements relating to the identification of **subsidiaries** and **joint arrangements** remain on the regulatory radar due to the relative newness of IFRS 10 and IFRS 11. Companies need to ensure that they correctly identify situations in which they have control or joint control of another entity and disclose the judgements involved. De facto control in particular is a highly judgemental area.

- **Other financial statements presentation issues,** such as inappropriate aggregation of items like accruals and deferred income or different classes of property, plant and equipment, failure to identify whether items of other comprehensive income would subsequently be recycled to the income statement and failure to include a description of material leasing arrangements.

- **Complex supplier arrangements** are still a hot topic following the FRC's press release on this subject a couple of years ago. Retailers should ensure that their disclosures about such arrangements give clear and relevant information to investors.

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On the horizon

Looking further ahead, the table to the right shows other new standards and amendments published by the IASB, along with their effective dates and EU endorsement status.

Note that the European Commission has decided not to endorse IFRS 14 – Regulatory Deferral Accounts for use in Europe.

In addition to these items, at the time of writing the IASB also has, inter alia, ongoing projects to develop:

- a new standard dealing with insurance contracts;
- revisions to the Conceptual Framework for Financial Reporting; and
- the disclosure initiative, a broad-based initiative to explore how IFRS disclosures can be improved.

Title	Per IASB IFRSs, mandatory for accounting periods starting on or after:	Per EU-endorsed IFRSs, mandatory for accounting periods starting on or after:
Amendments to IAS 12 (Jan 2016) -–Recognition of Deferred Tax Assets for Unrealised Losses	1 January 2017	TBC – endorsement expected Q4 2016
Amendments to IAS 7 (Jan 2016) – Disclosure Initiative	1 January 2017	TBC – endorsement expected Q4 2016
IFRS 9 – Financial Instruments	1 January 2018	TBC – endorsement expected Q4 2016
IFRS 15 – Revenue from Contracts with Customers	1 January 2018	TBC – endorsement expected Q4 2016
Clarifications to IFRS 15 Revenue from Contracts with Customers (Apr 2016)	1 January 2018	TBC – endorsement expected H1 2017
Amendments to IFRS 2 (Jun 2016) – Classification and Measurement of Share-based Payment Transactions	1 January 2018	TBC – endorsement expected H2 2017
IFRS 16 – Leases	1 January 2019	TBC – endorsement expected 2017
Amendments to IFRS 10 and IAS 28 (Sep 2014) – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Deferred indefinitely	Postponed – awaiting completion of the IASB's project on 'Elimination of gains or losses arising from transactions between an entity and its associate or joint venture'

04

Overall impressions

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Overall impressions

Top Tips

- Demonstrating linkage helps users get a holistic understanding of the business by appreciating the relationships between the various sections of the report such as objectives, strategy, KPIs and risks. 13 companies demonstrated a comprehensive degree of linkage between the different pieces of information presented in their report.

- Consider the application of materiality to both financial and non-financial matters in order to create a clearer and more concise report. The length of the annual reports surveyed increased by an average of eight pages (2015: 12 pages) this year, the seventh consecutive year where there has been an increase in length. 34 companies (2015: 33) referred to materiality within the annual report, although the process for determining materiality was only discussed by three companies for financial matters and 11 companies for non-financial matters.

- Bear in mind the benefits that can be realised through applying the principles of integrated thinking when managing your business. More businesses appear to be doing this, judging by the increasing number that are following the integrated reporting framework in putting together their annual reports. Eight (2015: two) explicitly stated that their report follows the <IR> framework or referred to it as an 'integrated report'.

- Consider the level of consistency between the financial reporting issues discussed in the audit committee report, the key risks covered in the audit report and the critical accounting judgements and key sources of estimation uncertainty identified by management. The FRC has indicated they will challenge unjustified inconsistencies between these reports. Complete consistency should not be seen as a goal, although ten of the companies we surveyed did show complete consistency in the issues discussed.

Keep an eye on

- Ways to create a clear and concise report. For example, 75% of companies who presented their remuneration policy in full had not had a change in remuneration policy during the year and were therefore not required to do so. Whilst some companies may be reluctant not to provide the full policy due to the current media focus on pay disclosures, a well-constructed summary can be more useful to an investor in their understanding of the remuneration policy and the related disclosures.

- The linkage between directors' remuneration performance measures and key performance indicators (KPIs). Such linkage helps provide users with a deeper understanding of a company's incentivisation policies and gives a clear indication as to how measures used to assess the performance of the company might impact directors' remuneration. 76% (2015: 68%) of companies used metrics in their performance related directors' remuneration which were also KPIs.

- The format of the annual report. This year only 18% (2015: 29%) of companies chose to present a HTML version of their report, showing that most now see that going to the cost and effort of producing a HTML version is of little benefit when the majority of investors prefer reports in a PDF format. However, few companies have responded to investors' views on effective digital communications, as expressed in the FRC's Financial Reporting Lab's Digital present report[18], with all 100 companies presenting their report in portrait, 91 companies using multiple columns of text and 66 companies using double page spreads to present information. All three factors are considered to inhibit the readability of a document for a digital user.

Introduction

In this chapter we examine various overall trends across the annual reports surveyed. The areas that we look at are guided by the FRC's Communication Principles (included in the FRC's Guidance on the Strategic Report[19]) and the <IR> Framework's Guiding Principles[20]. Both of these sets of principles consider the content of the annual report and the presentation of information therein, including discussion around connectivity, conciseness, and balance.

18 http://www.iasplus.com/en-gb/news/2015/05/fr-lab-report-digital-reporting
19 https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf
20 http://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf

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FRC's Communication Principles

- **The strategic report should be comprehensive but concise.**
- **The strategic report should highlight and explain linkages between pieces of information presented within the strategic report and in the annual report more broadly.**
- **The strategic report should be fair, balanced and understandable.**
- **Section 5 of the FRC Guidance also includes guidance on applying the concept of materiality to the strategic report.**
- **Where appropriate, information in the strategic report should have a forward-looking orientation.**
- **The strategic report should provide information that is entity-specific.**
- **The structure and presentation of the strategic report should be reviewed annually to ensure that it continues to meet its objectives in an efficient and effective manner.**
- **The content of the strategic report should be reviewed annually to ensure that it continues to be relevant in the current period.**

<IR> Framework Guiding Principles

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

We have considered the following specific areas.

- The length of the annual report – a crude but useful measure of whether reports are becoming clearer and more concise.
- The quality of linkage demonstrated between elements of the annual report – an area of greater importance given the ever-increasing length of reports. A good annual report tells the story of the organisation, giving a reader a holistic view of the business. One particular area that we have looked at in detail is the degree of consistency between the significant financial reporting issues discussed in the audit committee report, the key risks reported by the auditor and the critical judgements and key sources of estimation uncertainty disclosed in the financial statements.
- Discussion of the company's relationships with stakeholder groups – something that demonstrates the growing acknowledgement that a company's licence to operate comes not just from the financial investment of its shareholders but also from a wider perception of corporate citizenship and that its ability to create sustainable long-term value depends on broader social and environmental factors.
- The application of materiality – a linchpin in the drive to produce relevant, clear and concise reports.
- Directors' remuneration reporting – an area of great public scrutiny at the moment, particularly in the light of research[21] that casts doubt on the effectiveness of the 2013 changes in remuneration reporting requirements in achieving their aim of improving the link between pay and performance and curbing excessive CEO pay.

21 http://www.iasplus.com/en-gb/publications/research/remuneration-disclosure-research

- The extent to which companies have adopted the recommendations of the Financial Reporting Lab's Digital Present report – in recognition of the fact that an ever-increasing proportion of investors use the annual report as an electronic document.
- The speed with which companies report their results to the market and the way in which those results are initially reported.
- The way in which reports from the chairman and CEO are included in the annual report – another area in which there are potential gains to be made in terms of making the report clearer and more concise, by reducing duplication of information.

Length of the report

Our survey results show an average increase in the report length of eight pages from those surveyed in 2015 (see Figures 4.1 and 4.2); this is the seventh consecutive year of increases in the annual report length. This increase was driven by a five page increase in financial statements, and a three page increase in narrative. The increase in the back half was mainly due to the changes in Company Law which now require companies to include a full listing of related undertakings within the annual financial statements where previously this could have been included as an appendix to the annual return[22]. Across our sample these lists ranged from one to 19 pages in length, with an average of three pages.

Previously, companies were only required to disclose their 'principal' subsidiaries and other significant holdings in the annual financial statements, which was unlikely to be more than a page in length. The increase could also be partly down to an increase in the length of disclosures concerning the impact of new accounting developments, such as IFRS 9 ***Financial Instruments***, IFRS 15 ***Revenue from Contracts with Customers*** and IFRS 16 ***Leases*** where reporters have to consider the impact future standards will have on the financial statements.

The increase in the front half is likely down to the changes in the UK Corporate Governance Code, which were effective from 1 October 2014 and required companies to, amongst other things, enhance their principal risk disclosures (see chapter 8) and also include a viability statement setting out the directors' assessment of the longer term outlook for the company (see chapter 9). Another possibility is an increase in the use of case studies by companies – while these can help to bring a company's story to life a careful balance needs to be struck to avoid breaking up the flow of the report too much.

With annual reports being as long as they are these days, companies should make sure they make their reports easy for users to navigate. There are several ways to do this, including making sure there is a clear and logical layout, use of cross referencing, inclusion of contents pages for individual sections and creating a navigable PDF (see later).

Fig 4.1 How has the average length of the annual report changed over time?

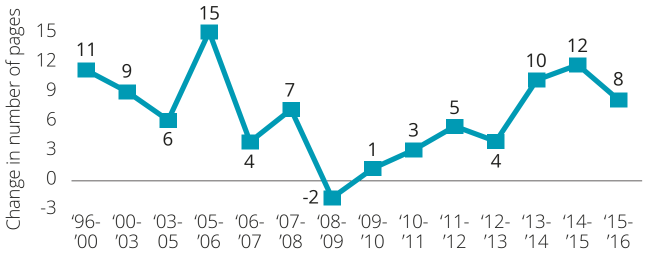
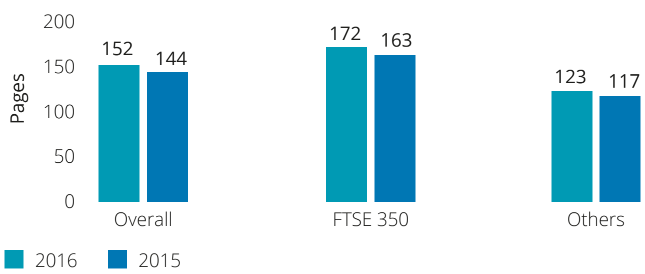


Figure 4.2 How long is the annual report?



Average percentage of the report which consisted of narrative information (i.e. not financial statements)	2016	2015
Overall	60%	59%
FTSE 350	61%	62%
Others	58%	56%

This has remained broadly consistent, though it is encouraging that smaller companies may be putting more effort into helping the user to better understand the company's story, an area where the FRC felt some small companies were previously struggling.[23]

22 http://www.iasplus.com/en-gb/news/2015/07/accounting-regulations-subsidiary-listing

23 https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf

Linkage and connectivity

This section focuses on the overarching concept of linkage. Linkage, or connectivity as it is referred to in the <IR> Framework, involves demonstrating relationships and interdependencies between information disclosed in the report in order to help give a user a holistic view of the company.

Linkage should not be confused with signposting/cross-referencing. Signposting consists merely of providing assistance to users in navigating around the annual report, while linkage relates to the underlying relationships and interdependencies between information presented in different sections of the report. Signposting can be used to illustrate where linkage exists between different sections of the report, but the existence of signposting does not mean that clear linkage exists, and equally good linkage can be evident in a report even if it is not clearly signposted.

<IR> Connectivity

The FRC's principle of linkage is very much consistent with connectivity of information, one of the guiding principles of <IR>. However, the FRC Guidance does not explicitly encompass the key factor of integrated thinking – the active consideration by an organisation of the relationships between its various operating and functional units and the capitals that the organisation either uses or affects.

The idea of <IR> connectivity is a reflection of this integrated thinking within an organisation, with all the parts of the organisation acting and moving together. For those companies that have adopted such integrated thinking we would expect this to be apparent in their annual report through a high level of connectivity. To demonstrate <IR> connectivity an organisation would therefore have to show a high level of linkage to illustrate the interdependencies and relationships existing between the information as a result of the organisation and its operations being considered as a coherent whole.

Whether the reader feels they have a holistic view of the business is subjective and assessing how connected a report is not an exact science. The FRC Guidance provides a number of examples of how linkage can be achieved. It differentiates between 'linkage' and 'signposting', with the latter being simple cross-references between sections of the annual report e.g. KPIs and strategic objectives, or to where more detail is provided.

In order to determine a measure of the linkage demonstrated by the companies surveyed, the extent to which various sections of the report were clearly linked to the other sections was considered. We considered the linkage between various sections of the report, for example, whether it shows the risks that relate to each element of the strategy or how the KPIs relate to the measures used to assess directors' remuneration.

It was encouraging to see that 83% of the companies we surveyed displayed some degree of linkage. 13 companies displayed a comprehensive level of linkage between various sections of the report. This was an encouraging statistic and a moderate increase on the prior year where 10% of companies demonstrated a comprehensive level of linkage. Good examples of how this linkage can be demonstrated are given by **G4S plc (Example 4.1)** and **Marks and Spencer Group plc (Example 4.2)**.

We have assessed various individual areas of linkage in our survey, which are discussed in the report as set out below.

Linkage between	Discussed in chapter
Remuneration and KPIs	4
Objectives, strategy, business model, KPIs, risks and CR	6
KPIs and strategy	7
Risks, strategy and KPIs	8

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<IR> Narrative

Along with the increase in the number of companies demonstrating a comprehensive level of linkage, there was also an increase in the number of companies mentioning integrated reporting, with 12 companies (2015: seven) specifically referring to <IR> in their annual reports. Of these:

- four (2015: two) indicated that their annual reports were prepared in line with the principles of the <IR> Framework, two of these companies being FTSE 100 (the same two preparing reports in line with the <IR> Framework in the prior year), the other two being FTSE 250;
- two (2015: two) noted that they are currently taking steps to report in an increasingly integrated way;
- four referred to an 'Integrated approach' in preparing the annual report, or referred to the report as an 'Integrated report' but did not specifically mention the <IR> Framework;
- one (2015: one) noted that the audit committee had discussed the presentation of the annual report in the context of <IR>; and
- one specifically mentioned that they had "chosen not to prepare an integrated report" although they had included a comprehensive overview of non-financial performance.

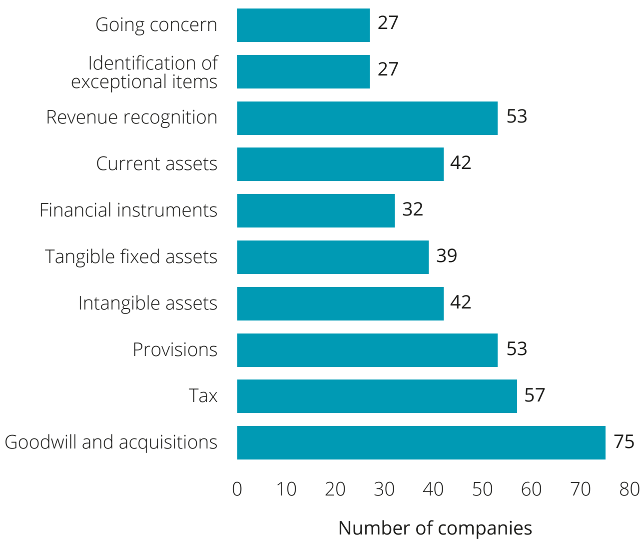
Linkage between risks identified by the audit committee, auditor and management

As part of our survey, we identified the most common matters noted by audit committees (as part of their analysis of significant financial reporting issues), auditors (based on the risks of material misstatements reported in their audit reports); and management (as part of their disclosure of critical accounting judgements and key sources of estimation uncertainty). Although these are all different requirements, there is a significant degree of overlap between them and so we would expect to see a degree of consistency in the issues discussed. We would expect the consistency between the audit committee report and financial statements to be the closest, since these are both written from an internal perspective whereas the audit report is based on an independent, external viewpoint. In relation to this, the FRC have indicated that, when companies' annual reports are reviewed by their Conduct Committee, they may challenge companies where the audit committee report or audit report mentions judgements or estimates that are not identified in the financial statements. For more information on the discussion of significant financial reporting issued by audit committees see chapter 12 and for further detail on the reporting of critical judgements and key sources of estimation uncertainty see chapter 14.

For 14 of the companies in our sample there was complete consistency between the issues discussed by the audit committee and those identified by management, with ten of these also showing complete consistency with the risks identified by the auditor. On the other hand, for four of the companies we looked at there were no consistent topics identified across all three sections.

Figure 4.3 shows the risks that were most commonly identified either by audit committees, auditors or management across the companies we surveyed.

Figure 4.3 What are the most common risks identified either by audit committees, auditors or management?



In particular, in relation to these risks we noted the following.

i. The risks identified in relation to goodwill and acquisitions were usually focused on (i) acquisition accounting (including identification and measurement of assets and liabilities acquired), and (ii) impairment of goodwill and intangible assets acquired (particularly around key judgements and assumptions to estimate the recoverability of the CGUs). In some cases, audit committees also mentioned a risk regarding disclosure in these areas.

ii. The risks identified in relation to revenue recognition included a wide range of estimates and judgements regarding topics such as: cut-off; multiple arrangements; long term contracts; loyalty schemes; refunds; and gross vs net (principal vs agent) presentation.

iii. Tax is in general considered a key risk by management in companies that operate in multiple jurisdictions because they consider the assessment of uncertain tax positions to be an area of significant judgement. Other areas mentioned were the recoverability of tax losses carried forward and assessment of deferred taxes.

iv. The risks identified in relation to current assets primarily related to the assessment of provisions against accounts receivable and inventory.

v. Going concern was in general an area of focus of audit committees and auditors. The main reasons mentioned were the following (i) assessment for the appropriateness of the going concern assumption (including disclosures); (ii) the potential implications for the going concern assumption when the entity has restrictive covenants; and (iii) liquidity risks and the economic environment.

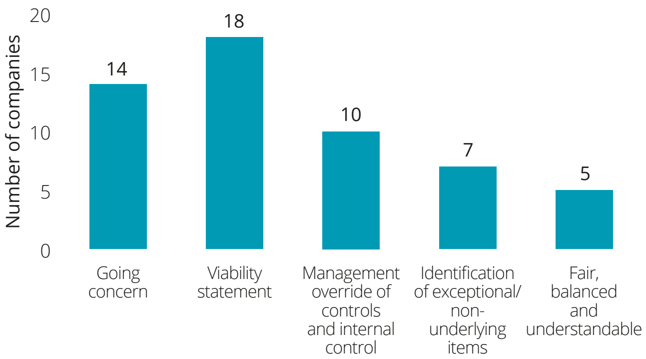
Generally the risks noted above are consistent with the areas identified by the FRC Conduct Committee in their Corporate Reporting Review Annual Report 2015 as areas of challenge, although consideration of current assets is an area not specifically identified by the FRC as a focus in their work. Other areas identified by the FRC but not by so many of the companies we surveyed include the identification of exceptional items, which was identified as a key risk more commonly by audit committees than the other groups; and the risk of cash flow misclassification which was not identified by any of the companies in our survey.

The table below shows other risks that were considered either by audit committees, auditors or management across the companies in our sample.

Risk	Number of companies
Share-based payments	9
Investment property valuation	9
Determination of joint venture or joint operation	5
Basis for consolidation	9
Complex supplier agreements	13
Leases	7
Viability statement	18
Management override of controls	7
Internal control	11
Fair, balanced and understandable	5

Figure 4.4 shows the number of companies for which the risks listed were only identified as key by audit committees (but not by auditors or management).

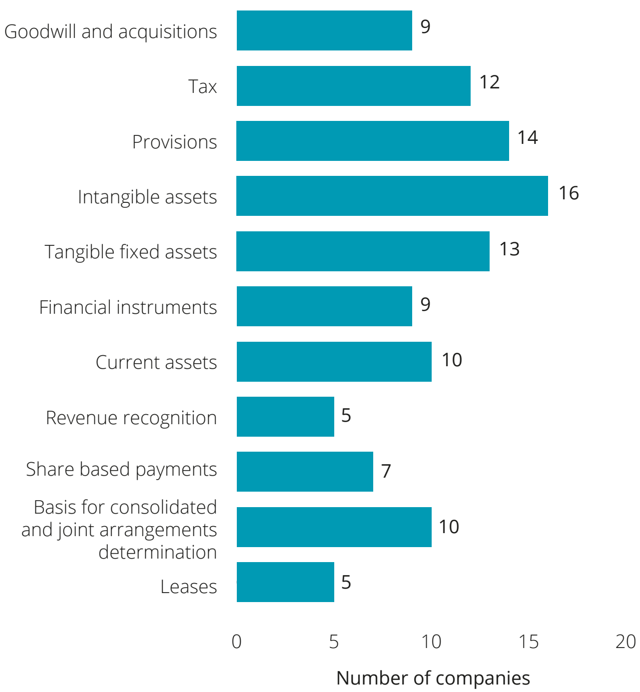
Figure 4.4 What are the most common risks identified primarily by audit committees as part of their annual report analysis?



In relation to the risks noted above, it is not surprising that the viability statement and fair, balanced and understandable are discussed only by audit committees – these would not be expected to be a risk for the auditor or be a critical accounting judgement. However, (i) the risk related to management override of control and internal control was also identified as a key risk by auditors only in three cases and in five cases by both audit committees and auditors; (ii) the identification of exceptional items was also identified as a key risk by both audit committee and management in four cases and by both the audit committee and auditor in seven cases.

Figure 4.5 shows the number of companies for which the risks listed were identified by management as part of their disclosures of critical accounting judgements and key sources of estimation uncertainty but not considered as a key risk by audit committees or auditors.

Figure 4.5 What are the risks identified only by management as part of their disclosure of critical accounting judgements and key sources of estimation uncertainty?



This graph highlights that, where there were differences between the areas considered by the three groups, it was most common for management to consider a wider range of risks as compared to audit committees and auditors. For example, we noted that in cases where management considered there to be estimates or judgements related to share-based payments, the basis for consolidation and joint arrangement determination and leases, these were rarely considered significant by the audit committee or auditor. This could be due to different views of materiality applied by management compared to the auditor, meaning that the areas reported by management in complying with IAS 1 would not necessarily represent key risks in the view of the auditors.

One other area in which there was a noticeable difference between the three sections of the report was in the identification of the risk of revenue recognition. For twelve of the companies surveyed this was identified as a risk area by the audit committee and auditor despite the fact that management had not identified any critical judgements or key sources of estimation uncertainty in relation to it. It is possible that this is because revenue recognition is deemed a presumed risk by Auditing Standards, in recognition of the fact that it is usually one of the most significant numbers to a user of the financial statements.

Stakeholder engagement

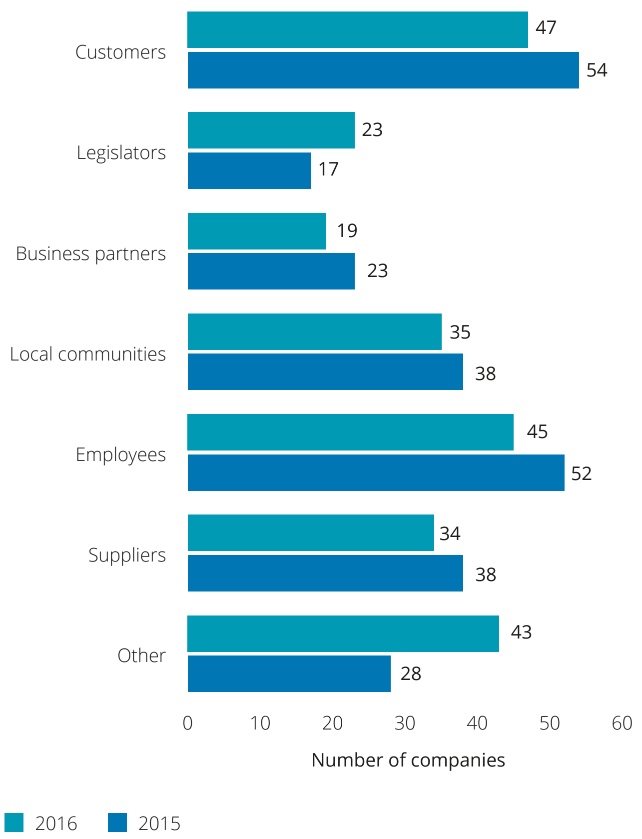
The FRC Guidance[24] stresses the importance of engaging with stakeholders, and also goes as far as to say that the annual report should address issues relevant to stakeholders where, because of the influence of those issues on the performance, position and future prospects of the company, they are also material to shareholders. One of the most important ways in which a company can acknowledge how it interacts with its stakeholders is by discussing how it takes into account their needs and interests, and responds to them in its business model – this is discussed in chapter 6. The importance of stakeholder engagement is also a guiding principle in the <IR> Framework. Figure 4.6 shows the stakeholders referred to by the companies in our sample.

A good example of discussing stakeholder engagement is given by **Paypoint Plc (Example 4.3)**.

<IR> Stakeholder engagement

A company's value is not created within a company alone; it is dependent on and influenced by the external environment, relationships with stakeholders and other resources. An integrated report should provide insight into the nature and quality of relationships with key stakeholders, including how and to what extent the organisation understands, takes into account and responds to their legitimate needs and interests. It is by doing this that it can demonstrate how the company creates value over time.

Figure 4.6 What different stakeholders are referred to?



Number of companies referring to stakeholders other than shareholders in their annual report	2016	2015
Yes	93	90
No	7	10

The moderate increase suggests companies are increasingly seeing the importance of stakeholders in a company's ability to create value. Consistent with the prior year, the most common stakeholders (other than shareholders) referred to were customers and employees (see Figure 4.7). Other stakeholders mentioned were mainly references to the environment or simply a generic reference to 'other' stakeholders with no definition.

Number of companies that referred to stakeholders other than shareholders, but did not clearly define who these were	2016	2015
Overall	35	24
FTSE 350	20	12
Others	15	12

Many companies are still not including a clear disclosure of the specific parties (other than shareholders) that they consider to be their key stakeholders. This was evidenced in some companies with a 'Dialogue with stakeholders' section, which referred only to how the company communicated with its shareholders, with no discussion of other stakeholders.

24 FRC Guidance, Section 3.4

Number of companies describing the nature and quality of the company's relationships with its key stakeholders (e.g. any process of communication & feedback with them)	2016	2015
Yes, for a variety of stakeholders	21	23
Yes, but just for shareholders	72	60
No	7	17

It is disappointing not to see an increase in this statistic given the importance of these relationships in demonstrating how a company creates value. 72 companies did however describe the nature and quality of their relationships with shareholders, an increase of 12 on the prior year. This was usually demonstrated through a 'Shareholder Communications' paragraph within the Corporate Governance section. Good examples of stakeholder engagement were given by **Paypoint Plc (Example 4.3)**, The Weir Group PLC and Morgan Sindall Group plc.

Materiality

Applying materiality involves assessing the likelihood that including or excluding an item, or changing how it is presented will affect the decisions made by the primary users of the report (the shareholders). It is a key judgment which reporters have to make, and when effectively applied, will help to produce clear, concise and relevant reporting. The FRC noted in their Corporate Reporting Review Annual Report 2015 (CRR Report) that judgements around materiality are a key area of importance to investors and will be an area of future focus for them as a result of concern about how some companies were assessing materiality. Within both the CRR Report and the FRC Guidance[25], it is made clear that materiality is entity-specific and should be based on both quantitative and qualitative factors. Deloitte's publication Thinking allowed – Materiality[26] and the IASB's draft Practice Statement Application of Materiality to Financial Statements[27] both give further guidance on considerations when determining whether information is material or not. 34 companies (2015: 33) referred to materiality, whether financial or non-financial, within the annual reports that we surveyed this year. Good examples of materiality disclosures are given by **Mondi Group (Example 4.4)** and **Premier Oil plc (Example 4.5)**.

The Global Reporting Initiative (GRI) has developed their own sustainability reporting guidelines, the latest version of which is referred to as G4[28].The G4 guidelines emphasise the need for companies to focus on reporting on those issues which are material to their business and key stakeholders. This materiality focus is intended to make reports more relevant, credible and user-friendly. However, it should be noted that the reporting referred to in the GRI guidelines is focused more on a company's sustainability report, rather than the annual report itself. Therefore the GRI guidance on materiality, which was the source of the discussion for many companies in our sample, does not necessarily give appropriate guidance when determining materiality in the context of the annual report.

<IR> Materiality

The <IR> Framework requires an integrated report to disclose information about matters that substantively affect the organisation's ability to create value over the short, medium and long term i.e. those matters which are material. Similarly, materiality needs to be applied when considering how to apply the guiding principle of conciseness. From the stakeholder engagement process, companies should have a better understanding of what matters to each stakeholder group, what their particular needs and interests in the company are, and how this impacts the company. This then feeds directly into the materiality determination process, which the <IR> Framework sets out as:

- identifying relevant matters based on their ability to affect value creation;
- evaluating the importance of relevant matters in terms of their known or potential effect on value creation;
- prioritising the matters based on their relative importance; and
- determining the information to disclose about material matters.

To be most effective, the materiality determination process is integrated into the company's management processes and includes regular engagement with stakeholders to ensure the integrated report meets its primary purpose. For more information on value creation, see chapter 6.

25 FRC's Guidance on the Strategic Report, Section 5.3
26 http://www.iasplus.com/en-gb/publications/global/thinking-allowed/2015/materiality
27 http://www.iasplus.com/en-gb/news/2015/10/materiality
28 https://www.globalreporting.org/standards/g4/Pages/default.aspx

Number of companies that referred to financial statement materiality, or those charged with governance's (TCWG) process to determine this	**2016**
Yes – process discussed	3
Yes – mentioned but did not discuss process	14
No	83

Generally discussions around financial statement materiality were located within the audit committee report in the committee's discussion with external auditors.

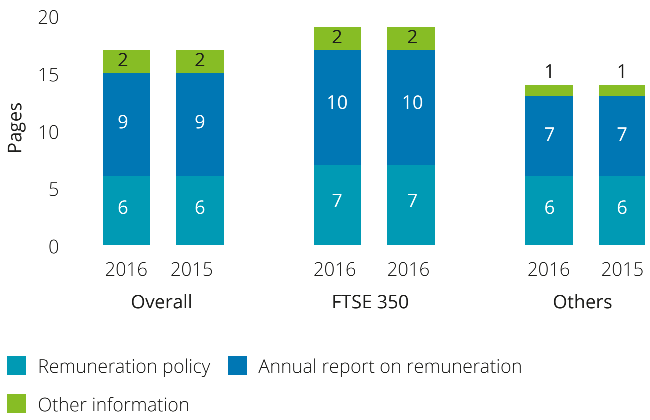
Number of companies that mentioned materiality for non-financial items e.g. sustainability or TCWG's process to determine this	**2016**
Yes – process discussed	11
Yes – mentioned but did not discuss process	12
No	77

11 companies discussed the process for determining their materiality threshold. This was usually in the context of risk determination, GHG carbon emissions or sustainability in general. Some reporters had also complied with the GRI's G4 sustainability reporting guidelines, which focuses on reporting those issues which are material to the business and key stakeholders, with a concentration on sustainability matters.

Directors' remuneration reporting

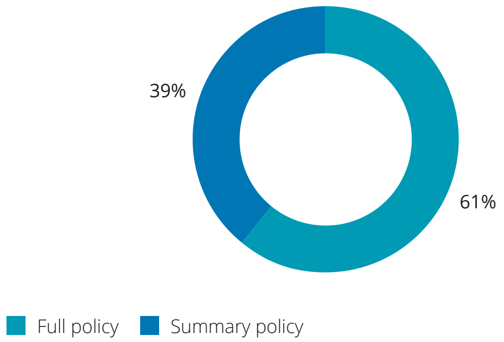
The FRC's update to the UK Corporate Governance Code made some minor changes to the requirements in respect of directors' remuneration to ensure boards focus on the long term success of the company and to include clawback provisions within the remuneration policy. Overall these changes have not had a significant effect on the length of directors' remuneration reports, with report lengths staying consistent with the prior year at 17 pages – see Figure 4.7.

Figure 4.7 How long, on average, is the directors' remuneration report?



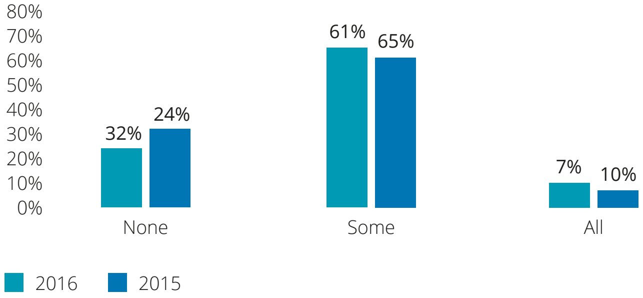
There has been an increase in the number companies providing a summary of their remuneration policy with only 61 companies (as per Figure 4.8) disclosing their remuneration policy in full, compared to 73 in the prior year. This is an encouraging trend as providing a summarised remuneration policy, sufficient to understand the remuneration disclosures of the report, helps produce a more clear and concise report. Company Law requires the full remuneration policy to be included in the annual report in the financial year preceding the shareholders' vote on the policy (every three years), or when there has been a change in policy. For companies that have not had a change of policy since they first presented one in their 2013/14 report, the 2016/17 annual report will need to contain a revised policy since the next mandatory vote will be required at the 2017 AGM. It was interesting to note that, of the 61 companies that included the policy in full, only 25% had a change in policy since the prior year. This shows that there is still plenty more scope to make reports more concise. Whilst some companies may be reluctant not to provide the full policy due to the current media focus on pay disclosures, a well-constructed summary can be more useful to an investor in their understanding of the remuneration policy and their related disclosures.

Figure 4.8 What percentage of companies disclose their remuneration policy in full?



Demonstrating linkage between the measures used to determine a company's directors' remuneration, KPIs and business strategy helps provide users with a deeper understanding of a company's incentivisation polices and gives a clear indication as to how measures used to assess the performance of the company might impact a director's remuneration – see Figure 4.9. Of the companies showing at least some linkage, 31% also demonstrated linkage between the relevant KPIs and the company's business strategy, although only 9% clearly linked all pay-related KPIs to business strategy. **Marks and Spencer Group Plc (Example 4.6)** demonstrated this linkage effectively in their Annual Report and Financial Statements 2016, showing clearly in their remuneration report the alignment between strategic objectives, KPIs and the relevant incentive.

Figure 4.9 Are metrics used for performance related pay included within the company's KPIs (both financial and non-financial)?



As companies take a more integrated view on reporting and how a business creates value, non-financial performance measures are becoming common in determining the level of directors' remuneration. As shown by Figure 4.10 below, of the 47 companies that used non-financial performance measures, a measure related to the strategic development was the most popular with 41 companies including one. Other popular measures were those relating to operational performance (24 companies) and people (21 companies). As companies take a more integrated approach to their business and see the importance of various stakeholders in creating value for the business, it is likely that non-financial performance measures will become increasingly more popular in determining the level of directors' remuneration.

Figure 4.10 Which non-financial measures are used to determine performance related pay?

Non-financial measures used in determining performance related pay	2016	2015
Overall	47	58
FTSE 350	30	42
Others	17	12

Auditor reporting

Since the amendments to ISA (UK & Ireland) 700 *The Independent Auditor's Report on Financial Statements* were issued in 2013, audit reports have been increasing in length as auditors include more detailed information regarding the significant risks of material misstatement and considerations they have made in respect of determining materiality. This trend has continued in the current year with the average length of the report increasing to 4.8 pages (2015: 4.2 pages). Given the increasing length of audit reports, it was encouraging to see that the number of companies including a separate audit report (usually for company-only financial statements) had dropped to ten (2015: 18), potentially as companies have taken the opportunity to deal with the audit of the parent company's financial statements in a combined audit report as a result of transitioning to new UK GAAP. Combining these two reports helps create a more clear and concise report with fewer pages dedicated to auditor reporting.

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Larger companies had longer reports and saw the greatest increase with reports rising to 5.1 pages from 4.4 pages, compared to smaller companies where reports increased by half a page to 4.5. Larger, more complex companies potentially contain more risks of material misstatement and more detailed procedures, compared to their smaller counterparts, a potential cause of this this difference in the length.

Chairman's and chief executive's statements

Neither a chairman's statement nor a chief executive's statement is required by law, although the Preface of the UK Corporate Governance Code does note that "Chairmen are encouraged to report personally in their annual statements". The FRC Guidance[29] notes that, whilst not required, a statement from the chairman and/or the chief executive could be included if it is considered the best way of ensuring the document is both relevant and understandable. Our survey showed that companies see both the chairman's statement and the chief executive's statement as key parts of the annual report, with 93 companies presenting a chairman's statement and 77 companies providing a chief executive's statement. 56 of the 77 companies that provided a chief executive's statement did so as a standalone statement rather than as an introduction to the strategic report. Whilst companies clearly see these statements as an opportunity for those charged with governance to provide users with an overview of progress of the company, providing a chief executive's statement as an introduction to the strategic report, or a combined statement with the chairman, could be a good opportunity to make the annual report more clear and concise, as it was noted that there was often duplication between the issues discussed in the two statements.

Compass Group PLC (Example 4.7) gives a good example of a statement from the chief executive which was presented in a question and answer format in their Annual Report 2015, an effective way of communicating the key issues to investors over the performance year in a concise manner.

Percentage of companies that included a chairman's statement	2016
Overall	92%
FTSE 350	91%
Other	93%

Percentage of companies that included a chairman's statement	2016
Overall	83%
FTSE 350	91%
Other	71%

There was little difference noted between FTSE 350 and Other companies in their decision to include these statements. It is clear companies see a chairman's statements as a more important disclosure to users, although it should be noted that of the 17% of companies which didn't include a statement from the chief executive, 6 companies had a single person fulfilling both the chief executive and chairman's role.

29 FRC Guidance on the Strategic Report, Section 3.8

Electronic communications

This section focuses on the format used to make electronic versions of reports available to users. As noted in the Financial Reporting Lab publication Digital present[30], a report on the use of digital media in corporate reporting, PDF is the preferred digital format for annual reports for the majority of users. This preference was reflected in our survey results with all companies surveyed issuing their annual report in PDF format, as shown by Figure 4.11. The Digital Present publication discusses a number of benefits of PDFs for both companies and investors (e.g. it can be downloaded, it is searchable, it is cheap to produce) and even suggests that there is no advantage in putting cost and effort into producing more complex formats such as e-books, interactive PDFs or enhanced HTMLs. Companies appear to have taken advantage of this potential saving on time and effort as only 15% of companies produced an enhanced HTML (i.e. a specifically designed website to host the content of the annual report) compared to 27% in 2015 – see Figure 4.12. The number of companies producing a basic HTML (e.g. an e-book or HTML version of the PDF) remained broadly consistent with the prior year at 3% (2015: 2%).

Whilst companies have taken on board investors' views with respect to HTML publications, very few companies seem to have considered the other recommendations noted in the Lab's report.

- All 100 companies presented their annual report in portrait with no alternative landscape version made available on the company's website. A landscape format fits much better on a screen for those viewing electronically.
- 91 companies displayed text in multiple columns despite the Lab report noting that a single column approach is more suitable for digital reports and reduces a user's frustration at having to scroll up and down the page to be able to view the report at a readable magnification on-screen.
- 66 companies presented information on double page spreads despite the difficulties in reading this information on screen.
- only 17 companies presented a report which was considered to be, or clearly marked as, printer friendly. Of these, two provided a separate printer friendly version of the annual report.

Companies should look to take more consideration of investors' views with respect to digital communications when producing their annual report, especially given the number of investors who will be reading annual reports digitally.

Figure 4.11 What type of PDF reports are prepared by companies?

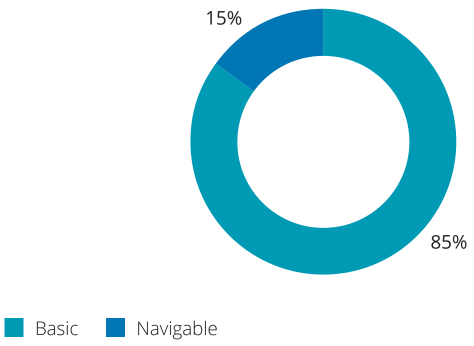
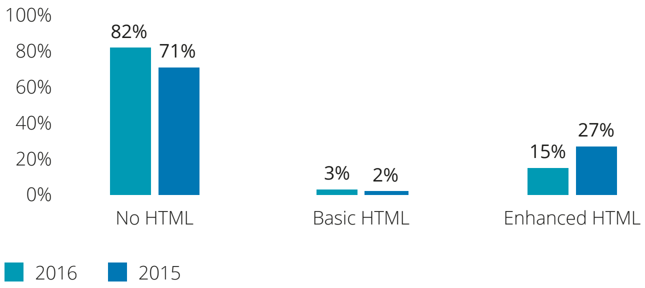


Figure 4.12 What type of electronic reports are produced by companies?



30 http://www.iasplus.com/en-gb/news/2015/05/fr-lab-report-digital-reporting

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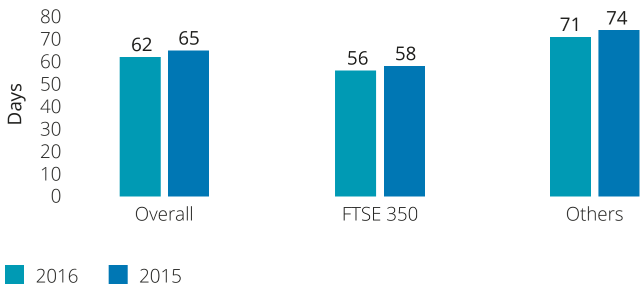
Reporting timetable

The average reporting times for companies approving their annual reports this year decreased to 62 days (2015: 65 days), as shown by Figure 4.13. This decrease occurred in both larger companies and smaller companies, with FTSE 350 companies reporting times reducing to 56 days (2015: 58 days) and other companies seeing a reduction to 71 days (2015: 74 days). The fastest reporter approved their report in 32 days (2015: 36 days) – marginally faster than the prior year. The slowest reporter took 120 days to approve their report (2015: 122 days). This overall decrease suggests companies are starting to plan the annual reporting process more effectively prior to year-end, such that the work to be performed subsequent to year end is minimised and information can be released to shareholders on a timelier basis. Our accompanying publication *Planning your report* contains ideas for how to make this process as efficient as possible.

Figure 4.13 How long did it take to approve the annual report?



Preliminary announcements

Providing a preliminary announcement to the market is a method for companies to demonstrate compliance with Listing Rule 9.7A.2 (announcement of dividend and distribution decisions) and DTR 2.2 (disclosure of price sensitive information). Whilst only voluntary, we continue to see companies placing importance on making an announcement to the market prior to the publication of the annual report with 100% (2015: 99%) of companies making some form of preliminary announcement.

Format of the first annual result announcement	2016	2015
Preliminary announcement that makes clear results still unaudited	4	4
Preliminary announcement with no mention of audit	4	6
Preliminary announcement based on audited results	88	86
Preliminary announcement based on audited results and includes a special-purpose audit report prepared specifically for the announcement	3	0
Full results in unedited text	1	3

Median number of days from year-end to preliminary announcement	2016	2015
Overall	60	61
FTSE 350	56	57
Others	69	71

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Good practice examples

Example 4.1

[G4S plc Integrated Report and Accounts 2015 (p10-11)]

G4S plc clearly links strategic priorities with key risks and KPIs; there are also cross references to other relevant sections which helps a user navigate the report.

STRATEGY AND PERFORMANCE

G4S is the world's leading global, integrated security company specialising in the delivery of security and related services to customers across six continents.

Our strategy addresses the positive, long-term demand for our services and we differentiate the G4S brand through our values and by investing in our customers, our people and our services. We build valuable, long-term relationships with our customers by combining a deep understanding of their businesses with our expertise in designing and delivering industry-leading, innovative services that protect and create value for their organisations.

Our strategic priorities are: investing in people, customers, service innovation and growth, operational and service excellence and disciplined financial management.

Our investment proposition is to provide shareholders with sustainable, long-term growth in earnings, cash flow and dividends.

* For a full description of the group's principal risks, please see pages 48 to 54.

** The group has a number of performance measures together with its financial key performance indicators (KPIs). A more detailed description of the financial KPIs and their 2015 performance is on page 36 and 37.

OUR STRATEGY	STRATEGIC PRIORITY	COMPETITIVE ADVANTAGE	KEY RISKS*	PROGRESS, PERFORMANCE MEASURES & KPIs **
We recruit, develop and deploy the best people in our industry	Investing in people	• Brand • Scale and breadth of business • Investment in selection, training, support and development • Recognition, incentives and rewards	• Our trained and skilled people are hired by competitors or other businesses (see Principal risks: People page 50)	• 130 new senior appointments • New leadership, operations and sales training programmes • Recruitment and retention
We build long-term customer relationships based upon trust and understanding of our customers' business and objectives	Investing in customers	• Sector expertise • Skilled account managers • Account and relationship management	• Failure to understand customers changing needs • Loss of customers (see Principal risks: Growth strategy page 52)	• Customer retention 90%+ • Contract retention 90%+
We design, market and deliver innovative, industry-leading services and solutions that protect and create value for our customers wherever they operate	Investing in growth and innovation	• Sector expertise • Investment in service innovation • Technology centres of excellence • Investment in sales and business development • Scale and breadth of market and service coverage	• Our service design fails to create adequate value for our customers • Failure to market or deliver services effectively (see Principal risks: Delivery of core service lines page 51 and Growth strategy page 52)	• Growing, diversified pipeline • Won new work of £1.3bn annual contract value (£2.4bn total contract value) in 2015 • New services and solutions launched • Integrated service offering • Global account wins / growth • Underlying revenue growth of 4.0%
We provide our clients with an outstanding service experience	Investing in service excellence	• Investment in training, supervision and development • Investment in systems and technology • Skilled account managers • Investment in account and relationship management	• Our service falls short of customer expectations (see Principal risks: Delivery of core service lines page 51 and Major contracts page 51)	• Established customer satisfaction programmes • Effective account management • Improving Net Promoter Score • Retention 90%+
We have secure, safe, reliable and efficient operations	Investing in operational excellence	• Investing in best in class operating and safety standards • Subject matter experts in operations, security and safety • Investment in systems and technology • Investment in global procurement • Investment in restructuring and lean process design	• Failure to comply with standards • Loss of expertise • Investment fails to deliver benefits	• Strengthened safety policies and resources • Successful implementation of major restructuring programmes • Lost time incidents • Zero harm
We manage risk effectively and ensure we have profitable, cash generative services	Financial discipline including portfolio management	• Standardised risk and contract assessment • Investment in skills and expertise • Investment in contract management capability • Investment in systems and technology	• Failure to comply with group standards • Inefficient capital management • Failure to realise expected value for disposals • See Principal risks: Major contracts page 51	• Group-wide capital allocation and efficiency • Focused working capital management • Major, accretive portfolio changes • Earnings per share (see page 37) • Operating cash flow (see page 37)

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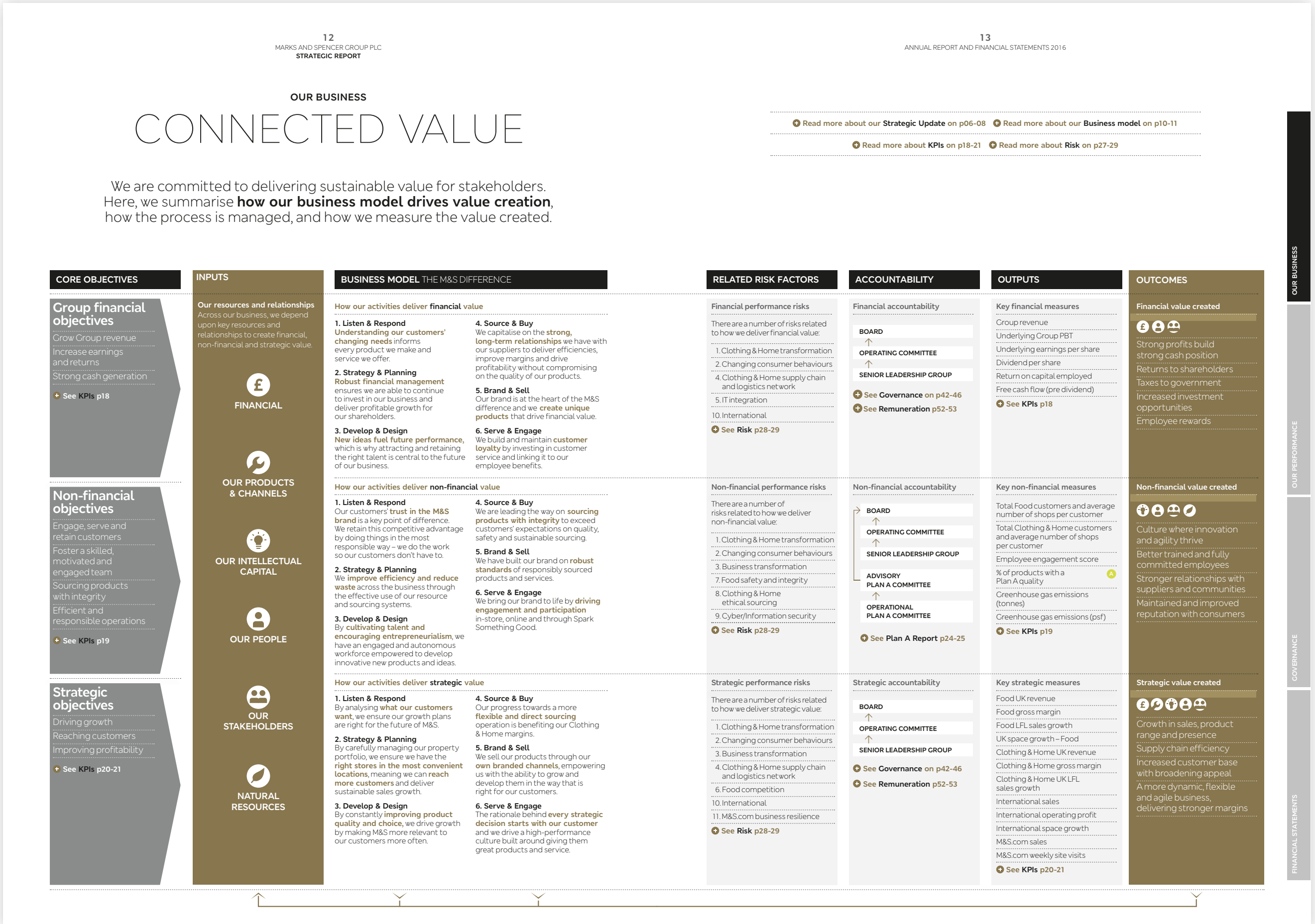
Example 4.2

[Marks and Spencer Group plc Annual Report and Financial Statements 2016 (p12-13)]

Clearly links together objectives, risks, KPIs and other factors in a single comprehensive chart.



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Example 4.3

[Paypoint Plc Annual Report 31 March 2016 (p20)](#)

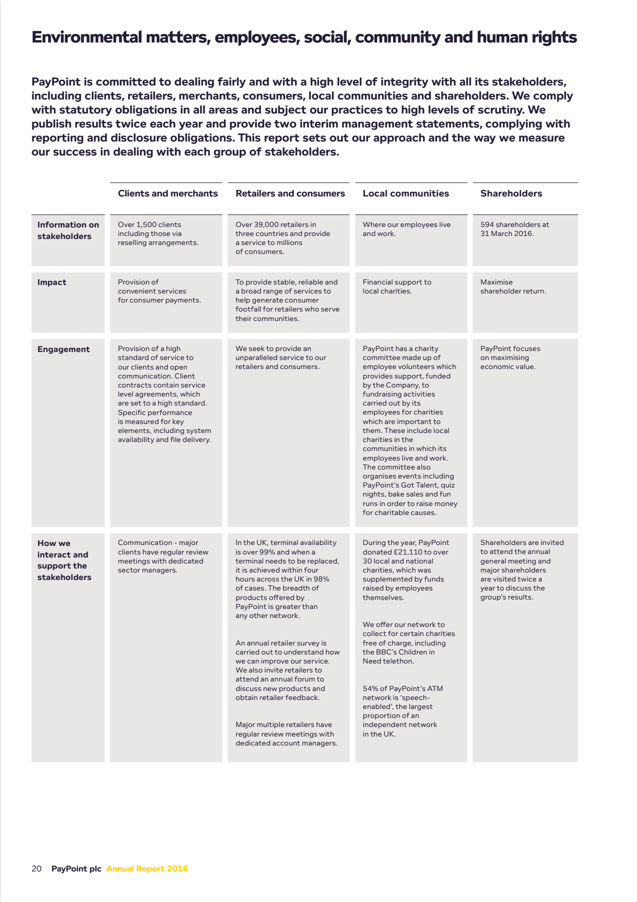
Clearly demonstrates who the company considers to be its key stakeholders and the process for interacting with and supporting them.

Example 4.4

[Mondi Group Integrated report and financial statements 2015 (p1)](#)

A brief but clear example of the considerations which went in to determining materiality for the annual report. This clearly shows the factors which were considered in determining whether financial or non-financial items were considered material.

Example 4.3



Environmental matters, employees, social, community and human rights

PayPoint is committed to dealing fairly and with a high level of integrity with all its stakeholders, including clients, retailers, merchants, consumers, local communities and shareholders. We comply with statutory obligations in all areas and subject our practices to high levels of scrutiny. We publish results twice each year and provide two interim management statements, complying with reporting and disclosure obligations. This report sets out our approach and the way we measure our success in dealing with each group of stakeholders.

	Clients and merchants	Retailers and consumers	Local communities	Shareholders
Information on stakeholders	Over 1,500 clients including those via reselling arrangements.	Over 39,000 retailers in three countries and provide a service to millions of consumers.	Where our employees live and work.	594 shareholders at 31 March 2016.
Impact	Provision of convenient services for consumer payments.	To provide stable, reliable and a broad range of services to help generate consumer footfall for retailers who serve their communities.	Financial support to local charities.	Maximise shareholder return.
Engagement	Provision of a high standard of service to our clients and open communication. Client contracts contain service level agreements, which are set to a high standard. Specific performance is measured for key elements, including system availability and file delivery.	We seek to provide an unparalleled service to our retailers and consumers.	PayPoint has a charity committee made up of employee volunteers which provides support, funded by the Company, to fundraising activities carried out by its employees for charities which are important to them. These include local charities in the communities in which its employees live and work. The committee also organises events including PayPoint's Got Talent, quiz nights, bake sales and fun runs in order to raise money for charitable causes.	PayPoint focuses on maximising economic value.
How we interact and support the stakeholders	Communication - major clients have regular review meetings with dedicated sector managers.	In the UK, terminal availability is over 99% and when a terminal needs to be replaced, it is achieved within four hours across the UK in 98% of cases. The breadth of products offered by PayPoint is greater than any other network. An annual retailer survey is carried out to understand how we can improve our service. We also invite retailers to attend an annual forum to discuss new products and obtain retailer feedback. Major multiple retailers have regular review meetings with dedicated account managers.	During the year, PayPoint donated £21,110 to over 30 local and national charities, which was supplemented by funds raised by employees themselves. We offer our network to collect for certain charities free of charge, including the BBC's Children in Need telethon. 54% of PayPoint's ATM network is 'speech-enabled', the largest proportion of an independent network in the UK.	Shareholders are invited to attend the annual general meeting and major shareholders are visited twice a year to discuss the group's results.

20 **PayPoint plc** Annual Report 2016

Example 4.4

Our 2015 performance

Underlying operating profit
€ million
€957m

Underlying earnings per share
euro cents
133.7 euro cents

Dividend per share
euro cents
52 euro cents

Return on capital employed
%
20.5%

- Significant profit improvements across all business units
- Completed major projects delivering to plan: contributing incremental €50 million to underlying operating profit in 2015
- Strong capital investment pipeline: €450 million in major projects approved and in progress
- Considerable progress made against our five-year sustainable development commitments

Scope

Mondi's Integrated report and financial statements 2015 is our primary report to shareholders.

The scope of this report covers the Group's main business and operations and provides an overview of the performance of the Group for the year ended 31 December 2015.

All significant items are reported on a like-for-like basis.

Our integrated report is prepared in accordance with the requirements of both the Listings Requirements of the JSE Limited and the Disclosure and Transparency and Listing Rules of the United Kingdom Listing Authority.

We also prepare a detailed sustainable development report, in accordance with the GRI G4 core requirements, and externally assured, which is available at **www.mondigroup.com/sd15**

Materiality

Mondi's Integrated report and financial statements 2015 aims to provide a fair, balanced and understandable assessment of our business model, strategy, performance and prospects in relation to material financial, economic, social, environmental and governance issues.

The material focus areas were determined considering the following:

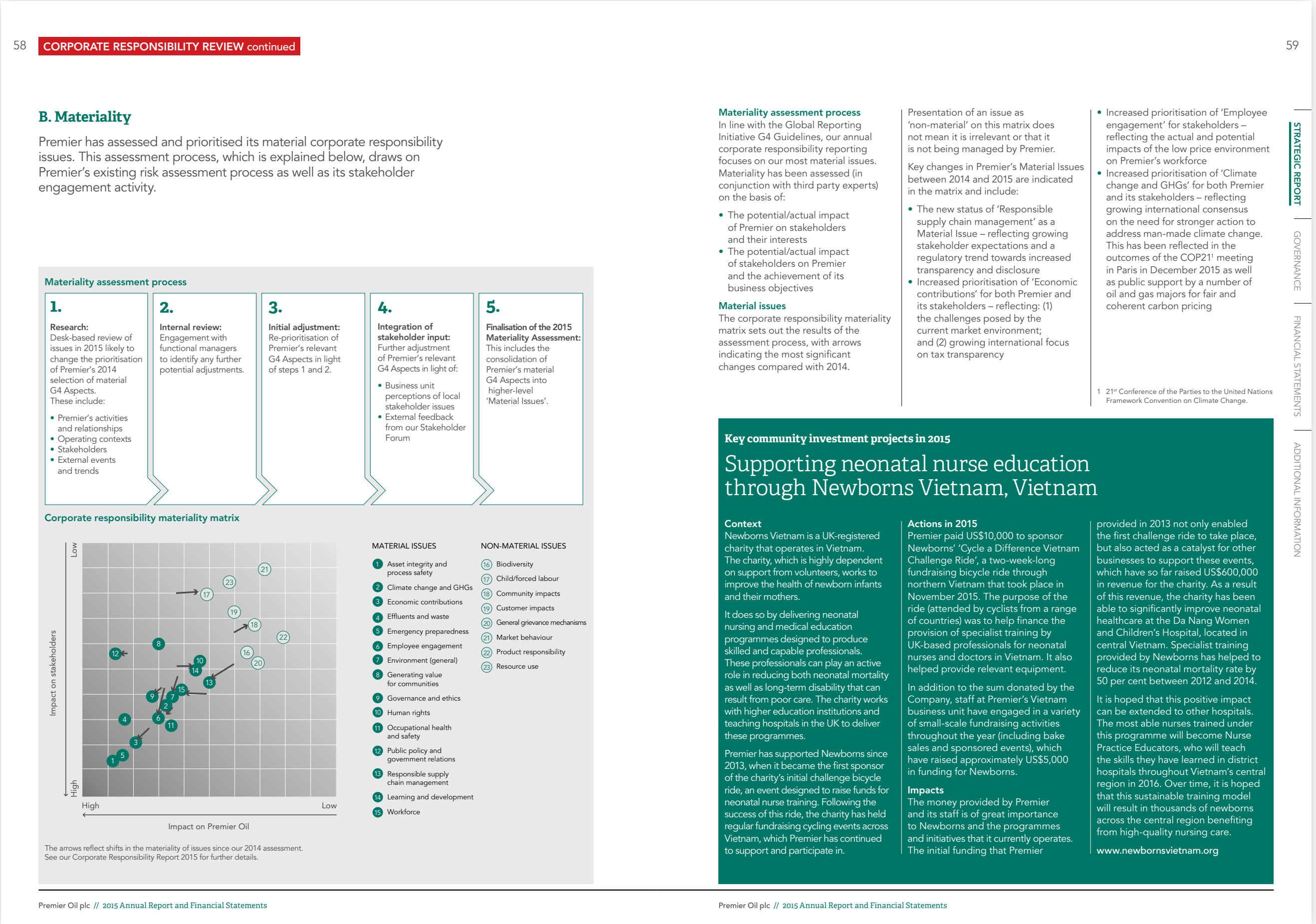
- Specific quantitative and qualitative criteria
- Matters critical in relation to achieving our strategic objectives
- Key risks identified through our risk management process
- Feedback from key stakeholders during the course of the year

Contents

Mondi Group Integrated report and financial statements 2015 1

Example 4.5
[Premier Oil plc 2015 Annual Report and Financial Statements (p58-59)]

Another good example of the materiality determination process with respect to sustainability was provided by Premier Oil plc. Non-financial issues have been assessed in terms of their impact on the company and stakeholders, and the materiality of each issue has been determined on that basis. This provides users with a clear understanding of how the Company has determined what issue they consider to be material.



58 CORPORATE RESPONSIBILITY REVIEW continued

B. Materiality

Premier has assessed and prioritised its material corporate responsibility issues. This assessment process, which is explained below, draws on Premier's existing risk assessment process as well as its stakeholder engagement activity.

Materiality assessment process

1. Research: Desk-based review of issues in 2015 likely to change the prioritisation of Premier's 2014 selection of material G4 Aspects. These include:
- Premier's activities and relationships
- Operating contexts
- Stakeholders
- External events and trends

2. Internal review: Engagement with functional managers to identify any further potential adjustments.

3. Initial adjustment: Re-prioritisation of Premier's relevant G4 Aspects in light of steps 1 and 2.

4. Integration of stakeholder input: Further adjustment of Premier's relevant G4 Aspects in light of:
- Business unit perceptions of local stakeholder issues
- External feedback from our Stakeholder Forum

5. Finalisation of the 2015 Materiality Assessment: This includes the consolidation of Premier's material G4 Aspects into higher-level 'Material Issues'.

Corporate responsibility materiality matrix

The arrows reflect shifts in the materiality of issues since our 2014 assessment. See our Corporate Responsibility Report 2015 for further details.

Premier Oil plc // 2015 Annual Report and Financial Statements

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Materiality assessment process
In line with the Global Reporting Initiative G4 Guidelines, our annual corporate responsibility reporting focuses on our most material issues. Materiality has been assessed (in conjunction with third party experts) on the basis of:
- The potential/actual impact of Premier on stakeholders and their interests
- The potential/actual impact of stakeholders on Premier and the achievement of its business objectives

Material issues
The corporate responsibility materiality matrix sets out the results of the assessment process, with arrows indicating the most significant changes compared with 2014.

Presentation of an issue as 'non-material' on this matrix does not mean it is irrelevant or that it is not being managed by Premier.

Key changes in Premier's Material Issues between 2014 and 2015 are indicated in the matrix and include:
- The new status of 'Responsible supply chain management' as a Material Issue – reflecting growing stakeholder expectations and a regulatory trend towards increased transparency and disclosure
- Increased prioritisation of 'Economic contributions' for both Premier and its stakeholders – reflecting: (1) the challenges posed by the current market environment; and (2) growing international focus on tax transparency
- Increased prioritisation of 'Employee engagement' for stakeholders – reflecting the actual and potential impacts of the low price environment on Premier's workforce
- Increased prioritisation of 'Climate change and GHGs' for both Premier and its stakeholders – reflecting growing international consensus on the need for stronger action to address man-made climate change. This has been reflected in the outcomes of the COP21[1] meeting in Paris in December 2015 as well as public support by a number of oil and gas majors for fair and coherent carbon pricing

1 21st Conference of the Parties to the United Nations Framework Convention on Climate Change.

STRATEGIC REPORT | GOVERNANCE | FINANCIAL STATEMENTS | ADDITIONAL INFORMATION

Key community investment projects in 2015

Supporting neonatal nurse education through Newborns Vietnam, Vietnam

Context
Newborns Vietnam is a UK-registered charity that operates in Vietnam. The charity, which is highly dependent on support from volunteers, works to improve the health of newborn infants and their mothers.

It does so by delivering neonatal nursing and medical education programmes designed to produce skilled and capable professionals. These professionals can play an active role in reducing both neonatal mortality as well as long-term disability that can result from poor care. The charity works with higher education institutions and teaching hospitals in the UK to deliver these programmes.

Premier has supported Newborns since 2013, when it became the first sponsor of the charity's initial challenge bicycle ride, an event designed to raise funds for neonatal nurse training. Following the success of this ride, the charity has held regular fundraising cycling events across Vietnam, which Premier has continued to support and participate in.

Actions in 2015
Premier paid US$10,000 to sponsor Newborns' 'Cycle a Difference Vietnam Challenge Ride', a two-week-long fundraising bicycle ride through northern Vietnam that took place in November 2015. The purpose of the ride (attended by cyclists from a range of countries) was to help finance the provision of specialist training by UK-based professionals for neonatal nurses and doctors in Vietnam. It also helped provide relevant equipment.

In addition to the sum donated by the Company, staff at Premier's Vietnam business unit have engaged in a variety of small-scale fundraising activities throughout the year (including bake sales and sponsored events), which have raised approximately US$5,000 in funding for Newborns.

Impacts
The money provided by Premier and its staff is of great importance to Newborns and the programmes and initiatives that it currently operates. The initial funding that Premier provided in 2013 not only enabled the first challenge ride to take place, but also acted as a catalyst for other businesses to support these events, which have so far raised US$600,000 in revenue for the charity. As a result of this revenue, the charity has been able to significantly improve neonatal healthcare at the Da Nang Women and Children's Hospital, located in central Vietnam. Specialist training provided by Newborns has helped to reduce its neonatal mortality rate by 50 per cent between 2012 and 2014.

It is hoped that this positive impact can be extended to other hospitals. The most able nurses trained under this programme will become Nurse Practice Educators, who will teach the skills they have learned in district hospitals throughout Vietnam's central region in 2016. Over time, it is hoped that this sustainable training model will result in thousands of newborns across the central region benefiting from high-quality nursing care.

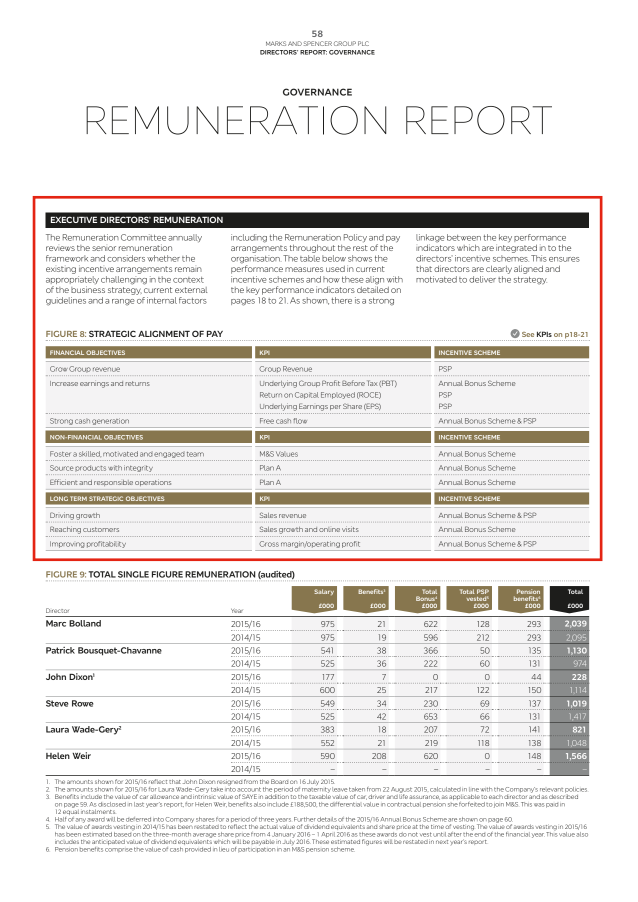
www.newbornsvietnam.org

Premier Oil plc // 2015 Annual Report and Financial Statements

Example 4.6

[Marks and Spencer Group plc Annual Report and Financial Statements 2016 (p58)]

This is a good example of linkage between strategy, KPIs and performance related pay. A cross reference has also been provided to the section on KPIs where further linkage is demonstrated to strategy and iconography has been used to illustrate which KPIs are related to performance related pay.



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MARKS AND SPENCER GROUP PLC
DIRECTORS' REPORT: GOVERNANCE

GOVERNANCE

REMUNERATION REPORT

EXECUTIVE DIRECTORS' REMUNERATION

The Remuneration Committee annually reviews the senior remuneration framework and considers whether the existing incentive arrangements remain appropriately challenging in the context of the business strategy, current external guidelines and a range of internal factors including the Remuneration Policy and pay arrangements throughout the rest of the organisation. The table below shows the performance measures used in current incentive schemes and how these align with the key performance indicators detailed on pages 18 to 21. As shown, there is a strong linkage between the key performance indicators which are integrated in to the directors' incentive schemes. This ensures that directors are clearly aligned and motivated to deliver the strategy.

FIGURE 8: STRATEGIC ALIGNMENT OF PAY

See KPIs on p18-21

FINANCIAL OBJECTIVES	KPI	INCENTIVE SCHEME
Grow Group revenue	Group Revenue	PSP
Increase earnings and returns	Underlying Group Profit Before Tax (PBT) Return on Capital Employed (ROCE) Underlying Earnings per Share (EPS)	Annual Bonus Scheme PSP PSP
Strong cash generation	Free cash flow	Annual Bonus Scheme & PSP
NON-FINANCIAL OBJECTIVES	**KPI**	**INCENTIVE SCHEME**
Foster a skilled, motivated and engaged team	M&S Values	Annual Bonus Scheme
Source products with integrity	Plan A	Annual Bonus Scheme
Efficient and responsible operations	Plan A	Annual Bonus Scheme
LONG TERM STRATEGIC OBJECTIVES	**KPI**	**INCENTIVE SCHEME**
Driving growth	Sales revenue	Annual Bonus Scheme & PSP
Reaching customers	Sales growth and online visits	Annual Bonus Scheme
Improving profitability	Gross margin/operating profit	Annual Bonus Scheme & PSP

FIGURE 9: TOTAL SINGLE FIGURE REMUNERATION (audited)

Director	Year	Salary £000	Benefits[3] £000	Total Bonus[4] £000	Total PSP vested[5] £000	Pension benefits[6] £000	Total £000
Marc Bolland	2015/16	975	21	622	128	293	2,039
	2014/15	975	19	596	212	293	2,095
Patrick Bousquet-Chavanne	2015/16	541	38	366	50	135	1,130
	2014/15	525	36	222	60	131	974
John Dixon[1]	2015/16	177	7	0	0	44	228
	2014/15	600	25	217	122	150	1,114
Steve Rowe	2015/16	549	34	230	69	137	1,019
	2014/15	525	42	653	66	131	1,417
Laura Wade-Gery[2]	2015/16	383	18	207	72	141	821
	2014/15	552	21	219	118	138	1,048
Helen Weir	2015/16	590	208	620	0	148	1,566
	2014/15	–	–	–	–	–	–

1. The amounts shown for 2015/16 reflect that John Dixon resigned from the Board on 16 July 2015.
2. The amounts shown for 2015/16 for Laura Wade-Gery take into account the period of maternity leave taken from 22 August 2015, calculated in line with the Company's relevant policies.
3. Benefits include the value of car allowance and intrinsic value of SAYE in addition to the taxable value of car, driver and life assurance, as applicable to each director and as described on page 59. As disclosed in last year's report, for Helen Weir, benefits also include £188,500, the differential value in contractual pension she forfeited to join M&S. This was paid in 12 equal instalments.
4. Half of any award will be deferred into Company shares for a period of three years. Further details of the 2015/16 Annual Bonus Scheme are shown on page 60.
5. The value of awards vesting in 2014/15 has been restated to reflect the actual value of dividend equivalents and share price at the time of vesting. The value of awards vesting in 2015/16 has been estimated based on the three-month average share price from 4 January 2016 – 1 April 2016 as these awards do not vest until after the end of the financial year. This value also includes the anticipated value of dividend equivalents which will be payable in July 2016. These estimated figures will be restated in next year's report.
6. Pension benefits comprise the value of cash provided in lieu of participation in an M&S pension scheme.

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Example 4.7

[Compass Group PLC Annual Report 2015 (p8-9)]

A concise chief executive's statement presented in the format of a question and answer session. The topics discussed were not duplicated in the chairman's statement and the statement provided a concise summary to users of the issues relevant to an understanding of the performance and position of the company.

Strategic report

CHIEF EXECUTIVE'S STATEMENT

CREATING SHAREHOLDER VALUE THROUGH DISCIPLINED GROWTH

"Compass has had another strong year. Performance in North America continues to be excellent, growth in Europe & Japan is accelerating and, despite some challenges, our Fast Growing & Emerging region continues to perform well.

Q WHAT WAS REVENUE GROWTH IN THE YEAR?

Revenue for the Group increased by 5.8% on an organic basis. Underlying revenue at reported rates increased by 4.6%, reflecting the strengthening of sterling against many of the Group's key currencies, which was partly offset by the benefit of the strengthening of the US dollar.

New business wins were 8.8%, driven by a strong performance in MAP 1 (client sales and marketing) in North America and Fast Growing & Emerging and accelerating growth in Europe & Japan. Our retention rate improved and is now 94.5%, reflecting our ongoing focus and investment.

We aim to increase consumer participation and spend through MAP 2 (consumer sales and marketing) initiatives. This, combined with a more benign macroeconomic environment in many of our markets, resulted in like for like revenue growth of 2.5%, reflecting modest price increases and improving volumes in North America and Europe & Japan. In Fast Growing & Emerging, we have seen like for like weakness in some emerging markets and in our Offshore & Remote business.

Q WHAT ACTIONS ARE YOU TAKING TO ADDRESS THE WEAKNESS IN EMERGING MARKETS AND IN THE OFFSHORE & REMOTE BUSINESS?

On 29 July 2015, we announced that in addition to our ongoing restructuring activities – which partly help us deliver yearly efficiencies – we are proactively reducing the cost base in our Offshore & Remote business globally and in some emerging markets. This incremental restructuring cost of around £50 million will be included in operating profit. In 2015, we incurred a £26 million charge, most of which was for labour cost reductions, with £9 million non-cash. We expect the remaining £20-25 million of restructuring costs to be incurred in 2016.

Q WHAT HAPPENED TO OPERATING PROFIT AND OPERATING MARGIN IN 2015?

Excluding the impact of the restructuring, organic operating profit increased by 6.5% and the underlying operating margin improved by 10 basis points as we continue to drive efficiencies across the business using our management and performance framework, MAP. We have maintained our focus on MAP 3 (cost of food) with initiatives such as menu planning and supplier rationalisation, as well as continually optimising MAP 4 (labour and in unit costs) and MAP 5 (above unit costs). These efficiencies are helping us to invest to support the exciting growth opportunities we see around the world and deliver further margin improvement. After restructuring costs, underlying operating profit increased by 4.6% on a constant currency basis, with the underlying operating margin remaining flat.

Q DID YOU RETURN SURPLUS CASH TO SHAREHOLDERS IN 2015?

Returns to shareholders continue to be an integral part of our business model. The Group bought back £328 million worth of shares in the year and going forward we will continue to maintain strong investment grade credit ratings, returning any surplus cash to shareholders to target net debt/EBITDA of around 1.5x.

Q WHAT IS THE GROUP'S STRATEGY?

Food is our focus and our core competence. The food service market is estimated to be more than £200 billion; with only around 50% of the market currently outsourced, it represents a significant opportunity. We believe the benefits of outsourcing become increasingly apparent as economic conditions and regulatory changes put increasing pressure on organisations' budgets. As one of the largest providers in all of our sectors, we are well placed to benefit from these trends.

Our approach to support and multi services is low risk and incremental, with strategies developed on a country by country basis. Our largest sector in this market is Defence, Offshore & Remote, where the model is almost universally multi service. In addition, we have an excellent support services business in North America and some operations in other parts of the world. This is a complex segment and there are significant differences in client buying behaviour across countries, sectors and sub-sectors.

8 Compass Group PLC Annual Report 2015

Q WHAT IS THE GROUP'S GEOGRAPHIC SPREAD?

We have a truly international business, with operations in over 50 countries. Our three geographic regions comprise countries with similar market characteristics or at similar stages of development.

North America (52% of Group revenue) is likely to remain the principal growth engine for the Group. We have a market leading business, which delivers high levels of growth by combining the cost advantage of our scale with a segmented, client facing sector approach. The outsourcing culture is vibrant and the addressable market is significant.

The fundamentals of our businesses in Europe & Japan (31% of Group revenue) are good and we see many opportunities to drive growth in revenue and margin. Our investment in MAP 1 sales and retention has accelerated our organic revenue growth and we continue to see opportunities to drive efficiencies and make our operations more competitive.

Fast Growing & Emerging (17% of Group revenue) offers excellent long term growth potential. Our largest markets are Australia, Brazil and Turkey, and we are growing rapidly in India and China. Lower commodity prices and a weak macroeconomic backdrop have impacted our Offshore & Remote business and some of our emerging markets in the year. We are in the process of restructuring our business where necessary to adapt to the changing market environment, and remain excited about the attractive long term growth prospects of the region.

In 2016, we will change the way we run the business and will adjust our regional reporting accordingly. Going forward, our three regions will be: North America (unchanged), Europe (including Turkey and Russia) and Rest of World (including Japan). We will publish restated historical financials on 19 January 2016.

Q WHAT ARE THE GROUP'S MAIN COMPETITIVE ADVANTAGES?

OUR SECTORISED APPROACH
We segment the market and create sectors and sub-sectors to develop customised dining solutions that meet the requirements of a growing range of clients and consumers. Our portfolio of B2B brands enables us to differentiate these propositions and maximise our market coverage, while benefiting from the cost advantages of scale in food procurement and back office costs.

OUR SCALE
As we continue to grow, our scale enables us to achieve our goal of being the lowest cost, most efficient provider of food and support services. Scale is a benefit in terms of food procurement, labour management and back office costs. It underpins our competitiveness and enables us to deliver sustainable growth over time.

OUR MAP CULTURE
We speak one common MAP language. All our employees use a simple framework to drive performance across the business. This framework helps us focus on a common set of business drivers, whether it is winning new business in the right sector on the right terms (MAP 1), increasing our consumer participation and spend (MAP 2), reducing our food costs (MAP 3), or labour costs (MAP 4 and 5).

Q WHAT ARE THE GROUP'S MAIN USES OF CASH AND BALANCE SHEET PRIORITIES?

The Group's cash flow generation remains excellent and it will continue to be a key part of the business model. Our priorities for how we use our cash remain unchanged. We will continue to: (i) invest in the business to support organic growth where we see opportunities with good returns; (ii) pursue M&A opportunities, our preference is for small to medium sized infill acquisitions, where we look for returns greater than our cost of capital by the end of year two; (iii) grow the dividend in line with earnings per share; and (iv) maintain strong investment grade credit ratings returning any surplus cash to shareholders to target net debt/EBITDA of around 1.5x.

Q HOW WOULD YOU SUMMARISE 2015?

Compass has had another strong year. North America continues to deliver excellent growth. Our business in Europe & Japan is enjoying a strong recovery as we are rewarded for our investment to accelerate growth in the region. Our Fast Growing & Emerging region continues to perform well despite lower volumes and pricing pressures in the Offshore & Remote sector, and in some emerging markets.

We continue to drive operating efficiencies around the business, which we are partly reinvesting in the growth opportunities we see across the Group. Excluding the £26 million of restructuring costs announced in July, underlying operating margin for the Group improved by 10 basis points.

Q WHAT IS YOUR OUTLOOK FOR 2016?

Our expectations for 2016 are positive and unchanged. The pipeline of new contracts is strong, and the savings from the restructuring, together with the margin improvement in the rest of the Group, are expected to offset the impact of lower volumes and pricing pressures in our Fast Growing & Emerging region.

In the longer term, we remain excited about the significant structural growth opportunities globally and the potential for further revenue growth, margin improvement, as well as continued returns to shareholders through dividends and ongoing share buybacks.

Richard Cousins

RICHARD COUSINS
Group Chief Executive
24 November 2015

Strategic report

Compass Group PLC Annual Report 2015 9

05

Summary material

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Summary material

Top Tips

- A summary section provides an opportunity to communicate the key messages in a clear and concise way and can also be used to demonstrate how key information within the report is inter-related e.g. strategy to KPIs. This helps users get a more comprehensive understanding of how the company creates value yet, disappointingly, only 7% (2015: 7%) of companies did this. However, 14% (2015: 15%) of companies did demonstrate this linkage outside of the summary section by including a single summary of how key information in the report inter-relates elswhere in the report.

- Providing a cross reference from the summary section to further detail contained in the annual report helps create a more concise report where information is not unnecessarily repeated. It also creates a more navigable report for users. 54% (2015: 47%) of companies provided a cross reference from material in the summary section to elsewhere in the annual report.

- Consider whether to include more discussion of non-financial measures in the summary section. This year 47 (2015: 44) companies provided some form of non–financial measure in the summary section, although only 13 (2015: 13) provided any of their non-financial KPIs in the summary section. If non-financial measures are considered key to understanding the performance of the business, and therefore identified as KPIs, companies should consider drawing these to the attention of the user earlier on in the report.

- Give appropriate context for numerical information presented in the summary section. Prior year comparatives and trend information can be helpful in this regard, as well as narrative commentary that indicates whether the actual results represent over or under-performance.

Keep an eye on

- How well the KPIs help users understand the company's performance. Including KPIs within the financial 'highlights' of a company's summary section demonstrates consistency in terms of how an entity monitors the performance of the business. 79% (2015: 73%) of companies included KPIs in their summary section although only 5% (2015: 8%) included all of their KPIs.

- Whether non-GAAP measures are consistent with other information presented in the annual report, e.g. the measures used to assess executive remuneration or the information presented as part of the IFRS 8 *Operating Segments* disclosure. This helps to demonstrate the purpose of the measure to users and shows it is fundamental to those charged with governance in assessing the performance of the business. 48% (2015: 37%) of companies demonstrated consistency between non-GAAP measures and IFRS 8 *Operating Segments* disclosures. Demonstrating the purpose of an APM is also a requirement of the ESMA Guidelines on APMs.

- The level of prominence given to non-GAAP measures. In order to comply with the ESMA Guidelines on Alternative Performance Measures (APMs) companies should not be giving non-GAAP measures more prominence than GAAP measures. However, in this year's reports 72% (2015: 70%) of companies that presented non-GAAP measures in their summary section gave more prominence to them than corresponding GAAP measures.

- The transparency of reconciliations of non-GAAP measures to GAAP measures. Such reconciliations provide users with a deeper understanding of how the measures relate to one another and what adjustments management have made. In this year's survey 37% of companies provided a clear reconciliation for all non-GAAP measures which was clearly cross referenced on the summary page. Provision of such reconciliations is another requirement of the ESMA Guidelines.

Introduction

There is no specific legal requirement for companies to include a summary section in their annual report. However, with annual reports getting longer (as discussed in chapter 4) and the continuing calls for clear and concise reporting, setting the scene upfront is a great way to help a user of the report understand the key messages.

A well-structured and informative summary section highlights the key financial and non-financial information contained within the annual report, demonstrates how they link together and provides signposts to further detail within the annual report.

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For the purposes of our survey, determining what constituted a 'summary section', as distinct from the strategic report more generally, required some level of judgement. Many companies did not make a clear distinction between the two, whereas others more clearly identified a discrete section before the strategic report. Nevertheless, in the former scenario summary-type information still tended to be provided very close to the start of the annual report. The information included in what we believed to represent summary sections, even if they were not labelled as such, is discussed in more detail below.

Although there is no requirement to present a summary section, having chosen to present one directors must ensure that the information contained in it does not mean that they fail to comply with the legal requirement that the strategic report is fair, balanced and comprehensive[31].

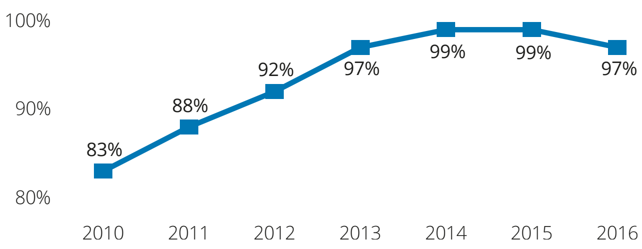
One way in which this might occur is by including good news in the summary section but only discussing less positive news later in the report, thereby giving undue prominence to the good news. Another is by using non-GAAP financial measures to demonstrate the company's performance to users without giving an appropriate level of information to enable users to understand them. For 2016 annual reports, the FRC will consider whether companies are materially non-compliant with ESMA's Guidelines on Alternative Performance Measures[32] (APMs) when deciding whether their annual report complies with the legal requirements[33]. One of the most significant of the requirements of the ESMA Guidelines is that APMs should not be presented with greater prominence than the most closely corresponding GAAP financial measures. Meeting this requirement will require a change in presentation for a large number of companies.

How popular was the inclusion of a summary section in the annual report?

A summary section provides an opportunity for companies to set the scene for users by highlighting the key messages and providing an overview of the key financial and non-financial information contained within the annual report. It can also be used to demonstrate how the various aspects of the annual report are connected to give a holistic view of the business, and is a good place to provide clear signposting and cross-referencing to where users can find more detail.

Despite there being no legal or regulatory requirement to provide a summary section, it continues to be common practice. Figure 5.1 shows the trend of the number of annual reports to include a summary section over the past seven years. Despite the marginal decrease it is clear that companies continue to see the benefits of a summary section in communicating the key messages to the users of the annual report.

Figure 5.1 How many annual reports include a summary information section?



Proportion of companies not presenting a summary section	2016	2015
FTSE 350	2%	0%
Others	5%	2%

In its Corporate Reporting Review Annual Report 2015[34] the FRC commented that some smaller companies fail to "explain their story fully". Given the importance of the summary section in setting the scene to the user, the lack of a summary in some smaller company reports could go some way in explaining the FRC's observation.

31 Companies Act 2006 s414C(2)(3)

32 http://www.iasplus.com/en-gb/news/2015/06/esma-apm

33 http://www.iasplus.com/en-gb/news/2016/05/frc-apm

34 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/October/FRC-publishes-Corporate-Reporting-Review-Annual-Re.aspx

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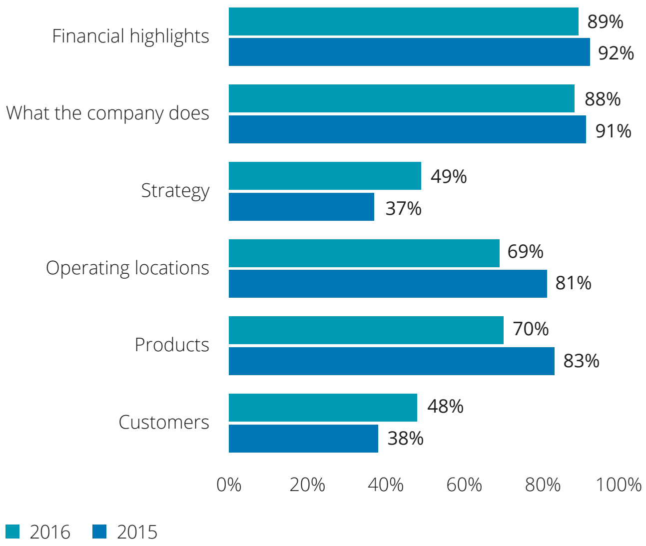
What kind of information is included in the summary section?

Whilst there are no legal or regulatory requirements with respect to a summary section, it is important that companies comply with the requirement of the UK Corporate Governance Code 2014 to give a “fair, balanced and understandable assessment of the company’s position and prospects” (Section C.1.). The summary section should therefore provide a balanced picture of good and bad news.

Companies presented a wide variety of information in their summary sections with a good a balance between financial and non-financial information. 95 (2015: 95) companies presented some sort of narrative information in the summary section and 89 companies (2015: 92) provided some financial information (see section on financial highlights for further discussion). Figure 5.2 shows in more detail what kind of information companies included in their summary sections.

Figure 5.2 What kind of summary information is presented?



Typically companies chose to set the scene by giving some brief information about the following.

- What the company does – though only 15 companies provided specific detail about their business model in the summary section – an example of this is given by **Acacia Mining plc (Example 5.1)**. A concise discussion of a company’s business model provides users with an understanding of the inputs, processes and outputs and an idea of how the company creates value for its stakeholders. It was therefore surprising to see so few companies discuss this.

- Where it does it – this is often presented as a map – an example of this is given by **Kaz Minerals plc (Example 5.2)**. As that tends to take up space, perhaps the 12% decrease this year is a result of companies feeling they could reduce the report length by cutting this out. Information is often given about the wider industry in which they operate as well.

- Their strategy – more companies are doing this year and furthermore, this year 26 companies (2015: 16) also discussed the progress that they made during the year against their strategic priorities. It is useful to do this as it gives context to any financial and non-financial KPIs presented.

The number of companies discussing customers in the summary section has increased, maybe as companies are increasingly taking a more integrated approach to the way they report, considering stakeholders and the role they play in the company’s value creation (as noted in chapter 4).

Companies also included a variety of other pieces of information in their summary section, including the items in the table and those listed below:

- financial and non-financial information on key divisions of the company (for example Sportech PLC and RM Plc);
- information on the company's approach to sustainability and corporate social responsibility (for example Croda International Plc and Mondi Group);
- a timeline showing key milestones since the company's incorporation (for example St. Modwen Properties PLC and Gresham Computing plc); and
- case studies illustrating various things such as the implementation of strategy, development of products, employee and customer experiences. Including one or two short, tailored case studies can be helpful to engage a reader with the report and bring it to life. However, including too many long case studies can break up the flow of the report and make it hard to follow.

Other Information presented in the summary section	2016	2015
Governance	14	22
Investment case	6	7

Most companies tend to summarise their governance information in the chairman's statement rather than the summary section of the annual report.

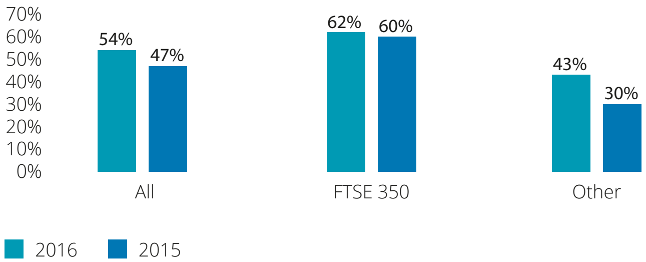
The number of companies presenting an explicit 'investment case' remains low. Such investment cases often tend to be promotional in nature and favour good news over bad, which can create a lack of balance in the summary section.

Linkage to the rest of the report

Providing an overview of the contents of the annual report upfront gives the company the opportunity to show how sections of the report hang together through cross-referencing and signposting e.g. how the environment the company operates in drives the strategy, the KPIs used to measure progress and the risks that might impact the performance of the business. As noted in the FRC's Guidance on the Strategic Report[35], care should be taken to ensure companies clearly explain a relationship where this has been highlighted to users, this helps create a more cohesive report and clearly demonstrates linkage between sections. The use of linkage is particularly relevant for summary sections as this is the first section users will see.

It was encouraging to see a small increase in the number of companies providing a cross–reference to where summary items are discussed in more detail within the annual report, as shown by Figure 5.3. It is encouraging to see a marked improvement in the proportion of smaller companies providing these cross-references. It was less encouraging to see few companies demonstrating a link between the various elements of the annual report within the summary section. Only 7% (2015: 7%) of companies demonstrated such linkage – an example of which is provided by **CLS Holdings plc (Example 5.5)**. Whilst few companies demonstrated this in the summary section, it is worth noting an additional 14% (2015: 15%) of companies did demonstrate this linkage outside of the summary section.

Figure 5.3 Is there a cross-reference to where the summary items are discussed in more detail (i.e. to facilitate navigation)*?



Presentation of financial highlights and use of GAAP v non–GAAP measures

As shown by Figure 5.2 above, the majority of companies included financial information in their summary section. This was often in a section called 'financial highlights'. Companies might want to consider whether the term 'highlights' is unduly positive and also ensure that the most relevant measures are included, not just those that provide the best news. Companies should also look to provide context for the

35 https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf

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financial information presented in the summary section – **John Wood Group plc (Example 5.6)** and **United Utilities Group PLC (Example 5.7)** provide good examples of this. Prior year comparatives (see below for further discussion on comparability with respect to the ESMA Guidelines) and trend information can be helpful in this regard, as well as narrative commentary that indicates whether the actual results represent over or under-performance.

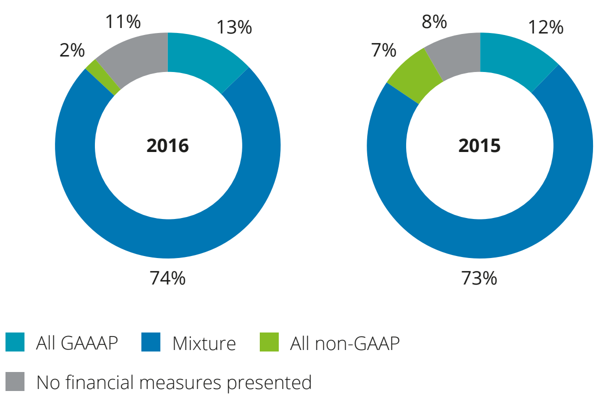
Figure 5.4 shows the types of financial measures that were presented by the companies surveyed. The number of companies presenting a mixture of GAAP and non-GAAP measures was broadly consistent with the previous year, with 74 companies doing so (2015: 73 companies).

A non-GAAP measure or Alternative Performance Measure (APM), as defined by The European Securities and Markets Authority (ESMA) in their Final Report: ESMA Guidelines on Alternative Performance Measures in June 2015[36] (ESMA Guidelines), is "a financial measure of historical or future financial performance, position or cash flows of an entity which is not a financial measure defined or specified in the applicable financial reporting framework." We have used this definition as a basis for determining whether companies have disclosed non-GAAP measures in their annual report.

The use of APMs in the context of KPI sections is discussed in chapter 7 and their presentation in the financial statements is examined in chapter 13.

The use of non-GAAP measures in summary sections is widespread. As they are not prescribed by GAAP, there has been a significant degree of flexibility in how companies identify and present them. This flexibility has caused concern amongst investors, with a study[37] by the CFA Society of the UK (a body representing investment professionals) noting that only a third of respondents preferred non-IFRS measures over IFRS measures.

Figure 5.4 What type of financial measures are presented by companies in their summary section?



Whilst there has been concern, the use of non-GAAP measures can be a useful way for companies to present their position and performance in a way they believe to be most meaningful, provided they are presented in a clear and transparent manner. However, a note of caution was sounded recently by the Chairman of the IASB, Hans Hoogervorst, who pointed out that "securities regulators in the world of IFRS Standards are concerned that non-GAAP numbers are getting increasingly detached from reality" and that "the bottom line of the income statement will always remain the most important performance measure over time"[38].

In order to address this concern within the market, the ESMA Guidelines have outlined the information that companies should be presenting to support these measures. Regulators have also acted on this concern, with the FRC announcing that their Conduct Committee will consider compliance with the ESMA Guidelines in their reviews of reports in the determination of whether the strategic report is fair, balanced and comprehensive, and will take enforcement action if required[39].

The ESMA Guidelines discuss a number of principles to ensure APMs are clearly presented, four of which have been assessed as part of this survey.

36 http://www.iasplus.com/en/news/2015/06/esma-apm

37 https://secure.cfauk.org/assets/1345/Analysis_of_FRAC_survey_2015.pdf

38 http://www.iasplus.com/en-gb/news/2016/05/hoogervorst-non-gaap

39 https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/May/FAQs-on-the-application-of-the-European-Securities.aspx

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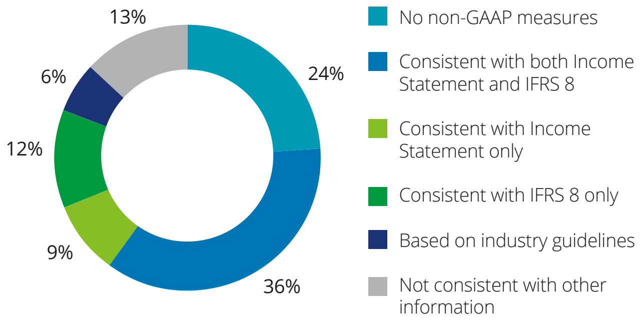
1. The **purpose** of the measure should be clearly set out. A company should explain why the non-GAAP measures give meaningful information to users of the annual report. Consistency between the non-GAAP measures used in the summary section and those used internally (for example, those reported to management and presented in the financial statements as part of IFRS 8 ***Operating Segments*** disclosures) makes this purpose easier to illustrate. Figure 5.5 shows the consistency between the non-GAAP measures presented in the summary section and other information in the annual report. Consistency of measures in the summary section with KPIs is also considered below. 48% (2015: 49%) of companies presented measures which were calculated on a consistent basis with that used in the IFRS 8 disclosures. However, 13% (2015: 10%) of companies disclosed non-GAAP measures in the summary section which were not consistent with industry guidelines or the way information was presented in the financial statements, a marginal increase on the prior year. Companies would be well advised to revisit measures used throughout the report to ensure consistency and to make sure that the purpose of the non-GAAP measures used is clear. It is an area that regulators are likely to be paying attention to. 6% (2015: 7%) of companies provided measures which were consistent with an 'industry-standard' measure, such as those published by the European Public Real Estate Association (EPRA) and the European Insurance CFO Forum (the forum that published the European Embedded Value 'EEV' measure). Companies who are in these industries, and are presenting these measures, need to ensure that the ESMA Guidelines are applied to these measures in addition to any other measures they are presenting.

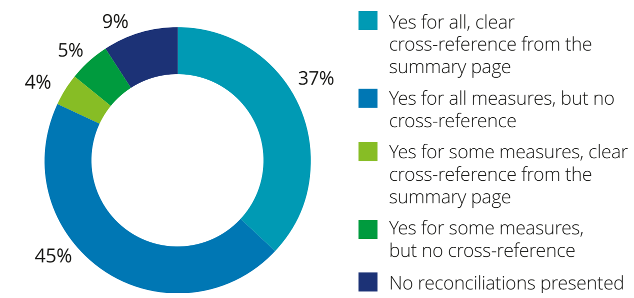
2. Non-GAAP measures should not be given more **prominence** than GAAP measures. ESMA Guidelines state that the equivalent GAAP measure should be presented alongside the non–GAAP measure and this should be of equal or more prominence. 72% (2015: 70%) of companies that presented a non-GAAP measure in the summary section did so without providing the GAAP equivalent or presented the non-GAAP measure in what appeared to be a more prominent way (e.g. presenting the GAAP measure in a smaller font below the non-GAAP measure). Although it is not yet clear exactly how the FRC will interpret the requirement for 'equal prominence' in a UK context, many companies will have to reconsider the way they are presenting APMs in their summary sections as the majority do not appear to be compliant with this aspect of the ESMA Guidelines.

Figure 5.5 How consistent are non-GAAP measures?



3. Provide clear **reconciliations** showing how a non-GAAP measure derives from the specific GAAP line item in the financial statements. Encouragingly, only 9% of the companies that presented non–GAAP measures failed to provide any reconciliation – see Figure 5.6. However, not all of those that did present some reconciliations necessarily gave enough information to meet the requirements of the ESMA Guidelines. Of the 91% of companies that provided reconciliations, 54% did not clearly cross reference these reconciliations from the summary page, or only provided reconciliations for some of the non–GAAP measures presented. For these reconciliations to be useful it is important that it is easy for a user to find them, something that a cross-reference makes quick and easy. Providing users with reconciliations clearly shows what adjustments have been made to the GAAP line items and, when comparatives are provided, allows users to assess consistency between non-GAAP measures between periods. Companies are therefore encouraged to revisit these disclosures and ensure clear reconciliations are provided and these are cross referenced when the relevant non-GAAP measure is referred to in the report.

Figure 5.6 Were reconciliations presented by those companies which presented non-GAAP measures?



4. **Comparatives** should be given for all APMs. 87% of companies that presented non-GAAP measures provided a comparative for at least one year, the average being two years. Providing comparatives allows users to understand year-on-year performance of the company and, alongside clear reconciliations, gives an understanding of the consistency of reconciling items. It was therefore encouraging to see the majority of companies' present comparatives. It is worth noting that those companies who failed to provide comparatives for non-GAAP measures will need to do so in their next annual report in order to be compliant with the ESMA Guidelines.

In order to assist companies in complying with the ESMA Guidelines, Deloitte has published Need to know – Alternative performance measures: A practical guide[40]. This publication explores some of the key messages from regulators, standard setters and investors about the use of APMs, with a particular focus on assisting compliance with the ESMA Guidelines and sets out what is considered to be best practice in presenting APMs.

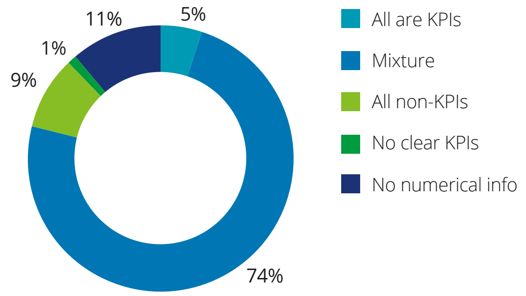
National Grid (Example 5.3), **BT Group plc (Example 5.4)** and Rolls-Royce Holdings plc appear to have taken on board aspects of the ESMA Guidelines.

Inclusion of KPIs in summary information

Companies clearly continue to see the benefit of drawing users' attention to those measures considered key to understanding the performance of the company at the beginning of the annual report. Figure 5.7 shows that many companies presented KPIs in their summary sections. However, despite 70 (2015: 74) companies presenting a non-financial KPI later on in the annual report, only 13 (2015: 13) of them included any of these in the summary section. When comparing this to financial KPIs, 79 (2015: 74) of the 93 (2015: 90) companies that presented financial KPIs included some of these in the summary section. This demonstrates that companies still appear to see financial KPIs as more important to a user in their understanding of the business. Companies do however see value in providing some non-financial measures in the summary section with 47 (2015: 44) companies providing some form of non–financial measure in the summary section, although for most these were not included as KPIs later on in the report.

Given KPIs are considered key measures in understanding the performance and position of the business, you would have thought drawing these to the attention of the user early on would provide them with a useful initial snapshot of the business, and set the scene for the report. It was therefore interesting to note that few companies favour presenting all of their KPIs in the summary section (sometimes along with non-KPIs), with only eight (2015: five) companies doing so and with nine companies not including any of their KPIs in the summary section. For more discussion of how companies presented their KPIs, see chapter 7.

Figure 5.7 Are measures presented in the summary section the same as KPIs?



	Type of KPIs presented in the in the summary section (i.e. financial, non-financial or a mixture)	2016	2015
Overall	Financial	66	61
	Both financial and non-financial	13	13
	N/A*	21	26
FTSE 350	Financial	39	34
	Both financial and non-financial	10	10
	N/A*	9	13
Other	Financial	27	27
	Both financial and non-financial	3	3
	N/A*	12	13

*N/A relates to companies that either didn't present a summary section, companies that only presented narrative information in the summary section or companies that did not present any KPIs in their summary section.

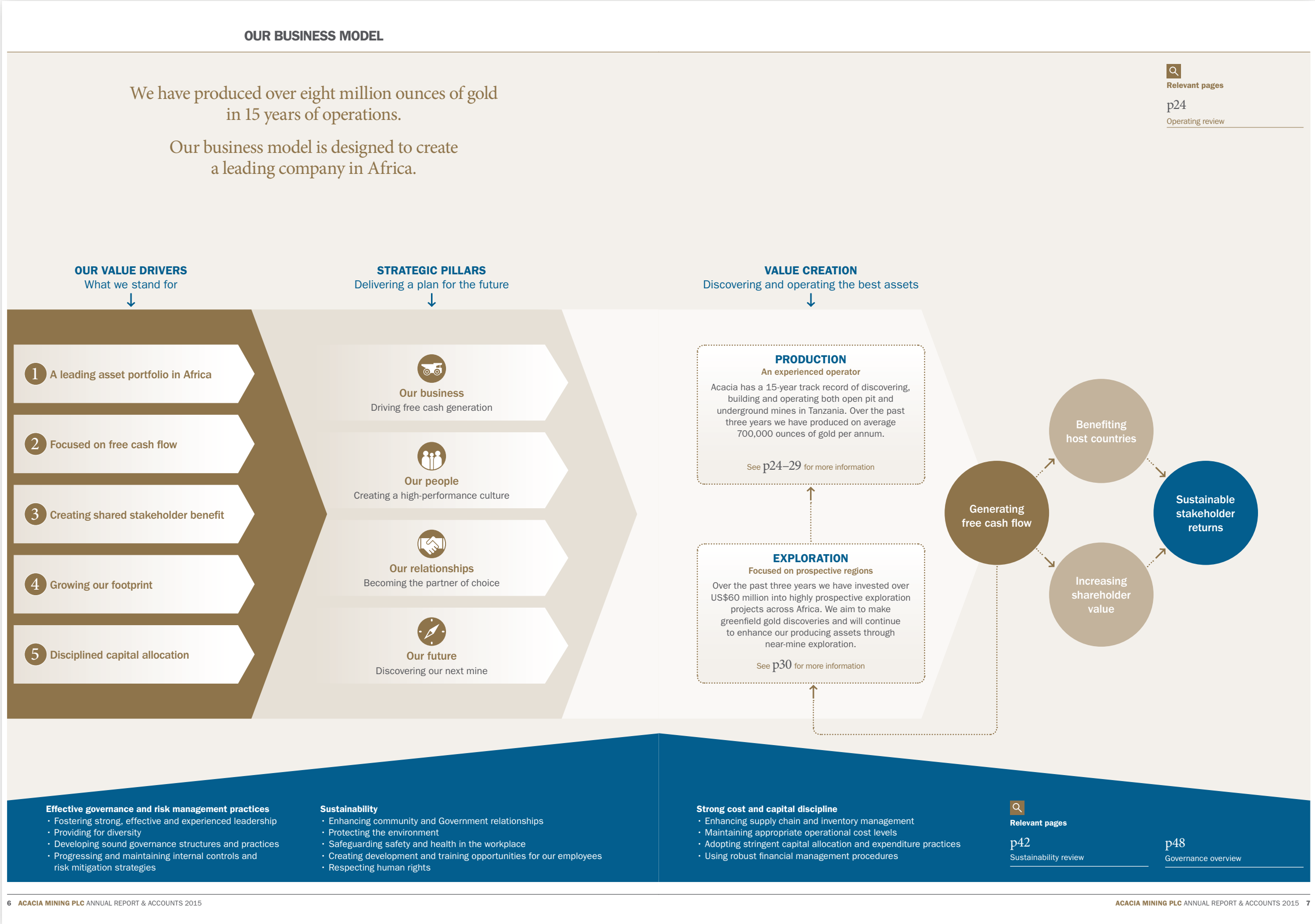
40 http://www.iasplus.com/en-gb/publications/uk/need-to-know/2016/ntk-apms

Good practice examples

Example 5.1

[Acacia Mining plc Annual Report & Accounts 2015 (p6-7)](#)

One of the companies who chose to present their business model within the summary section was Acacia Mining plc. In doing so, they have clearly demonstrated to users how they create value to stakeholders upfront. They have also incorporated their strategic pillars into their business model and signposted further information to the user.



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Example 5.2

Kaz Minerals plc Annual Report and Accounts 2015 (p2-3)

Kaz Minerals plc provided a good example of how to present a company's locations. This was achieved through a map where locations were clearly marked and key information was provided for each location.

STRATEGIC REPORT AT A GLANCE

POSITIONED FOR GROWTH

Kazakhstan is an ideal location for the development of natural resources, combining mineral wealth with ready access to the necessary factors of production and sharing a land border with China, the largest market for commodities in the world.

Kazakhstan continues to attract significant foreign direct investment, including a strong partnership with China, for the development of natural resources under the 'one belt one road' investment programme.

WHY KAZAKHSTAN?

1. Stable socio-political environment
2. Experienced mining workforce
3. Direct access to key markets – China and Europe
4. Established infrastructure and transport links
5. Availability of water
6. Access to energy at a competitive cost

OUR STRATEGY

KAZ Minerals' vision is to be the leading natural resources company in Central Asia. By 2018 we aim to produce over 300 kt of copper, with 80% of that production coming from our new open pit mines. In 2015 we have made significant progress in delivering on our three strategic priorities:

Deliver the major growth projects

Optimise our existing assets

Take advantage of natural resource opportunities in Central Asia

For more information, see pages
18 Strategy
38 Operating Review

STRATEGIC REPORT

BOZSHAKOL
• Concentrator commissioning began in December 2015, first copper in February 2016
• 1,220 MT of mineral resources at grade of 0.36% and 0.7 strip ratio
• Mine life of 40 years
• Estimated annual output 100 kt copper cathode equivalent[1]
• Net cash cost 70-90 USc/lb[2]

AKTOGAY
• Oxide production commenced December 2015, sulphide completion in 2017
• 1,700 MT of mineral resources at grade of 0.34% and 0.2 strip ratio
• Mine life of 50 years
• Estimated annual output 105 kt copper cathode equivalent[1]
• Net cash cost 100-120 USc/lb[2]

BOZYMCHAK
• Copper-gold mine in Kyrgyzstan
• Copper grade 0.76%
• Gold grade 1.25 g/t
• 2015 optimisation complete
• 6 kt of copper and 28 koz of gold output per annum on average expected over the 17 year life of the mine

EAST REGION
• Underground operations
• Copper mines with significant gold, silver and zinc by-products
• Average copper grade 2.42% in 2015
• Net cash cost 111 USc/lb in 2015

KOKSAY
• Scoping phase
• 3.1 MT of contained copper
• Copper grade 0.42%
• Mine life of over 20 years
• Estimated annual output 85 kt copper cathode equivalent[1]

[1] Average annual copper cathode equivalent production for the first 10 years after the concentrator has been commissioned.
[2] Average expected net cash cost for the first 10 years after the concentrator has been commissioned, in 2016 terms.

2 KAZ Minerals Annual Report and Accounts 2015

www.kazminerals.com 3

Example 5.3

[National Grid Plc Annual Report and Accounts 2015/16 (IFC)]

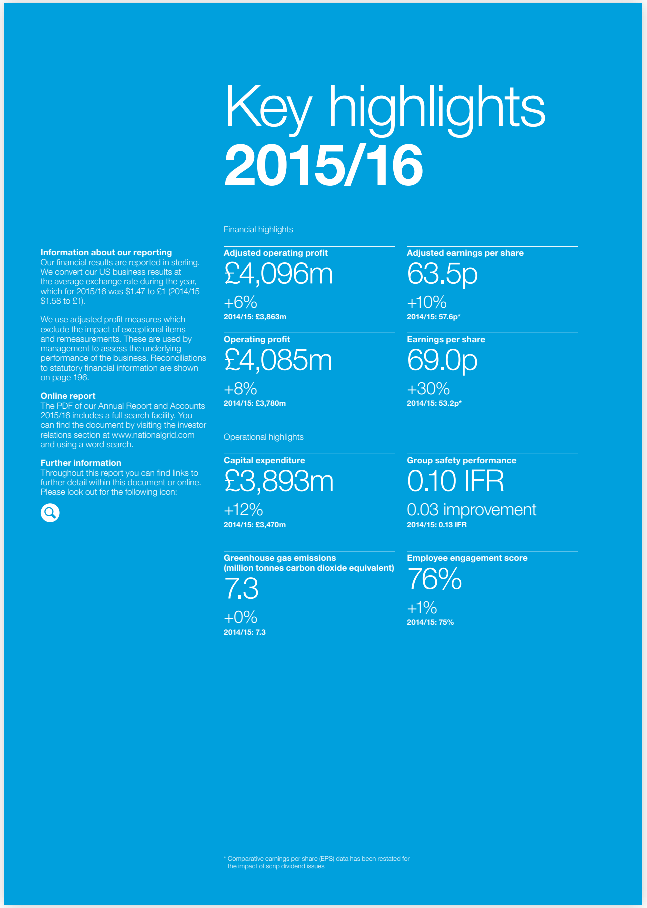
A good example of clear disclosure with respect to non-GAAP measures was provided by National Grid Plc. Equal prominence has been given to both GAAP and non-GAAP measures with the equivalent GAAP measure being provided for each non-GAAP measure presented, comparatives for each measure have been provided and there is a clear cross reference to where reconciliations have been disclosed later on in the annual report. On that basis, this disclosure appears to be materially in line with the ESMA Guidelines.

Example 5.4

[BT Group plc Annual Report 2016 (p241)]

BT Group plc included an appendix which explains how they use APMs, explains the adjustments (termed 'specific items') made to GAAP measures and provides reconciliations, with two years of comparatives, clearly showing how the APM derives from the GAAP measure. The disclosure shown is an extract of the appendix showing a reconciliation for the 'Adjusted EBITDA' figure.

Example 5.3



Key highlights
2015/16

Information about our reporting
Our financial results are reported in sterling. We convert our US business results at the average exchange rate during the year, which for 2015/16 was $1.47 to £1 (2014/15 $1.58 to £1).

We use adjusted profit measures which exclude the impact of exceptional items and remeasurements. These are used by management to assess the underlying performance of the business. Reconciliations to statutory financial information are shown on page 196.

Online report
The PDF of our Annual Report and Accounts 2015/16 includes a full search facility. You can find the document by visiting the investor relations section at www.nationalgrid.com and using a word search.

Further information
Throughout this report you can find links to further detail within this document or online. Please look out for the following icon:

Financial highlights

Adjusted operating profit
£4,096m
+6%
2014/15: £3,863m

Adjusted earnings per share
63.5p
+10%
2014/15: 57.6p*

Operating profit
£4,085m
+8%
2014/15: £3,780m

Earnings per share
69.0p
+30%
2014/15: 53.2p*

Operational highlights

Capital expenditure
£3,893m
+12%
2014/15: £3,470m

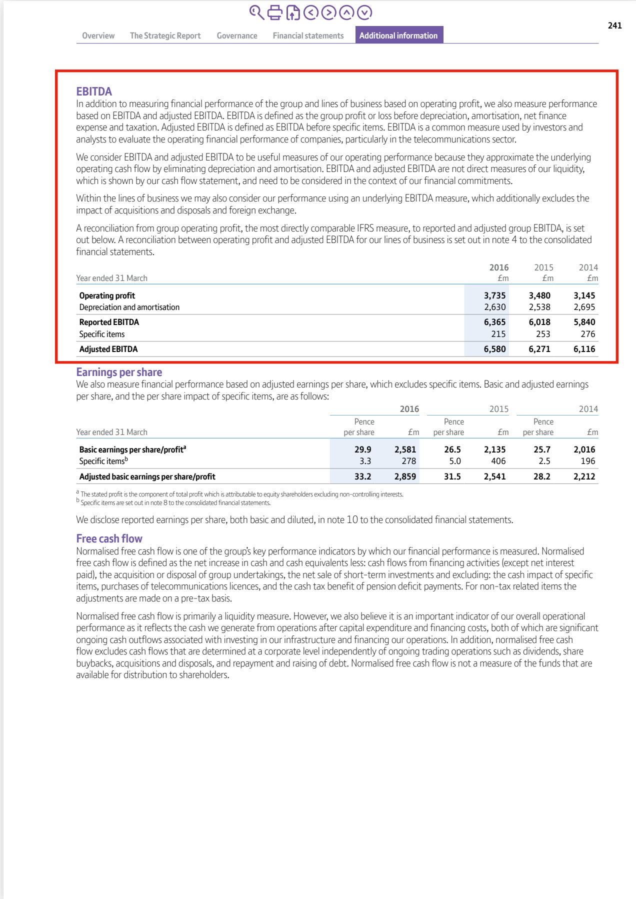
Group safety performance
0.10 IFR
0.03 improvement
2014/15: 0.13 IFR

Greenhouse gas emissions (million tonnes carbon dioxide equivalent)
7.3
+0%
2014/15: 7.3

Employee engagement score
76%
+1%
2014/15: 75%

* Comparative earnings per share (EPS) data has been restated for the impact of scrip dividend issues

Example 5.4



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EBITDA
In addition to measuring financial performance of the group and lines of business based on operating profit, we also measure performance based on EBITDA and adjusted EBITDA. EBITDA is defined as the group profit or loss before depreciation, amortisation, net finance expense and taxation. Adjusted EBITDA is defined as EBITDA before specific items. EBITDA is a common measure used by investors and analysts to evaluate the operating financial performance of companies, particularly in the telecommunications sector.

We consider EBITDA and adjusted EBITDA to be useful measures of our operating performance because they approximate the underlying operating cash flow by eliminating depreciation and amortisation. EBITDA and adjusted EBITDA are not direct measures of our liquidity, which is shown by our cash flow statement, and need to be considered in the context of our financial commitments.

Within the lines of business we may also consider our performance using an underlying EBITDA measure, which additionally excludes the impact of acquisitions and disposals and foreign exchange.

A reconciliation from group operating profit, the most directly comparable IFRS measure, to reported and adjusted group EBITDA, is set out below. A reconciliation between operating profit and adjusted EBITDA for our lines of business is set out in note 4 to the consolidated financial statements.

Year ended 31 March	2016 £m	2015 £m	2014 £m
Operating profit	**3,735**	**3,480**	**3,145**
Depreciation and amortisation	2,630	2,538	2,695
Reported EBITDA	**6,365**	**6,018**	**5,840**
Specific items	215	253	276
Adjusted EBITDA	**6,580**	**6,271**	**6,116**

Earnings per share
We also measure financial performance based on adjusted earnings per share, which excludes specific items. Basic and adjusted earnings per share, and the per share impact of specific items, are as follows:

	2016		2015		2014	
Year ended 31 March	Pence per share	£m	Pence per share	£m	Pence per share	£m
Basic earnings per share/profit[a]	**29.9**	**2,581**	**26.5**	**2,135**	**25.7**	**2,016**
Specific items[b]	3.3	278	5.0	406	2.5	196
Adjusted basic earnings per share/profit	**33.2**	**2,859**	**31.5**	**2,541**	**28.2**	**2,212**

[a] The stated profit is the component of total profit which is attributable to equity shareholders excluding non-controlling interests.
[b] Specific items are set out in note 8 to the consolidated financial statements.

We disclose reported earnings per share, both basic and diluted, in note 10 to the consolidated financial statements.

Free cash flow
Normalised free cash flow is one of the group's key performance indicators by which our financial performance is measured. Normalised free cash flow is defined as the net increase in cash and cash equivalents less: cash flows from financing activities (except net interest paid), the acquisition or disposal of group undertakings, the net sale of short-term investments and excluding: the cash impact of specific items, purchases of telecommunications licences, and the cash tax benefit of pension deficit payments. For non-tax related items the adjustments are made on a pre-tax basis.

Normalised free cash flow is primarily a liquidity measure. However, we also believe it is an important indicator of our overall operational performance as it reflects the cash we generate from operations after capital expenditure and financing costs, both of which are significant ongoing cash outflows associated with investing in our infrastructure and financing our operations. In addition, normalised free cash flow excludes cash flows that are determined at a corporate level independently of ongoing trading operations such as dividends, share buybacks, acquisitions and disposals, and repayment and raising of debt. Normalised free cash flow is not a measure of the funds that are available for distribution to shareholders.

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Example 5.5

[CLS Holdings plc Annual Report and Accounts 2015 (p4-5)]

CLS Holdings plc demonstrated a link between various elements of the annual report within the summary section through the use of a table which linked the company’s business model, strategy, KPIs, risks and achievements. Cross references are also provided to where further information on these elements is given later on in the report.


CLS Holdings plc

HOW WE OPERATE

OUR CORPORATE OBJECTIVE IS TO CREATE SUSTAINABLE LONG-TERM SHAREHOLDER VALUE THROUGH OWNING AND ACTIVELY MANAGING HIGH-YIELDING OFFICE PROPERTIES IN KEY EUROPEAN CITIES

+12% p.a.

+28% p.a.

BUSINESS MODEL	STRATEGY	KPIs	ACHIEVEMENTS IN 2015	PLANS FOR 2016	RISKS
Investments	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Customers	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cost Control	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Finance	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Example 5.6

[John Wood Group plc Annual Report and Accounts 2015 (p1)]

John Wood Group plc provides a good example where context is given for the overall financial performance during the year. The chief executive indicates how the performance related to expectations. This helps set the scene for the user and provides some perspective for the remainder of the annual report.

Example 5.7

[United Utilities Group Plc Annual Report and Financial Statements 2016 (p3)]

A good example of a company providing context for the financial information presented in the summary section was demonstrated by United Utilities Plc. Prior year comparatives and narrative commentary that discusses trend information has been provided. This helps provide some context for the financial information presented.

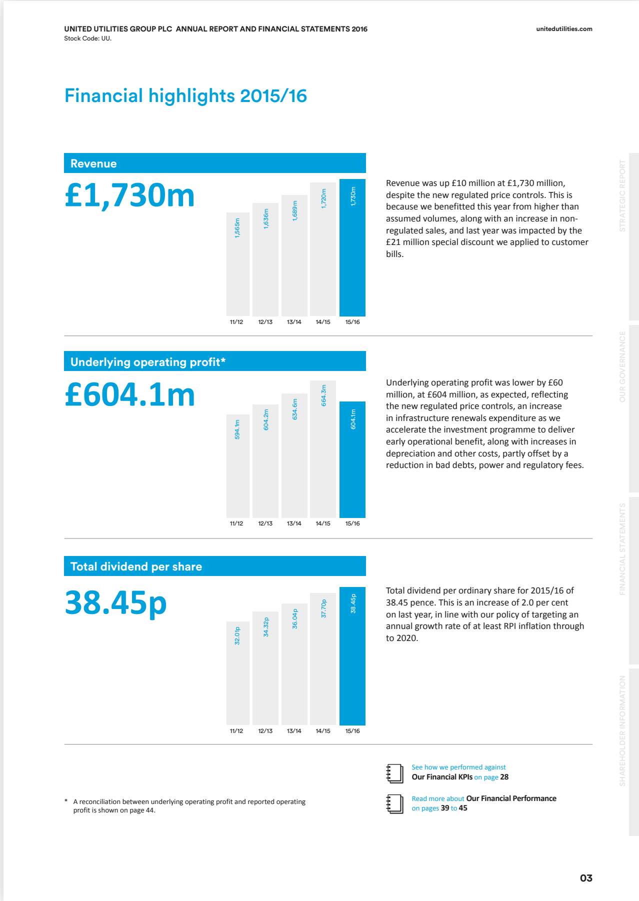
Example 5.6

Contents

"Against a backdrop of significantly reduced customer activity, the Group delivered EBITA of $470m in line with expectations and 14.5% lower than 2014. Our continued actions to reduce costs, improve efficiency and broaden our service offering through organic initiatives and strategic acquisitions, position us as a strong and balanced business in both the current environment and for when market conditions recover"

Robin Watson, Chief Executive

Example 5.7



UNITED UTILITIES GROUP PLC ANNUAL REPORT AND FINANCIAL STATEMENTS 2016
Stock Code: UU.

unitedutilities.com

Financial highlights 2015/16

Revenue

£1,730m

Revenue was up £10 million at £1,730 million, despite the new regulated price controls. This is because we benefitted this year from higher than assumed volumes, along with an increase in non-regulated sales, and last year was impacted by the £21 million special discount we applied to customer bills.

Underlying operating profit*

£604.1m

Underlying operating profit was lower by £60 million, at £604 million, as expected, reflecting the new regulated price controls, an increase in infrastructure renewals expenditure as we accelerate the investment programme to deliver early operational benefit, along with increases in depreciation and other costs, partly offset by a reduction in bad debts, power and regulatory fees.

Total dividend per share

38.45p

Total dividend per ordinary share for 2015/16 of 38.45 pence. This is an increase of 2.0 per cent on last year, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

See how we performed against **Our Financial KPIs** on page **28**

Read more about **Our Financial Performance** on pages **39** to **45**

* A reconciliation between underlying operating profit and reported operating profit is shown on page 44.

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The strategic report

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The strategic report

Top Tips

- To help keep the annual report clear and concise, consider including CR information that is not material in a separate report or on the company website and provide a cross-reference in the annual report to where this can be accessed – 49% (2015: 34%) of companies currently do this.

- When describing the strategy of the company, think about how other parts of the strategic report can be linked into the strategy to demonstrate the holistic nature of the company's operations.

- It is useful when presenting the company's objectives to include information on how progress towards achieving the objectives is measured. 62% (2015: 63%) of companies did not provide any link between their objectives and how these were measured.

- The business model should explain how the company creates value – 71 companies included a business model discussing this with 33 (2015: 25) companies talking about value creation for a variety of their stakeholders.

Keep an eye on

- Whether the linkage given is logical when linking elements of the strategic report together. Try to ensure that there is a clearly discernible relationship between the elements being linked when doing this. Linkage of strategy and risks was frequently not particularly logical with only 28% (of the 18% of companies that linked these two elements at all) presenting linkage that, in our view, made complete sense.

- The usefulness of a visual representation of the company's business model. 70 (2015: 57) companies used a visual representation to illustrate their business model. However, in our view only 41 (2015: 38) of these representations made it easier to understand the business model, with others failing to be clearly structured or company-specific.

Introduction

Section 414C of the Companies Act 2006 requires that all UK companies (other than those that meet the CA06 definition of 'small') prepare a strategic report, which should be approved by the directors. This approval may be combined with that of the directors' report, as long as it is clear that each report has been approved by the board. The strategic report is required to contain:

- a fair, balanced and comprehensive review of the company's business;

- a description of the principal risks and uncertainties facing the company; and

- to the extent necessary for an understanding of the development, performance or position of the company, analysis using financial key performance indicators (KPIs) and where appropriate, analysis using other KPIs, including information relating to environmental and employee matters.

For quoted companies, the strategic report should also contain the following (although the first two items are only required to the extent necessary for an understanding of the company's development, performance or position):

- information on the main trends and factors likely to affect the future development, performance and position of the company's business;

- information on environmental matters, employees and social, community and human rights issues, including any policies in these areas and their effectiveness (if any of these disclosures are omitted this should be stated);

- a description of the company's business model and its strategy (plus its objectives, as suggested by the UK Corporate Governance Code and the FRC's Guidance on the Strategic Report – see below); and

- a gender analysis of the parent company's directors, the group's senior management and the group's employees as a whole.

Although technically a requirement of the directors' report, most companies also include the information that they are required to present about greenhouse gas emissions in the strategic report, taking advantage of the legal provision that allows them to do this.

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For those companies looking to produce a strategic report that complies with the legal requirements in the most effective way possible, the FRC's Guidance on the Strategic Report[41] (the FRC Guidance) gives helpful insight into how to do this – see also chapter 4. The FRC has also published Clear & Concise: Developments in Narrative Reporting[42], which includes further practical tips to help companies achieve clear & concise reporting. Another, even more effective method of ensuring that your reporting is as meaningful as possible is to take on board the principles of Integrated Reporting (<IR>) – throughout this chapter, and within other chapters of the publication, you will find boxes highlighting the relevant parts of the <IR> framework. <IR> is discussed in more detail in chapter 3. Ultimately though, integrated reporting is not about reporting, it is about applying integrated thinking in running a business, and from this an integrated report is a natural output. The better practice examples identified within this chapter also provide examples of how companies have put the recommendations of <IR> and the FRC Guidance into practice.

The FRC Guidance sets out three broad categories of content elements, most of which are drawn directly from the law. However, the best annual reports don't present the information as separate 'silos' but instead incorporate and integrate these various elements throughout their strategic report.

Strategic management	Environmental context	Business performance
How the entity intends to generate and preserve value	**The internal and external environment in which the entity operates**	**How the entity has developed and performed and its position at the year end**
Strategy and objectives (section 2 of this chapter) Business model (section 1 of this chapter)	Trends and factors (section 2 of this chapter) Principal risks and uncertainties (chapter 9) Environmental, employee, social, community and human rights matters (section 3 of this chapter)	Analysis of performance and position (chapters 14 and 15) Key performance indicators (chapter 8) Employee gender diversity (section 3 of this chapter)

This chapter is divided into sections that cover several of these content elements.

- The business model, including how well companies make use of diagrammatic representations of this and the extent to which they apply the principles of <IR> when showcasing it.
- The company's strategy and objectives, including linkage between these and other elements of the strategic report.
- Consideration of sustainability/corporate responsibility disclosures, including the extent to which these are integrated into the rest of the report and the extent to which companies provide voluntary disclosures that go beyond the requirements of the law in relation to areas such as bribery and corruption, modern slavery, payment of suppliers and gender pay gap.

It also includes a section examining the extent of disclosures made in relation to two current hot topics where the law does not require as much disclosure as some groups believe is necessary. These are the disclosure of dividend policy and resources and disclosures about tax.

Throughout this chapter there is discussion of both 'linkage' and 'cross-referencing' in terms of how companies can tie together the relevant key parts of their strategic report. These two terms are used in the context given to them by the FRC, detailed below. It is important to note that linkage is a more comprehensive connection between two elements of an annual report, e.g. a strategic element and a KPI, than cross-referencing. However cross-referencing can be useful in ensuring that the annual report is kept clear and concise by ensuring that similar information is not duplicated throughout the narrative.

CROSS-REFERENCING
A means by which an item of information which has been disclosed in one component of an annual report, can be included as an integral part of another component of the annual report.

LINKAGE
A relationship or interdependency between, or the cause and effect of, facts and circumstances disclosed in the annual report.

41 http://www.iasplus.com/en-gb/news/2014/06/frc-strategic-report-guide

42 http://www.iasplus.com/en-gb/news/2015/12/frc-narrative-reporting-report

Section 1. Business Model

Overall business model

A business model is a key component of the strategic report as it gives information as to what an entity does and how and why it does it. By including such information the company can then demonstrate how the entity generates and preserves value. In July 2015 the FRC's Financial Reporting Lab (the Lab) announced a new project on effective business model reporting. The initial findings of this project revealed that the majority of companies are not convinced that business model disclosures are valued by investors. However most investors interviewed as part of the Lab's project in fact revealed that they would like to see more detailed information provided on the business model, particularly in relation to value creation. Furthermore investors highlighted that a failure by company management to provide a clear and concise business model in their annual report was a concern, with some investors deciding not to invest as a result of this[43].

Both the Companies Act 2006[44] and the UK Corporate Governance Code[45] require the strategic report to include a description of the company's business model. This description should provide information on how the company generates or preserves value through its activities. However the business model should include more than just an account of what the company does.

The FRC Guidance includes a variety of areas that a company should seek to cover in the information they provide in their business model including its structure, the markets it operates in and the nature of the relationships, resources and other inputs necessary for the success of the company's business. Where a business is complex it may be helpful to include a visual representation (such as a diagram or flow chart) to help explain the process – see the 'Visual representation of the business model' section later for further discussion.

In order to keep their business model clear and concise a company should focus on those parts of its business that are most significant in generating, preserving and capturing value. Business model disclosures can therefore be expected to vary considerably based on the size and complexity of the particular company in question – there is no 'one size fits all'. **BT Group plc (Example 6.1)** for example included a detailed business model diagram containing a considerable amount of information whereas **Howden Joinery Group Plc (Example 6.2)** included equally as detailed information in the form of narrative in their Chief Executive's statement.

LINKAGE

The FRC's Guidance suggests the business model is a good place to demonstrate linkage existing between key elements of the strategic report e.g. strategy, risks and KPIs. This is discussed in more detail in the sections on visual representation of the business model and on interaction of the strategy and business model.

<IR> Business model

Like a strategic report, an integrated report must also describe the business model, including the key inputs, business activities, outputs and outcomes. The <IR> Framework defines a company's business model as "its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfil the organisation's strategic purposes and create value over the short, medium and long term". A good example of an 'integrated' business model is provided by **Aggreko PLC (Example 6.3)**.

Other observations

Report included a section entitled business model	2016	2015
Overall	84%	87%
FTSE 350	90%	88%
Others	76%	86%

Report included a section that was obviously the business model but was not described as such*	2016	2015
Overall	9%	9%
FTSE 350	7%	11%
Others	12%	7%

*Such sections were described in a variety of ways including 'Understanding our business' and 'How we create value'.

43 https://www.frc.org.uk/Our-Work/Corporate-Governance-Reporting/Our-Work-Codes-Standards-Financial-Reporting-Lab/Current-Projects.aspx

44 Section 414C(8)(b)

45 Provision C.1.2

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Visual representation of the business model

70 of the 93 companies that discussed their business model (2015: 57 out of 96) included a visual representation of their business model. Although this can help in presenting business model information in a reader-friendly way, particularly where the activities of the company are complex, companies should give careful thought as to whether the visual representation they provide does in fact aid understandability. Of these visual representations presented, there was a drop in the proportion that were deemed to make the business model easier to understand, with 59% (2015: 67%) achieving this. This shift was largely driven by the smaller listed companies surveyed, with only 46% (2015: 52%) of the visual representations included by smaller companies helping to make the business model easier to understand. For smaller, simpler businesses visual representations can add confusion by presenting a business model in an overly-complicated illustration. See **Howden Joinery Group Plc (Example 6.2)** for a concise portrayal of a business model without using a diagram.

> **LINKAGE**
> Using a visual representation to display its business model gives a company a good opportunity to include both cross-references (see the **BT Group plc Example 6.1**) and linkage between elements of their strategic report. In their 2015 Annual Report, **Fresnillo plc (Example 6.4)** displayed linkage between their business model, their CR policies, their risk management framework and their strategy.

To ensure that a visual representation of their business model is effective, companies should beware of using generic diagrams (such as simplistic circular diagrams that only illustrate the different business divisions of the company) and instead should concentrate on presenting something that is meaningful and specific to their own activities. A good diagram would usually include:

- a description of the resources/inputs used by the company;
- a description of the activities/processes that add value to these to produce the outputs and outcomes of the company; and
- a description of how key inputs relate to the capitals on which the company depends, or that provide a source of differentiation to the company, ideas which are discussed in the <IR> Framework (see section on Resources and Relationships below).

Relationships and resources

A good business model should illustrate the relationships, resources and other inputs necessary for the success of the business.[46] The business model should then demonstrate how these various factors, which go beyond those reflected in the financial statements, are utilised in order to create value. The resources that are material to a company will clearly differ depending on the nature of that company's operations but could include both tangible and intangible resources (such as reputation, brand, employees, research and development and natural resources).

> **<IR> Inputs, outputs and outcomes**
>
> As identified above, a business model should include discussion of the company's key inputs, business activities, outputs and outcomes. <IR> also introduces the concept of 'capitals' to describe a company's relationships and resources. 'Capitals' are the stocks of value that are used as inputs into a business model and which are increased, decreased or transformed through the business' activities and outputs. The <IR> Framework determines that, broadly, there are six categories of capitals: financial, manufactured, intellectual, human, natural and social and relationship.
>
> In an integrated report a company should demonstrate how key inputs relate to the capitals on which the company depends, or that provide a source of differentiation to the company. This is, in part, an extension of the FRC Guidance which recommends that the description of the business model should provide shareholders with a broad understanding of the nature of the relationships, resources and other inputs that are necessary for the success of the business, and also a description of what makes the entity different from its peers.
>
> Outputs of the business activities are considered to be items such as products, services, by-products and waste. However, an integrated report will also consider the 'outcomes' of the business cycle, namely the internal and external effects (both positive and negative) on the company's capitals as a result of the business activities and outputs. There is no requirement under the <IR> Framework to identify all six capitals as being material to a company, nor to use the same terminology as that used in the <IR> Framework. The examples later in this chapter of companies applying the concepts of the <IR> Framework to their business model demonstrate the different resources and relationships, specific to the companies themselves, which have been identified as capitals.

46 FRC Guidance Section 7.15

65 companies (2015: 51) included a business model that contained reference to relationships or resources (or ‘capitals’ using <IR> terminology) that were central to their business model. This increase was driven by a noticeable rise in the FTSE 350 companies surveyed of which 78% (2015: 58%) included a business model containing some discussion of resources. It was encouraging to see that several companies had revised their business model for this year’s report, incorporating more detail about their resources and relationships. This increasing awareness of the broader resources on which a company depends, amongst the companies in our sample, is evident in Figure 6.1. As above, the <IR> Framework identifies six capitals – of those identifying resources, most referred to resources that fell broadly into four of the <IR> capitals. It is important to note that it would not be expected for most companies to refer to all six capitals given that some will not be as relevant to their business activities as others e.g. a financial services firm would be less affected by natural capital than say a mining business.

Figure 6.1 How many capitals were identified by each company?

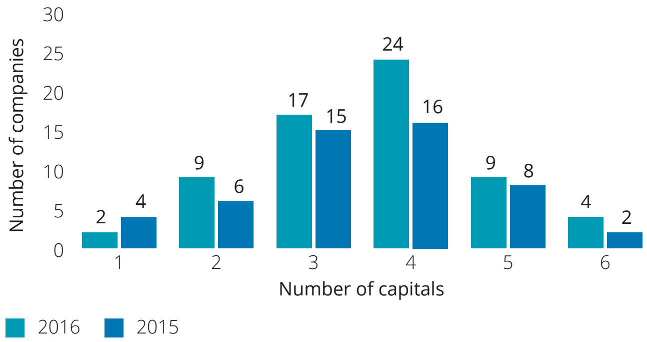


Figure 6.2 Of those companies identifying <IR> capitals, which ones are referred to?

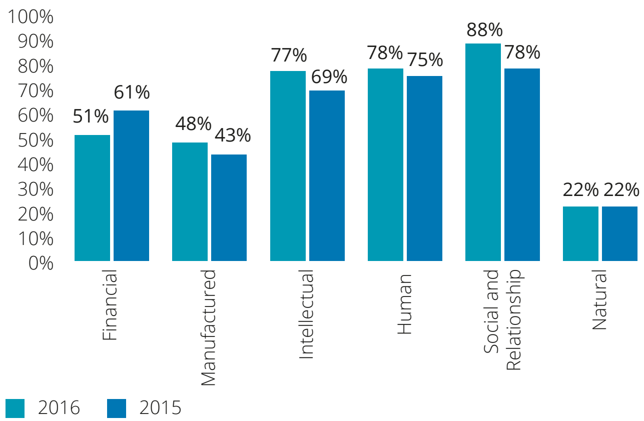


Figure 6.2 gives further detail on which resources were identified by companies. Consistent with the previous year the most common resources discussed were human (such as employees) and social and relationship (with stakeholders such as customers) which is understandable given the importance of these to the majority of industries. It is encouraging to see an increase in the number of companies referring to intellectual capital, which includes brands, reputation and other intellectual property (e.g. patents), given that the 2016 Reputation Dividend Report[47] indicated that UK corporate reputations contributed £790bn of shareholder value at the start of 2016 (up from £620bn in 2015).

Key resources were clearly identified and discussed as part of the business model by **Anglo American plc (Example 6.5)** and by Tate & Lyle PLC. A minority of annual reports in our survey, having identified the resources that were key to their business model then went on to discuss how the company intended to develop and maintain such resources going forward (see detail in the ‘<IR> Resource allocation and development’ box below). **Xaar plc (Example 6.6)** was one of the companies that did this clearly through the use of a colour key and column detailing their plans for the next financial year.

47 http://www.reputationdividend.com/files/7814/5441/0391/UK_2016_Reputation_Dividend_report.pdf

<IR> Resource allocation and development

The <IR> Framework requires an integrated report to answer the question "Where does the organisation want to go and how does it intend to get there?" Ordinarily, this would include identifying the resource allocation plan the company has to implement its strategy, both as regards current resources and how it will further develop these resources in the future.

13 companies clearly identified some resource allocation or development plans i.e. specifically identified financial investment needed or a numerical target that it hoped to achieve as regards meeting future resource requirements. Another 48 companies provided this detail in part, by, for example, including the need to recruit a certain number of people to be able to support those value-creating activities identified as part of the business model.

Information on resources will be crucial in demonstrating how the company creates value for its various stakeholders. Such stakeholders will include shareholders but also others depending on the nature of the company's operations, such as employees, suppliers, regulators and the local community. **Persimmon plc (Example 6.7)** clearly identified the outcomes produced by its business model for various stakeholders in its annual report. Good practice is for companies to include details of the impact of their activities on their varying stakeholders, often described as Corporate Responsibility (CR), throughout their strategic report (see the CR section later for further discussion). For further discussion of stakeholder engagement see chapter 4.

<IR> Impact on stakeholders

Through the process of identifying its capitals, a company would have identified the stakeholders upon which its business activities have a material impact. Similarly, to satisfy the <IR> Framework's question of "What does the organisation do and what are the circumstances under which it operates?" a company should consider factors affecting the external environment which, in turn, impact the company. These impacts could be direct or indirect, such as influencing the availability, quality and affordability of a capital that the company uses or affects.

Applying integrated thinking requires an organisation to consider not only the outputs of their business, but also the outcomes i.e. the effects that outputs have on other capitals including those capitals directly related to the sustainability of the business. As such, the impact on these wider groups of stakeholders would ordinarily be considered.

Value creation

Value creation is central to the business model, which should clearly set out how a company generates or preserves value over the longer term. In simple terms this involves describing what the company actually does in its day-to-day operations. This should not just be a basic explanation of what the company's activities are but should describe why the company carries out its operations in the way it does and how, as a result, value is generated for its stakeholders. Such a description should be specific to the company itself and thus demonstrate how the company can be differentiated from its peers in terms of its ability to create value.

A number of companies go on to use case studies in their annual report in order to demonstrate how they have created value for their stakeholders. When using case studies it is important that companies bear in mind the necessity of keeping the annual report clear and concise and therefore avoid including long case studies scattered throughout the narrative. In their Annual Report and Form 20-F 2015, BP plc included brief case studies where relevant in order to demonstrate their value creation in action whilst including cross-references to where readers could access further information outside the annual report.

<IR> Value creation

In the world of <IR>, value is not restricted to financial capital for just the company and its shareholders, but is considered more widely in terms of value generated by the impact of the business activities and outputs upon all capitals. The ability of a company to create value for itself is linked to the value that it creates for others. For example, value can be created through enhancing customer satisfaction, suppliers' willingness to trade with the company and the terms under which they do so, and the impact of business activities on the company's brand. An integrated report includes details of those interactions, activities and relationships which are material to the company's ability to create value for itself. The business model in an integrated report should describe value creation over the short, medium and long term.

43% of companies included an explicit reference to value creation in their business model (i.e. specifically discussed value creation using those words). A further 28% of companies surveyed included a business model that discussed value creation generally without using the specific wording. Overall 71% (2015: 54%) discussed value creation either implicitly or explicitly. It is encouraging to see that a majority of companies are considering their business model in value creation terms rather than as a simple description of the company's activities. Those companies surveyed that didn't address the issue of value creation frequently presented a business model that simply described the company's activities e.g. by setting out the different business divisions of the company.

Figure 6.3 illustrates how the business models in our sample talked about value creation (this included those companies that used terms such as 'value creation'/'creates value' explicitly, in addition to those that talked about the concept without using those specific words). **Johnson Matthey Plc** discuss value creation for a variety of stakeholders by including a pie-chart showing how financial value had been distributed amongst the company's stakeholders in the year **(Example 6.8)**.

Value creation was most commonly discussed over the longer-term (see Figure 6.4) – a medium term period was assessed to be the period covered by the entity's viability statement (see chapter 10 for further information on the viability statement). Of those companies discussing value creation over the longer-term some did so explicitly whereas others made it clear that they were considering a long term period e.g. by discussing the next ten years of company activities.

Focusing discussion of value creation on the long term is important given recent criticisms over the short-termism of many companies and the need for investors to consider their responsibilities under The UK Stewardship Code[48] to influence and promote companies' long-term performance. The FRC Guidance also encourages companies to include within their business model a description of how the company generates or preserves value over the long term. Good examples of discussion of value creation in a business model were provided by **National Grid Plc (Example 6.9)** and International Personal Finance plc who included detail on how value was created for various groups of different stakeholders in the pages following the business model itself.

Figure 6.3 Does the business model talk about value creation?

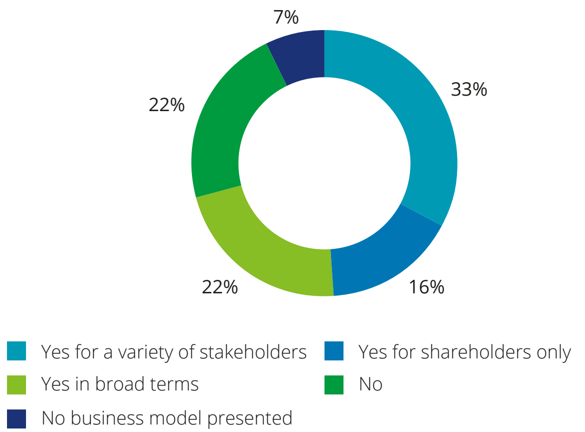
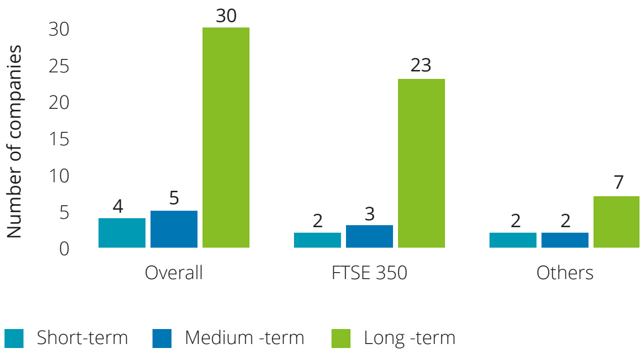


Figure 6.4 Over what period is value creation discussed?



Interaction of strategy and business model

LINKAGE

The FRC Guidance suggests that the business model could contain linkage to elements of the strategy that relate to specific parts of the model. There would be expected to be some sort of interaction between the strategy and the business model, as the strategy should be talking about how the company and its business model will evolve in order to meet a company's objectives.

48 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf

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Few companies surveyed illustrated any clear linkage between their business model and strategy. While we would not expect all companies to be able to comprehensively incorporate their strategy into every element of their business model, especially if this could only result from 'shoe-horning' information together, it is surprising that many gave no linkage and did not provide a cross reference either. **St James' Place plc (Example 6.10)** provided a good example of illustrating how their strategy will develop their business model by discussing strategy in terms of the key stakeholder relationships identified earlier in the business model. G4S plc incorporated their strategy directly into the visual representation of their business model by including detail on their strategic priorities and how they link to the activities of the business and value creation.

Other observations

Cross-reference between business model and discussion of strategy given	2016
Yes	20%
Both sections on same page	17%
No	63%

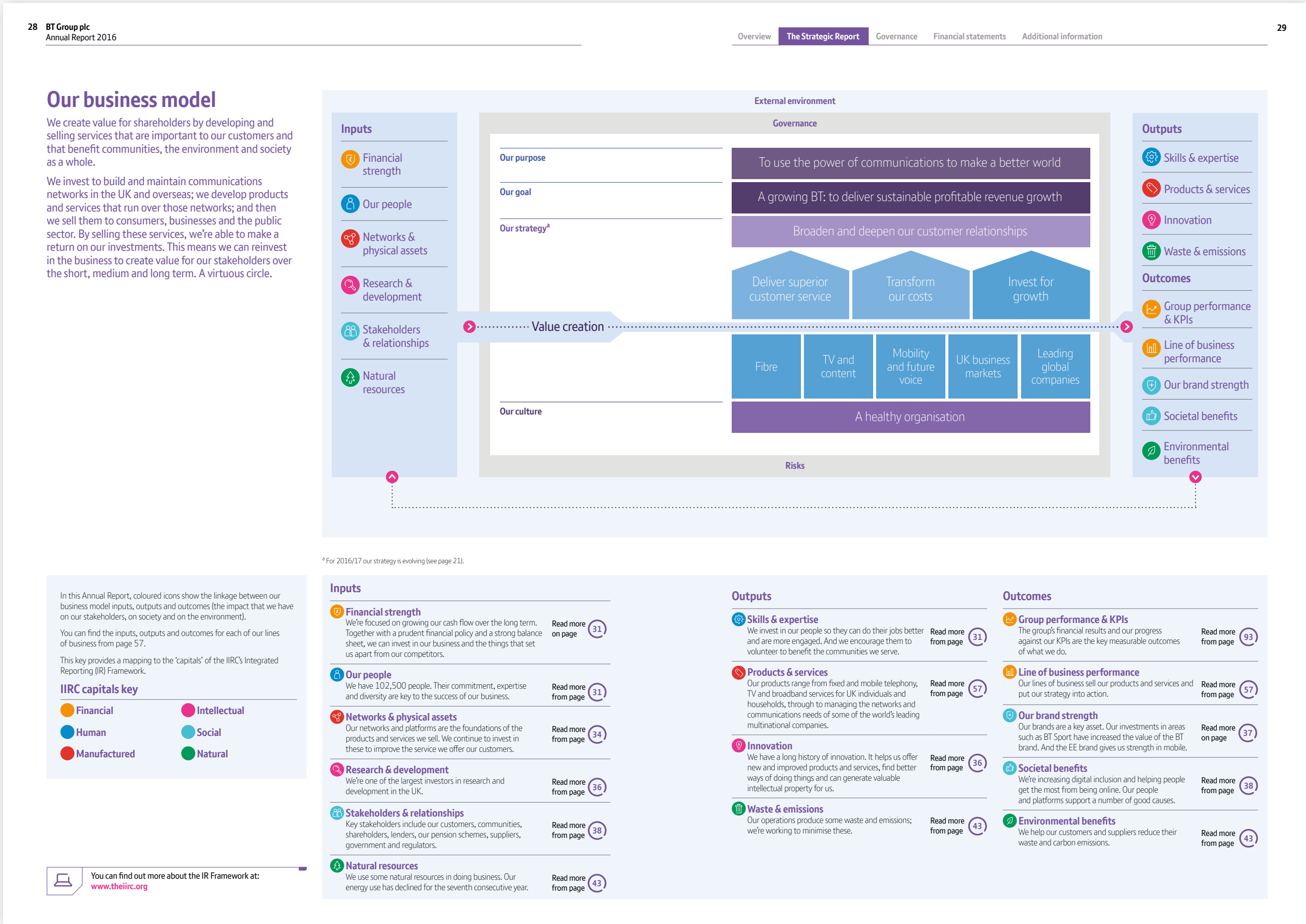
Section 1. Business model – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 6.1

[BT Group plc Annual Report & Form 20-F 2016 (p28-29)]

- Detailed business model diagram containing considerable amount of information and cross references.
- 'Integrated' business model.



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Annual Report 2016

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Our business model

We create value for shareholders by developing and selling services that are important to our customers and that benefit communities, the environment and society as a whole.

We invest to build and maintain communications networks in the UK and overseas; we develop products and services that run over those networks; and then we sell them to consumers, businesses and the public sector. By selling these services, we're able to make a return on our investments. This means we can reinvest in the business to create value for our stakeholders over the short, medium and long term. A virtuous circle.

[a] For 2016/17 our strategy is evolving (see page 21).

In this Annual Report, coloured icons show the linkage between our business model inputs, outputs and outcomes (the impact that we have on our stakeholders, on society and on the environment).

You can find the inputs, outputs and outcomes for each of our lines of business from page 57.

This key provides a mapping to the 'capitals' of the IIRC's Integrated Reporting (IR) Framework.

IIRC capitals key

Financial
Intellectual
Human
Social
Manufactured
Natural

You can find out more about the IR Framework at: www.theiirc.org

Inputs

Financial strength
We're focused on growing our cash flow over the long term. Together with a prudent financial policy and a strong balance sheet, we can invest in our business and the things that set us apart from our competitors. Read more on page 31

Our people
We have 102,500 people. Their commitment, expertise and diversity are key to the success of our business. Read more from page 31

Networks & physical assets
Our networks and platforms are the foundations of the products and services we sell. We continue to invest in these to improve the service we offer our customers. Read more from page 34

Research & development
We're one of the largest investors in research and development in the UK. Read more from page 36

Stakeholders & relationships
Key stakeholders include our customers, communities, shareholders, lenders, our pension schemes, suppliers, government and regulators. Read more from page 38

Natural resources
We use some natural resources in doing business. Our energy use has declined for the seventh consecutive year. Read more from page 43

Outputs

Skills & expertise
We invest in our people so they can do their jobs better and are more engaged. And we encourage them to volunteer to benefit the communities we serve. Read more from page 31

Products & services
Our products range from fixed and mobile telephony, TV and broadband services for UK individuals and households, through to managing the networks and communications needs of some of the world's leading multinational companies. Read more from page 57

Innovation
We have a long history of innovation. It helps us offer new and improved products and services, find better ways of doing things and can generate valuable intellectual property for us. Read more from page 36

Waste & emissions
Our operations produce some waste and emissions; we're working to minimise these. Read more from page 43

Outcomes

Group performance & KPIs
The group's financial results and our progress against our KPIs are the key measurable outcomes of what we do. Read more from page 93

Line of business performance
Our lines of business sell our products and services and put our strategy into action. Read more from page 57

Our brand strength
Our brands are a key asset. Our investments in areas such as BT Sport have increased the value of the BT brand. And the EE brand gives us strength in mobile. Read more on page 37

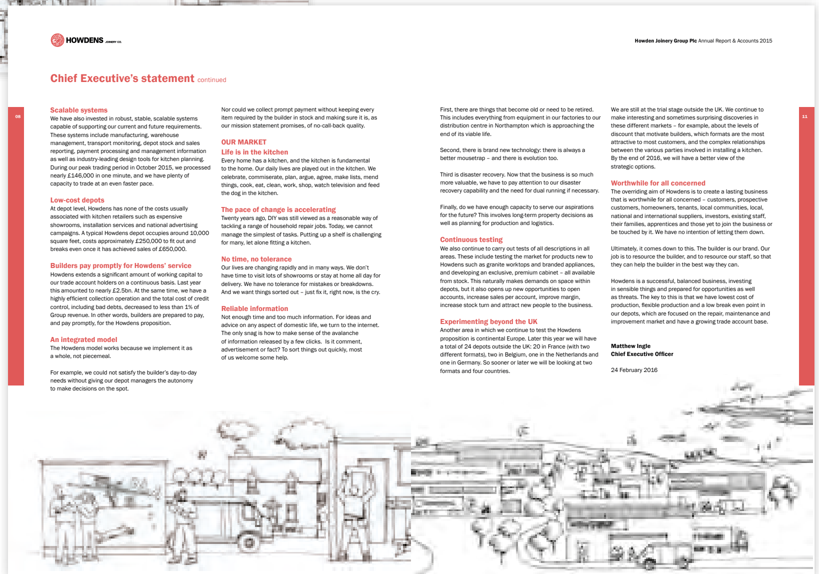
Societal benefits
We're increasing digital inclusion and helping people get the most from being online. Our people and platforms support a number of good causes. Read more from page 38

Environmental benefits
We help our customers and suppliers reduce their waste and carbon emissions. Read more from page 43

Example 6.2

[Howden Joinery Group Plc Annual Report and Accounts 2015 (p6-9)]

Detailed, concise business model in the form of narrative as opposed to using a visual representation.



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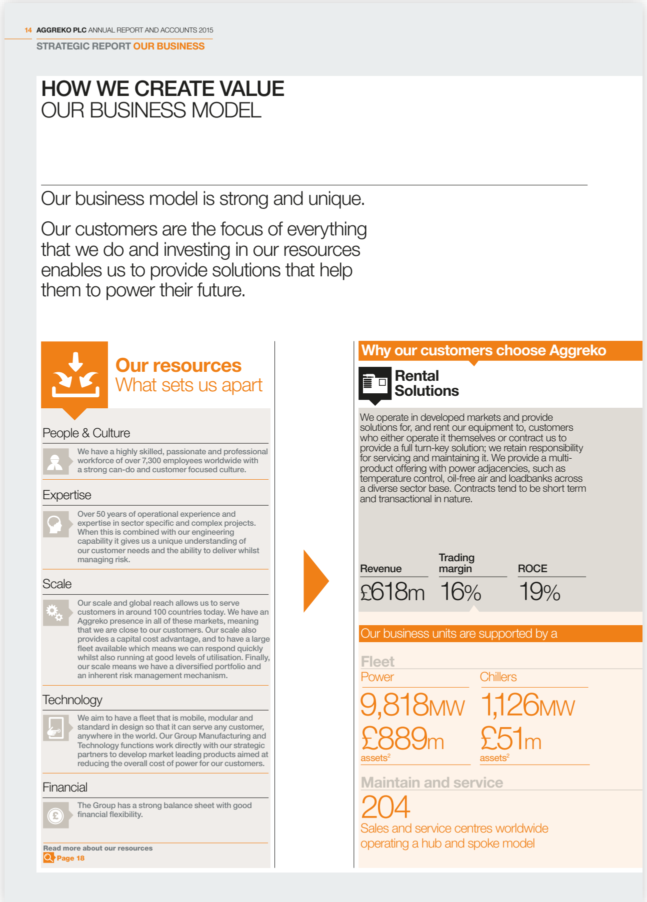
Example 6.3
Aggreko PLC Annual Report and Accounts 2015 (p14)

'Integrated' business model.


14 AGGREKO PLC ANNUAL REPORT AND ACCOUNTS 2015
STRATEGIC REPORT OUR BUSINESS

HOW WE CREATE VALUE
OUR BUSINESS MODEL

Our business model is strong and unique.

Our customers are the focus of everything that we do and investing in our resources enables us to provide solutions that help them to power their future.

Our resources
What sets us apart

People & Culture

We have a highly skilled, passionate and professional workforce of over 7,300 employees worldwide with a strong can-do and customer focused culture.

Expertise

Over 50 years of operational experience and expertise in sector specific and complex projects. When this is combined with our engineering capability it gives us a unique understanding of our customer needs and the ability to deliver whilst managing risk.

Scale

Our scale and global reach allows us to serve customers in around 100 countries today. We have an Aggreko presence in all of these markets, meaning that we are close to our customers. Our scale also provides a capital cost advantage, and to have a large fleet available which means we can respond quickly whilst also running at good levels of utilisation. Finally, our scale means we have a diversified portfolio and an inherent risk management mechanism.

Technology

We aim to have a fleet that is mobile, modular and standard in design so that it can serve any customer, anywhere in the world. Our Group Manufacturing and Technology functions work directly with our strategic partners to develop market leading products aimed at reducing the overall cost of power for our customers.

Financial

The Group has a strong balance sheet with good financial flexibility.

Read more about our resources
Page 18

Why our customers choose Aggreko

Rental Solutions

We operate in developed markets and provide solutions for, and rent our equipment to, customers who either operate it themselves or contract us to provide a full turn-key solution; we retain responsibility for servicing and maintaining it. We provide a multi-product offering with power adjacencies, such as temperature control, oil-free air and loadbanks across a diverse sector base. Contracts tend to be short term and transactional in nature.

Revenue	Trading margin	ROCE
£618m	16%	19%

Our business units are supported by a

Fleet

Power	Chillers
9,818MW	1,126MW
£889m assets[2]	£51m assets[2]

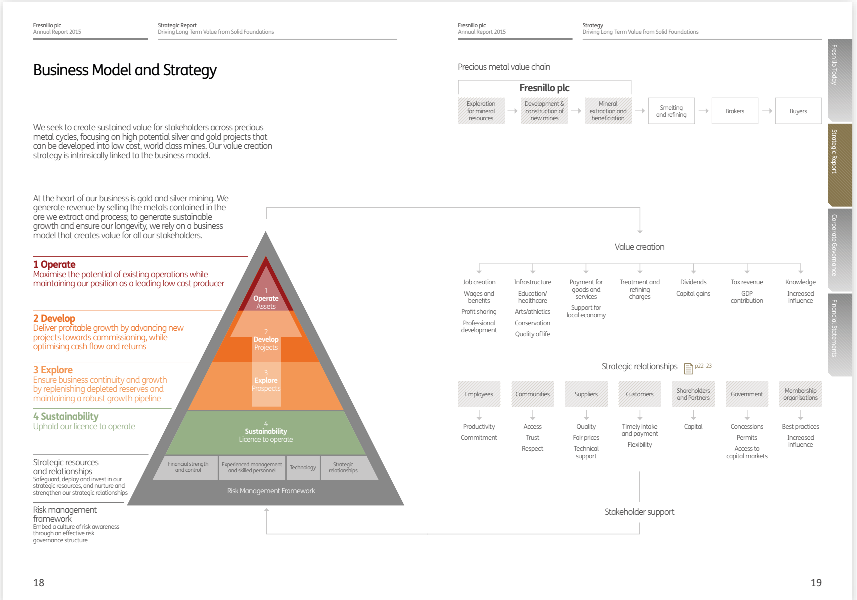
Maintain and service

204
Sales and service centres worldwide operating a hub and spoke model

Example 6.4

[Fresnillo plc Annual Report 2015 (p18-20)](#)

Linkage between business model and other key elements of the strategic report, particularly CR priorities.



Business Model and Strategy

Precious metal value chain

Fresnillo plc

1 Operate

2 Develop

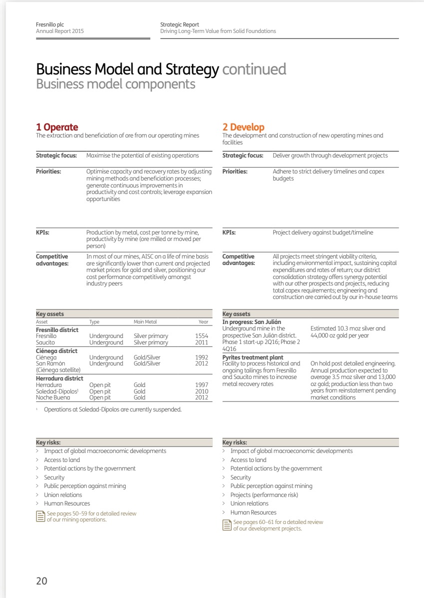
3 Explore

4 Sustainability

Value creation

Strategic relationships

Stakeholder support



Business Model and Strategy continued

Business model components

1 Operate

2 Develop

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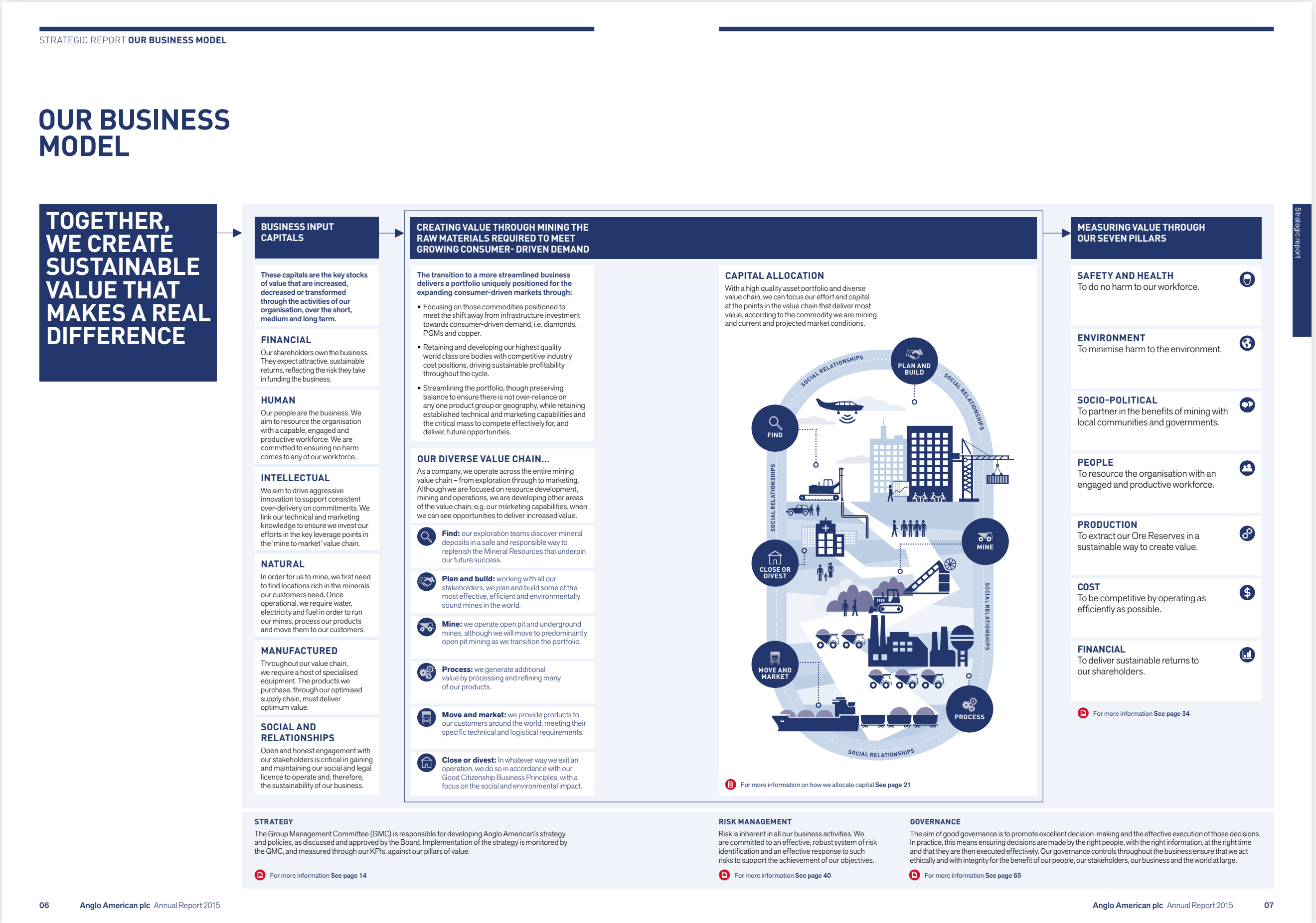
Appx. 1
Appx. 2
Contacts
Resources

1 2 3 4 5 6 7 8 9 10 11 12 13 14 Appx. 1 Appx. 2 Contacts Resources

Example 6.5

[Anglo American plc Annual Report 2015 (p6-7)]

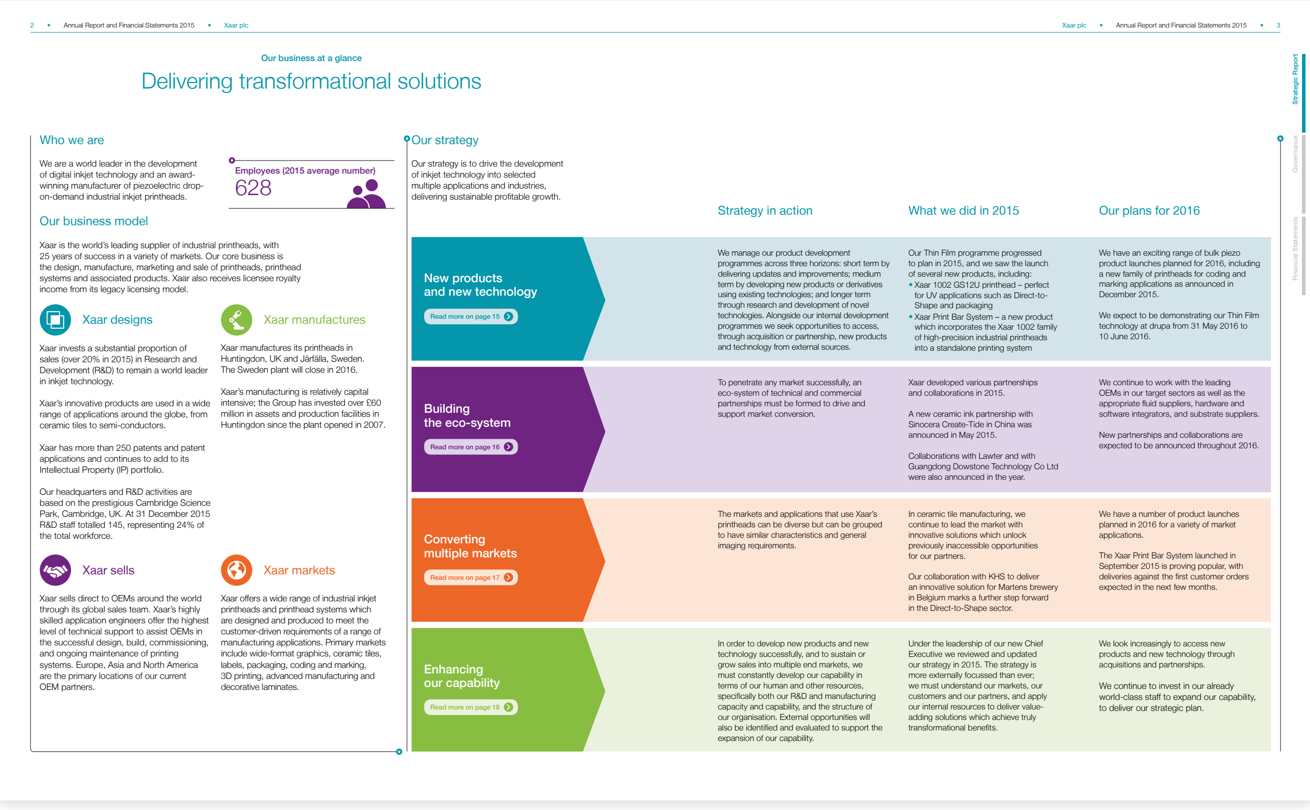
- Good visual representation of a business model.
- Clear identification and discussion within the business model of the business' key resources.



Example 6.6

[Xaar plc Annual Report and Financial Statements 2015 (p2-3)]

Provides information as to how the company is planning to nurture the resources that are key to the business model in the 'Our plans for 2016' column e.g. continued investment in staff.



2 • Annual Report and Financial Statements 2015 • Xaar plc

Xaar plc • Annual Report and Financial Statements 2015 • 3

Our business at a glance

Delivering transformational solutions

Who we are

We are a world leader in the development of digital inkjet technology and an award-winning manufacturer of piezoelectric drop-on-demand industrial inkjet printheads.

Employees (2015 average number)
628

Our business model

Xaar is the world's leading supplier of industrial printheads, with 25 years of success in a variety of markets. Our core business is the design, manufacture, marketing and sale of printheads, printhead systems and associated products. Xaar also receives licensee royalty income from its legacy licensing model.

Xaar designs

Xaar invests a substantial proportion of sales (over 20% in 2015) in Research and Development (R&D) to remain a world leader in inkjet technology.

Xaar's innovative products are used in a wide range of applications around the globe, from ceramic tiles to semi-conductors.

Xaar has more than 250 patents and patent applications and continues to add to its Intellectual Property (IP) portfolio.

Our headquarters and R&D activities are based on the prestigious Cambridge Science Park, Cambridge, UK. At 31 December 2015 R&D staff totalled 145, representing 24% of the total workforce.

Xaar manufactures

Xaar manufactures its printheads in Huntingdon, UK and Järfälla, Sweden. The Sweden plant will close in 2016.

Xaar's manufacturing is relatively capital intensive; the Group has invested over £60 million in assets and production facilities in Huntingdon since the plant opened in 2007.

Xaar sells

Xaar sells direct to OEMs around the world through its global sales team. Xaar's highly skilled application engineers offer the highest level of technical support to assist OEMs in the successful design, build, commissioning, and ongoing maintenance of printing systems. Europe, Asia and North America are the primary locations of our current OEM partners.

Xaar markets

Xaar offers a wide range of industrial inkjet printheads and printhead systems which are designed and produced to meet the customer-driven requirements of a range of manufacturing applications. Primary markets include wide-format graphics, ceramic tiles, labels, packaging, coding and marking, 3D printing, advanced manufacturing and decorative laminates.

Our strategy

Our strategy is to drive the development of inkjet technology into selected multiple applications and industries, delivering sustainable profitable growth.

	Strategy in action	What we did in 2015	Our plans for 2016
New products and new technology Read more on page 15	We manage our product development programmes across three horizons: short term by delivering updates and improvements; medium term by developing new products or derivatives using existing technologies; and longer term through research and development of novel technologies. Alongside our internal development programmes we seek opportunities to access, through acquisition or partnership, new products and technology from external sources.	Our Thin Film programme progressed to plan in 2015, and we saw the launch of several new products, including: • Xaar 1002 GS12U printhead – perfect for UV applications such as Direct-to-Shape and packaging • Xaar Print Bar System – a new product which incorporates the Xaar 1002 family of high-precision industrial printheads into a standalone printing system	We have an exciting range of bulk piezo product launches planned for 2016, including a new family of printheads for coding and marking applications as announced in December 2015. We expect to be demonstrating our Thin Film technology at drupa from 31 May 2016 to 10 June 2016.
Building the eco-system Read more on page 16	To penetrate any market successfully, an eco-system of technical and commercial partnerships must be formed to drive and support market conversion.	Xaar developed various partnerships and collaborations in 2015. A new ceramic ink partnership with Sinocera Create-Tide in China was announced in May 2015. Collaborations with Lawter and with Guangdong Dowstone Technology Co Ltd were also announced in the year.	We continue to work with the leading OEMs in our target sectors as well as the appropriate fluid suppliers, hardware and software integrators, and substrate suppliers. New partnerships and collaborations are expected to be announced throughout 2016.
Converting multiple markets Read more on page 17	The markets and applications that use Xaar's printheads can be diverse but can be grouped to have similar characteristics and general imaging requirements.	In ceramic tile manufacturing, we continue to lead the market with innovative solutions which unlock previously inaccessible opportunities for our partners. Our collaboration with KHS to deliver an innovative solution for Martens brewery in Belgium marks a further step forward in the Direct-to-Shape sector.	We have a number of product launches planned in 2016 for a variety of market applications. The Xaar Print Bar System launched in September 2015 is proving popular, with deliveries against the first customer orders expected in the next few months.
Enhancing our capability Read more on page 18	In order to develop new products and new technology successfully, and to sustain or grow sales into multiple end markets, we must constantly develop our capability in terms of our human and other resources, specifically both our R&D and manufacturing capacity and capability, and the structure of our organisation. External opportunities will also be identified and evaluated to support the expansion of our capability.	Under the leadership of our new Chief Executive we reviewed and updated our strategy in 2015. The strategy is more externally focussed than ever; we must understand our markets, our customers and our partners, and apply our internal resources to deliver value-adding solutions which achieve truly transformational benefits.	We look increasingly to access new products and new technology through acquisitions and partnerships. We continue to invest in our already world-class staff to expand our capability, to deliver our strategic plan.

Strategic Report
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Example 6.7

Persimmon PLC Annual Report 2015 (p12-13)

Identification of outcomes produced by the company's business model for various stakeholders.

Business model

How we create value

INPUTS

These are the things we need to be able to operate as a business.

Land

A long term supply of land is critical to our maintaining and increasing housing completions because of the inherent delays in obtaining implementable planning consent.

- **17,700** acres of strategic land
- **54,300** plots of land with implementable planning consent

People

Our people are essential to implementing our strategy. We currently employ over 4,400 staff and use many subcontractors and suppliers to meet our production targets.

- **4,400** employees

Geographic coverage

We have 28 regional offices across the UK to maintain geographical coverage to maximise sales potential and minimise risk in regional markets.

- **28** regional offices

Materials

We have Group supply contracts for our major construction materials to ensure best prices and continuity of supply.

Space4

We manufacture advanced insulated closed timber frames for an increasing number of our new homes to enable us to build to the best sustainability standards of energy efficiency and quality.

- **6,011** timber frame kits produced

WHAT WE DO

We build a wide range of new homes across the UK. We combine quality and efficiency to provide a sustainable balance between affordable prices and a good operating margin for the business.

Obtaining planning permission

We control land which has potential for development but requires further promotion or investment in order for this potential to be realised. Our dedicated land teams maintain and replenish our strategic land portfolio and our planning teams promote land through the planning system.

17,700

Acres of strategic land

Buying land

Our development sites are acquired from our strategic land portfolio at a discount to open market value, or purchased on the open market with an existing planning consent. Maintaining our landbank gives continuity of supply and enables us to be selective in our land acquisitions.

54,300

Plots with implementable planning consent

Design & build

We focus on building family housing nationally under our key brands. Space4 technology supports our production rates by delivering energy efficient modern methods of construction. We maintain tight control over our construction costs and work in progress, so that we can react quickly to changes in housing demand.

380

Average site numbers

Sales & customer care

We build quality homes to order across the UK, from Plymouth to Perth and Swansea to Scarborough. By maintaining a national site network we can maximise our sales potential across the UK. Customer service from our sales teams is an important element in achieving high levels of customer satisfaction.

14,572

Homes sold

OUTCOMES

These are the results, both financial and non financial, of what we do.

14,572

Energy efficient homes

£629.5m

Profit before tax

Tax paid

In 2015 the Group paid £185.3m in corporation tax, national insurance, stamp duty, output VAT and irrecoverable input VAT

£291m

Capital returned to shareholders

Sustainable communities

In 2015 we provided £46m of community infrastructure, schools and open space

Financial strength

Balance sheet net assets of £2.46bn

Waste recycling

Increased to 92% of all construction waste

All figures as at 31 December 2015

Strategic report | Governance | Financial statements | Other information

12 Persimmon Plc Annual Report – December 2015

Persimmon Plc Annual Report – December 2015 13

Example 6.8
[Johnson Matthey Plc Annual Report & Accounts 2016 (p41)]

Distribution of value created to stakeholders.


Performance in 2015/16

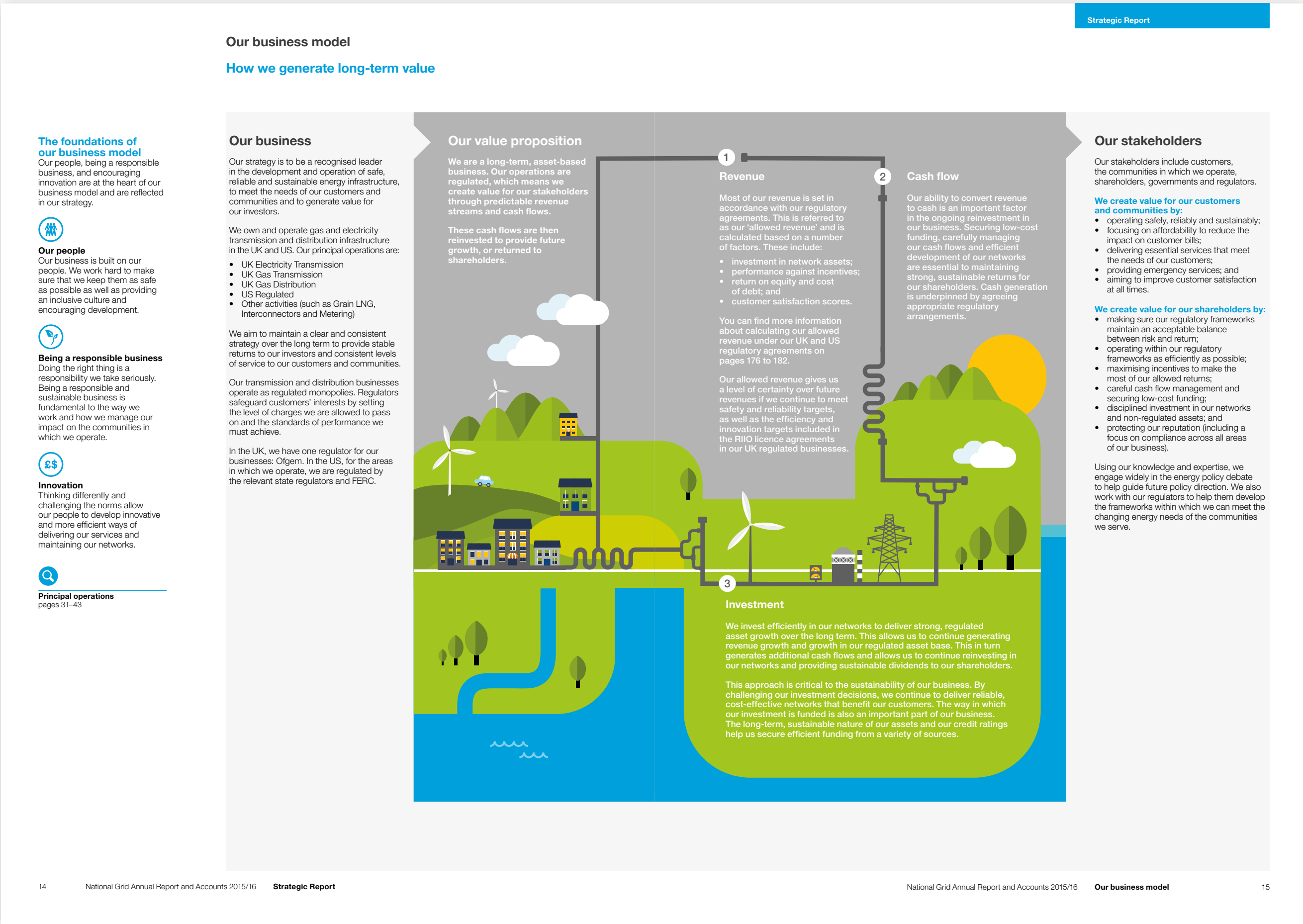
Economic Impact and Distribution of Value to Stakeholders

Johnson Matthey – Distribution of Underlying Added Value 2015/16

Example 6.9

[National Grid Plc Annual Report and Accounts 2015/16 (p14-15)]

- Discussion of value creation in the business model.
- Good visual representation of the business model.



Strategic Report

Our business model

How we generate long-term value

The foundations of our business model
Our people, being a responsible business, and encouraging innovation are at the heart of our business model and are reflected in our strategy.

Our people
Our business is built on our people. We work hard to make sure that we keep them as safe as possible as well as providing an inclusive culture and encouraging development.

Being a responsible business
Doing the right thing is a responsibility we take seriously. Being a responsible and sustainable business is fundamental to the way we work and how we manage our impact on the communities in which we operate.

Innovation
Thinking differently and challenging the norms allow our people to develop innovative and more efficient ways of delivering our services and maintaining our networks.

Principal operations
pages 31–43

Our business

Our strategy is to be a recognised leader in the development and operation of safe, reliable and sustainable energy infrastructure, to meet the needs of our customers and communities and to generate value for our investors.

We own and operate gas and electricity transmission and distribution infrastructure in the UK and US. Our principal operations are:

- UK Electricity Transmission
- UK Gas Transmission
- UK Gas Distribution
- US Regulated
- Other activities (such as Grain LNG, Interconnectors and Metering)

We aim to maintain a clear and consistent strategy over the long term to provide stable returns to our investors and consistent levels of service to our customers and communities.

Our transmission and distribution businesses operate as regulated monopolies. Regulators safeguard customers' interests by setting the level of charges we are allowed to pass on and the standards of performance we must achieve.

In the UK, we have one regulator for our businesses: Ofgem. In the US, for the areas in which we operate, we are regulated by the relevant state regulators and FERC.

Our value proposition

We are a long-term, asset-based business. Our operations are regulated, which means we create value for our stakeholders through predictable revenue streams and cash flows.

These cash flows are then reinvested to provide future growth, or returned to shareholders.

1 **Revenue**

Most of our revenue is set in accordance with our regulatory agreements. This is referred to as our 'allowed revenue' and is calculated based on a number of factors. These include:

- investment in network assets;
- performance against incentives;
- return on equity and cost of debt; and
- customer satisfaction scores.

You can find more information about calculating our allowed revenue under our UK and US regulatory agreements on pages 176 to 182.

Our allowed revenue gives us a level of certainty over future revenues if we continue to meet safety and reliability targets, as well as the efficiency and innovation targets included in the RIIO licence agreements in our UK regulated businesses.

2 **Cash flow**

Our ability to convert revenue to cash is an important factor in the ongoing reinvestment in our business. Securing low-cost funding, carefully managing our cash flows and efficient development of our networks are essential to maintaining strong, sustainable returns for our shareholders. Cash generation is underpinned by agreeing appropriate regulatory arrangements.

3 **Investment**

We invest efficiently in our networks to deliver strong, regulated asset growth over the long term. This allows us to continue generating revenue growth and growth in our regulated asset base. This in turn generates additional cash flows and allows us to continue reinvesting in our networks and providing sustainable dividends to our shareholders.

This approach is critical to the sustainability of our business. By challenging our investment decisions, we continue to deliver reliable, cost-effective networks that benefit our customers. The way in which our investment is funded is also an important part of our business. The long-term, sustainable nature of our assets and our credit ratings help us secure efficient funding from a variety of sources.

Our stakeholders

Our stakeholders include customers, the communities in which we operate, shareholders, governments and regulators.

We create value for our customers and communities by:
- operating safely, reliably and sustainably;
- focusing on affordability to reduce the impact on customer bills;
- delivering essential services that meet the needs of our customers;
- providing emergency services; and
- aiming to improve customer satisfaction at all times.

We create value for our shareholders by:
- making sure our regulatory frameworks maintain an acceptable balance between risk and return;
- operating within our regulatory frameworks as efficiently as possible;
- maximising incentives to make the most of our allowed returns;
- careful cash flow management and securing low-cost funding;
- disciplined investment in our networks and non-regulated assets; and
- protecting our reputation (including a focus on compliance across all areas of our business).

Using our knowledge and expertise, we engage widely in the energy policy debate to help guide future policy direction. We also work with our regulators to help them develop the frameworks within which we can meet the changing energy needs of the communities we serve.

14 National Grid Annual Report and Accounts 2015/16 **Strategic Report**

National Grid Annual Report and Accounts 2015/16 **Our business model** 15

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Example 6.10

St James' Place PLC Annual Report & Accounts 2015 (p7)

How the company's strategy will develop its business model.

7

OUR BUSINESS MODEL

Strategic Report

St. James's Place Foundation

Governance

Financial Statements

Other Information

St. James's Place plc is a FTSE 100 listed Company. The business is centred on the UK and seeks to attract clients from the mass affluent and high net worth markets.

SJP is a wealth management business; the Group's advisers, the St. James's Place Partnership, provide clients with a financial planning service and face-to-face advice, and clients' wealth is managed through the Group's distinctive Investment Management Approach (IMA). Almost uniquely within the UK wealth management market, this vertically integrated model means that the Group is directly responsible for the whole offering, including advice, management of investments and any related services.

The Partnership is critical to the success of the business. Partners are able to attract clients and, through building trust, develop long term relationships, supporting clients with their financial needs over time. This relationship-based approach is greatly valued by the Group's clients, no more so than in periods of financial uncertainty. The Group's experience is that there is an increasing demand for trusted advice from experienced advisers, backed by a strong brand and an organisation which takes responsibility for all aspects of the service.

As a result, the Group is able to attract and retain retail funds under management from which it receives an annual management fee. This is the principal source of income for the Group, and it grows with additional new business and also as a result of growth in markets and the success of our approach to investment management.

Attracting new funds under management is core to the success of the Group, and growth in new business arises as a result of both increasing Partner numbers and also encouraging further development by existing Partners. By providing an attractive proposition, the Group is able to recruit new members to the Partnership, and the provision of high quality support enables Partners to grow both their own businesses and ours.

Group expenditure is carefully managed with clear objectives set and with a particular focus on managing fixed costs. Many activities are outsourced so we can benefit from industry specialists and expenses that vary with business levels. Such expenses include the costs of client administration and investment administration, the costs of which can then be met from margins in our products. Overall, a small proportion of expenditure is required to maintain existing funds, but the majority is invested in supporting and growing the Partnership and acquiring new funds.

Profits emerge from the business principally as a result of the annual management income from funds under management exceeding expenses.

ST. JAMES'S PLACE PLC ANNUAL REPORT AND ACCOUNTS 2015

1 2 3 4 5 6 7 8 9 10 11 12 13 14 Appx. 1 Appx. 2 Contacts Resources

Section 2. Strategy

Market overview and company strategy

By providing information on the markets in which it operates and how it engages with these markets, a company can demonstrate not only how it creates value for its stakeholders through its business model but also provide a background or context for its strategy and for its discussion of its performance in the year. This will be particularly important for companies that are intending to implement a new strategy/change in strategy in the next financial year as they will need to discuss both the previous strategy and how the new strategy will continue to develop the company. Discussion of strategy will differ based on the nature and size of the company – some companies disclose a large amount of information as regards their varying 'strategic elements', whereas others include briefer overviews of their strategy. Some companies include a specific strategy for each of their business divisions in addition to the overall company strategy – companies that do this should ensure that there is some link between the division-specific and the company strategy as this was not always the case.

The FRC Guidance notes that the main trends and factors likely to affect the future development, performance or position of the business should be included in the strategic report to the extent necessary for an understanding of the company's business.[49] 79% (2015: 73%) of companies surveyed presented an overview of trends in the markets in which their businesses operate.

It was particularly encouraging to see an increase in the number of smaller listed companies surveyed that provided such a market overview (69% up from 53% in 2015). Treatt PLC was one of the smaller listed companies that did provide such an overview.

The best annual reports illustrate how the company is responding to the market trends identified, rather than just producing an analysis of the market/industry trends that is factual but not tailored to the company. 66% of companies surveyed provided such information as to how they are responding to market trends – **Johnson Matthey Plc (Example 6.11)** provided a good explanation of their strategic responses to changing market trends, as did **Vectura Group plc (Example 6.12)**. Resilient, sustainable business models are one of the key themes of current narrative reporting and emphasise the importance of a company's business model, including detail on their response to both positive and negative market trends.

<IR> – outlook and opportunities

An integrated report should answer the question: what challenges and uncertainties is the organisation likely to encounter in pursuing its strategy, and what are the implications for its business model and future performance? Part of this forward-looking outlook is identifying relevant risks (see chapter 9) and also the opportunities that the company faces. This goes beyond the Act's requirement to include the main trends and factors likely to affect the future development, performance and position of the company's business (often included in strategic reports under the heading 'Outlook').

Other observations

Report includes discussion of outlook facing the company	2016
In CEO's statement	29%
In chairman's statement	24%
In CEO's and chairman's statements	34%
Only elsewhere in strategic report	8%
No discussion	5%

Including forward-looking information is a requirement of the Companies Act as well as being key for integrated reporting. Most companies give such information significant prominence by including it in the CEO's or Chairman's statements and in some cases it is discussed again elsewhere in the strategic report. However, 5% of companies surveyed are still not providing any information on the outlook for their business. Pearson PLC was one of the FTSE 350 companies surveyed that provided detailed disclosure of its outlook.

Report includes discussion of specific opportunities presenting themselves to the company	2016
In CEO's statement	33%
In chairman's statement	1%
In CEO's and chairman's statements	4%
Only elsewhere in strategic report	40%
No discussion	22%

The fact that 22% of companies are not providing any discussion of their future opportunities suggests that their discussion of the outlook facing them could be further developed to make it a more comprehensive analysis of their circumstances and thus identify potential opportunities as part of it. Croda International Plc discussed their opportunities in the context of the industry's global drivers of change.

49 FRC Guidance Section 7.17

Strategy and objectives

A quoted company is required to describe its strategy in its strategic report by the Companies Act. 97% (2015: 95%) of companies surveyed, in our view, clearly set out their strategy in their annual report. 84% presented a discussion of strategy in a clearly distinct section of their report, although this was less popular with smaller companies, with only 69% of those outside the FTSE 350 electing to do so.

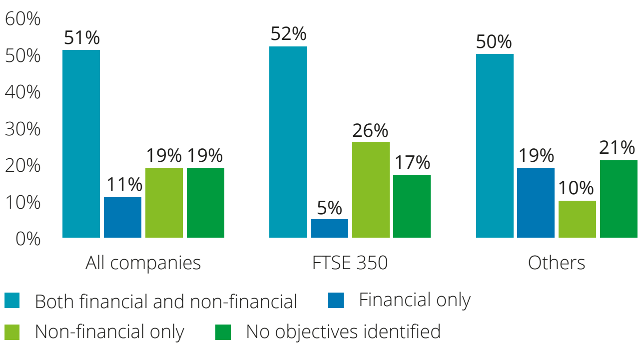
Provision C.1.2 of the UK Corporate Governance Code states that the annual report should contain an explanation of "the strategy for delivering the objectives of the company". Objectives (frequently described as 'strategic priorities') are commonly understood to be the goals, aims or missions of the company whereas the strategy denotes the intended plan as to how these objectives should be achieved. These two terms are frequently used interchangeably by companies and this can, at times, lead to some confusion in the articulation of both. Of the companies surveyed 81% clearly set out the objectives of their business; objectives reported ranged from detailed descriptions to more basic 'mission statements' e.g. "the company's objective is to increase total shareholder value". The latter was more common amongst the smaller listed companies, a number of which then failed to go on to explain a coherent strategy for achieving such an objective. British Polythene Industries PLC was an example of a smaller listed company that did clearly identify its objectives.

LINKAGE

Given the interrelationship between strategy and objectives it is beneficial to present these in a linked way. Popular ways of doing this included a table setting out what the company wanted to achieve (its objective) and alongside how they were going to go about achieving this (its strategy). By showing linkage in these areas it demonstrates why the company has adopted the strategy it has, by setting out what the business wants to achieve.

The majority of companies included a mix of financial and non-financial objectives (see Figure 6.5) indicating that they consider their goals to be of a more holistic nature than merely meeting financial targets. Inclusion of non-financial objectives also demonstrates the integration of CR priorities into the wider strategic report discussion. Non-financial objectives included by companies in our survey ranged from "to become the bank of choice for our stakeholders" to "to work with our customers to find innovative solutions".

Figure 6.5 What type of objectives are identified by companies?



Other observations

Report clearly illustrates linkage between objectives and the financial/operational metric measuring them*	2016	2015
All objectives linked		
Overall	19%	23%
FTSE 350	22%	28%
Others	14%	16%

Given the low proportion of companies that explain how they intend to measure achievement or otherwise of their objectives (through a KPI or other measure), companies may want to consider how best to explain their performance. **The Unite Group plc (Example 6.13)** linked all their strategic priorities to how progress against them was measured as part of their 'Strategic Plan'.

Some objectives linked		
Overall	19%	14%
FTSE 350	21%	19%
Others	17%	7%

The slight increase in the number of companies linking some of their objectives to a measurement metric suggests that companies find certain objectives easier to measure than others (hence the drop in the number linking all their objectives as seen above).

No objectives linked		
Overall	62%	63%
FTSE 350	57%	53%
Others	69%	77%

*Financial and operating metrics were not only measures specifically designated as KPIs (linkage between objectives/overall strategy and KPIs specifically is examined in the next section).

Strategy linkage

Linkage between separate parts of the annual report helps a company show how its strategy underpins the business and management consider the business in a holistic way. Good linkage goes beyond a simple cross-reference by providing some context or explanation as to how the different areas of the reports link. For further discussion of linkage and cross-referencing see the start of this chapter.

The table below contains statistics on linkage and cross-references as included in the discussion of objectives/strategy and not elsewhere in the annual report. Statistics have also been collected on linkage and cross-referencing between strategy and KPIs (see chapter 7) and between strategy and the discussion of principal risks (see chapter 8), regardless of where that linkage is presented. There are also some overall considerations in relation to linkage in the annual reports of the companies surveyed in chapter 4.

LINKAGE

A company's strategy articulates what it wants to achieve given the resources it has access to in order to create and deliver long term value to its stakeholders. The best strategy disclosures are those that display qualitative linkage between the strategy and other key parts of the strategic report, namely KPIs, risks and CR priorities. This demonstrates connectivity throughout the strategic report and also helps keep the annual report clear and concise by preventing both repetition of narrative and excessively lengthy disclosure in any of these separate parts.

Report includes a basic cross reference from:	2016
Objectives/strategy to KPIs	
Overall	27%
FTSE 350	36%
Others	14%

A company should make sure that, when using a cross-reference it specifically identifies the nature and location of the information to which it relates. KPIs were the most common element that was cross-referenced to strategy, perhaps not surprising given that they should demonstrate how the strategy is measured.

Objectives/strategy to principal risks	
Overall	20%
FTSE 350	29%
Others	7%

The fact that only a minority of companies provided a cross-reference between their strategy discussion and their principal risks implies that there may be a failure to consider these two elements as interrelated, i.e. that your principal risks should be identified bearing in mind what your strategy actually is.

Linkage from Strategy to KPIs (i.e. information is provided for each strategy element about which KPIs are related to it)	2016
Complete linkage	15%
Partial linkage	11%
No linkage	74%

It is surprising that the majority of companies do not directly link their strategy to any of their KPIs (although a slightly higher number do provide linkage between their objectives and the means by which these are measured as detailed in the section above). Thought should be given as to whether KPI measures are those 'key' to the company if they cannot be linked in any way to the company's strategy. Where any non-GAAP measures have been chosen as KPIs, providing a link between these and the company's strategy can be an easy way of showing their purpose – something that will be required in future by the ESMA Guidelines on Alternative Performance Measures.

Is linkage from strategy to KPIs logical? (as % of the 26 companies including linkage)	2016
Completely	50%
In part	50%

To determine whether the linkage presented was logical, the KPIs were examined in light of the strategic element they had been linked to in order to see if it was clear that there was a genuine relationship between the two. The fact that only half of those companies presenting some linkage gave linkage that always appeared logical suggests that some companies need to consider whether there is in fact a relationship present in the manner suggested or to explain it more clearly. **Acacia Mining PLC (Example 6.14)** was an example of one of the few companies surveyed that presented logical linkage between all strategic elements and KPIs.

Report includes linkage from strategy to risks (i.e. information is provided for each strategy element about which risks are related to it)	2016
Complete linkage	17%
Partial linkage	1%
No linkage	82%

It is interesting to note that for those companies that did present linkage between their strategy and risks the vast majority provided linkage between all areas. This suggests that perhaps when companies do think about this linkage they find it easier to connect a risk to every element of strategy rather than to identify only some potential relationships.

Is linkage from strategy to risks logical? (as % of the 18 companies including linkage)	2016
Completely	28%
In part	72%

As noted directly above most companies that provided linkage associated a risk with all the components of their strategies. However only a minority of companies that provided any linkage in this area presented linkage where the logic was deemed self-evident. For example, some companies provided very generic linkage by linking overarching risks e.g. ‘business risk’ to a specific part of their strategy without properly explaining how that element of their strategy was linked to the wider risk. Such information is useful in the strategy section, rather than solely relying on descriptions in the principal risks section, as a failure to do so can result in linkage in the strategy section being unclear or seeming superficial. Other companies provided linkage that did not seem logical, i.e. there was no apparent relationship discernible between the risk and strategy – this was perhaps a result of trying to ‘shoehorn’ elements of the report together. G4S plc and **St Modwen Properties PLC (Example 6.15)** both provided a good example of how to logically link risks and strategy.

Report includes linkage between strategy and corporate responsibility (i.e. information is provided for each strategy element about which CR priorities are related to it)	2016
Complete linkage	1%
Partial linkage	9%
No linkage	90%

Generally, CR content in the strategic report is presented in the form of a separate report most commonly towards the end. Better companies demonstrate how CR considerations are embedded in their strategy. Companies should give consideration as to how content that may currently be included in the annual report does actually relate to the company’s overall strategy as, if it does not, it could instead be included in a standalone CR report thereby keeping the annual report clear and concise. **Rexam plc (Example 6.16)** and **Fresnillo plc (Example 6.4)** incorporated CR priorities well into their strategy/business models. It should be noted that it may not be the case that every strategy element would have CR linkage and companies should consider this in light of their own specific facts and circumstances.

Is linkage between strategy and corporate responsibility logical? (as % of 10 companies including any linkage)	2016
Completely	60%
In part	40%

Again, companies need to consider whether the linkage they are illustrating is logical rather than trying to create linkage where none exists.

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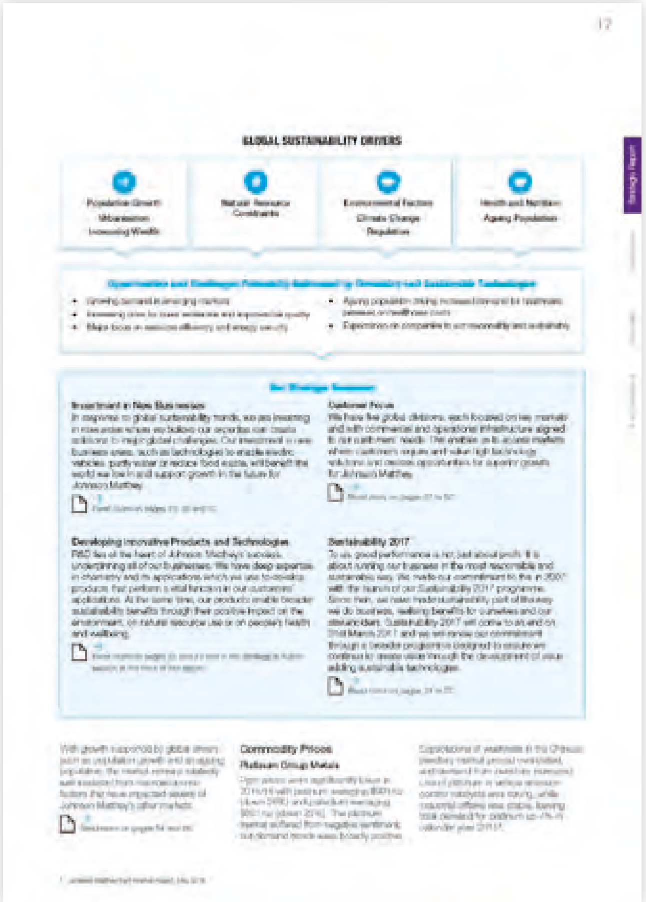
Section 2. Strategy disclosures – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 6.11

[Johnson Matthey Plc 2016 Annual Report & Accounts (p17)]

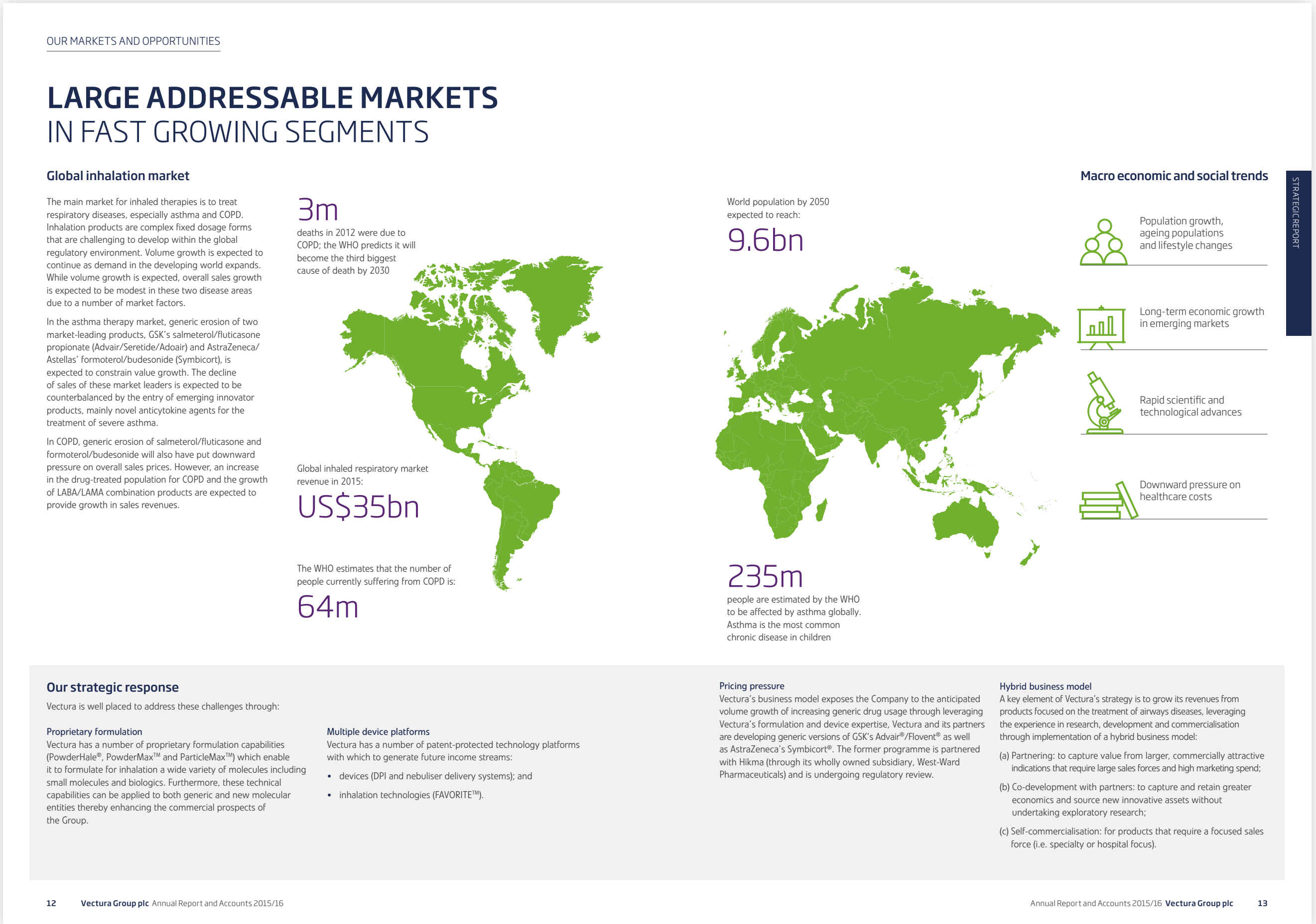
Good explanation of a company's strategic responses to changing market trends.


GLOBAL SUSTAINABILITY DRIVERS

Example 6.12

[Vectura Group plc Annual Report and Accounts 2015/16 (p12-13)](#)

Good explanation of a company's strategic responses to changing market trends.



OUR MARKETS AND OPPORTUNITIES

LARGE ADDRESSABLE MARKETS IN FAST GROWING SEGMENTS

Global inhalation market

The main market for inhaled therapies is to treat respiratory diseases, especially asthma and COPD. Inhalation products are complex fixed dosage forms that are challenging to develop within the global regulatory environment. Volume growth is expected to continue as demand in the developing world expands. While volume growth is expected, overall sales growth is expected to be modest in these two disease areas due to a number of market factors.

In the asthma therapy market, generic erosion of two market-leading products, GSK's salmeterol/fluticasone propionate (Advair/Seretide/Adoair) and AstraZeneca/Astellas' formoterol/budesonide (Symbicort), is expected to constrain value growth. The decline of sales of these market leaders is expected to be counterbalanced by the entry of emerging innovator products, mainly novel anticytokine agents for the treatment of severe asthma.

In COPD, generic erosion of salmeterol/fluticasone and formoterol/budesonide will also have put downward pressure on overall sales prices. However, an increase in the drug-treated population for COPD and the growth of LABA/LAMA combination products are expected to provide growth in sales revenues.

Our strategic response

Vectura is well placed to address these challenges through:

Proprietary formulation
Vectura has a number of proprietary formulation capabilities (PowderHale®, PowderMax™ and ParticleMax™) which enable it to formulate for inhalation a wide variety of molecules including small molecules and biologics. Furthermore, these technical capabilities can be applied to both generic and new molecular entities thereby enhancing the commercial prospects of the Group.

Multiple device platforms
Vectura has a number of patent-protected technology platforms with which to generate future income streams:

- devices (DPI and nebuliser delivery systems); and
- inhalation technologies (FAVORITE™).

Pricing pressure
Vectura's business model exposes the Company to the anticipated volume growth of increasing generic drug usage through leveraging Vectura's formulation and device expertise, Vectura and its partners are developing generic versions of GSK's Advair®/Flovent® as well as AstraZeneca's Symbicort®. The former programme is partnered with Hikma (through its wholly owned subsidiary, West-Ward Pharmaceuticals) and is undergoing regulatory review.

Hybrid business model
A key element of Vectura's strategy is to grow its revenues from products focused on the treatment of airways diseases, leveraging the experience in research, development and commercialisation through implementation of a hybrid business model:

(a) Partnering: to capture value from larger, commercially attractive indications that require large sales forces and high marketing spend;

(b) Co-development with partners: to capture and retain greater economics and source new innovative assets without undertaking exploratory research;

(c) Self-commercialisation: for products that require a focused sales force (i.e. specialty or hospital focus).

12 **Vectura Group plc** Annual Report and Accounts 2015/16

Annual Report and Accounts 2015/16 **Vectura Group plc** 13

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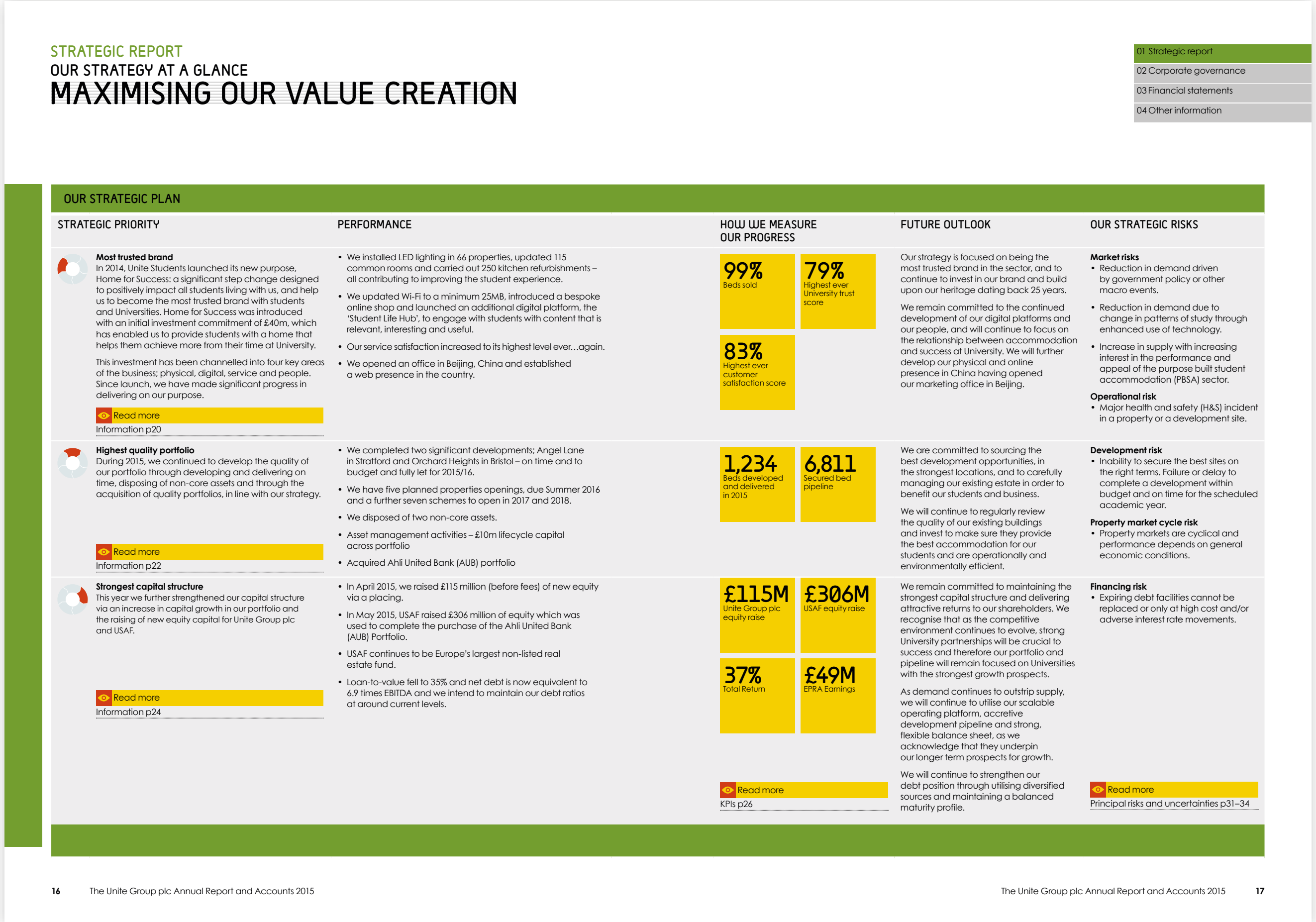
Example 6.13

[The Unite Group plc Annual Report and Accounts 2015 (p16-17)]

- Linkage of all strategic priorities to how progress against them is measured.
- Linkage between strategy/objectives and risks.
- Discussion of company outlook.



STRATEGIC REPORT

OUR STRATEGY AT A GLANCE

MAXIMISING OUR VALUE CREATION

01 Strategic report
02 Corporate governance
03 Financial statements
04 Other information

OUR STRATEGIC PLAN

STRATEGIC PRIORITY	PERFORMANCE	HOW WE MEASURE OUR PROGRESS	FUTURE OUTLOOK	OUR STRATEGIC RISKS
Most trusted brand In 2014, Unite Students launched its new purpose, Home for Success: a significant step change designed to positively impact all students living with us, and help us to become the most trusted brand with students and Universities. Home for Success was introduced with an initial investment commitment of £40m, which has enabled us to provide students with a home that helps them achieve more from their time at University. This investment has been channelled into four key areas of the business; physical, digital, service and people. Since launch, we have made significant progress in delivering on our purpose. Read more Information p20	• We installed LED lighting in 66 properties, updated 115 common rooms and carried out 250 kitchen refurbishments – all contributing to improving the student experience. • We updated Wi-Fi to a minimum 25MB, introduced a bespoke online shop and launched an additional digital platform, the 'Student Life Hub', to engage with students with content that is relevant, interesting and useful. • Our service satisfaction increased to its highest level ever…again. • We opened an office in Beijing, China and established a web presence in the country.	99% Beds sold 79% Highest ever University trust score 83% Highest ever customer satisfaction score	Our strategy is focused on being the most trusted brand in the sector, and to continue to invest in our brand and build upon our heritage dating back 25 years. We remain committed to the continued development of our digital platforms and our people, and will continue to focus on the relationship between accommodation and success at University. We will further develop our physical and online presence in China having opened our marketing office in Beijing.	**Market risks** • Reduction in demand driven by government policy or other macro events. • Reduction in demand due to change in patterns of study through enhanced use of technology. • Increase in supply with increasing interest in the performance and appeal of the purpose built student accommodation (PBSA) sector. **Operational risk** • Major health and safety (H&S) incident in a property or a development site.
Highest quality portfolio During 2015, we continued to develop the quality of our portfolio through developing and delivering on time, disposing of non-core assets and through the acquisition of quality portfolios, in line with our strategy. Read more Information p22	• We completed two significant developments; Angel Lane in Stratford and Orchard Heights in Bristol – on time and to budget and fully let for 2015/16. • We have five planned properties openings, due Summer 2016 and a further seven schemes to open in 2017 and 2018. • We disposed of two non-core assets. • Asset management activities – £10m lifecycle capital across portfolio • Acquired Ahli United Bank (AUB) portfolio	1,234 Beds developed and delivered in 2015 6,811 Secured bed pipeline	We are committed to sourcing the best development opportunities, in the strongest locations, and to carefully managing our existing estate in order to benefit our students and business. We will continue to regularly review the quality of our existing buildings and invest to make sure they provide the best accommodation for our students and are operationally and environmentally efficient.	**Development risk** • Inability to secure the best sites on the right terms. Failure or delay to complete a development within budget and on time for the scheduled academic year. **Property market cycle risk** • Property markets are cyclical and performance depends on general economic conditions.
Strongest capital structure This year we further strengthened our capital structure via an increase in capital growth in our portfolio and the raising of new equity capital for Unite Group plc and USAF. Read more Information p24	• In April 2015, we raised £115 million (before fees) of new equity via a placing. • In May 2015, USAF raised £306 million of equity which was used to complete the purchase of the Ahli United Bank (AUB) Portfolio. • USAF continues to be Europe's largest non-listed real estate fund. • Loan-to-value fell to 35% and net debt is now equivalent to 6.9 times EBITDA and we intend to maintain our debt ratios at around current levels.	£115M Unite Group plc equity raise £306M USAF equity raise 37% Total Return £49M EPRA Earnings Read more KPIs p26	We remain committed to maintaining the strongest capital structure and delivering attractive returns to our shareholders. We recognise that as the competitive environment continues to evolve, strong University partnerships will be crucial to success and therefore our portfolio and pipeline will remain focused on Universities with the strongest growth prospects. As demand continues to outstrip supply, we will continue to utilise our scalable operating platform, accretive development pipeline and strong, flexible balance sheet, as we acknowledge that they underpin our longer term prospects for growth. We will continue to strengthen our debt position through utilising diversified sources and maintaining a balanced maturity profile.	**Financing risk** • Expiring debt facilities cannot be replaced or only at high cost and/or adverse interest rate movements. Read more Principal risks and uncertainties p31–34

16 The Unite Group plc Annual Report and Accounts 2015

The Unite Group plc Annual Report and Accounts 2015 17

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Example 6.14

[Acacia Mining PLC Annual Report & Accounts 2015 (p16-17)]

Logical linkage between all strategic elements and KPIs.

OUR STRATEGY

Throughout 2015, we continued to make progress against our refreshed strategic approach and our ambition to become a leading company in Africa.

Relevant pages
p20 Key performance indicators
p42 Sustainability review
p80 Principal risks and uncertainties

OUR VISION

To be the leading gold producer in Africa.

We will do this through focusing on the following strategic pillars.

STRATEGIC PILLAR	PROGRESS IN 2015	PRIORITIES FOR 2016	2015 KPIs	RELEVANT RISK AREAS
Our business We have made significant technical changes to our business to ensure that each of our mines are correctly engineered, set up to deliver free cash flow and able to drive operating efficiencies. Each mine is transitioning to operate as its own commercial business unit, with regulatory and strategic oversight being provided by the central offices.	• Completed transition of North Mara into a combined open pit and underground operation • Progressed the mechanisation of mining at Bulyanhulu • Delivered a further 30% reduction in capital expenditure	• Complete the second access portal at the Gokona Underground • Identify alternative areas to source ore tonnes underground at Bulyanhulu • Accelerate waste movement at the Buzwagi pit to enable access to higher-grade areas	732 GOLD PRODUCTION (koz) 1,112 AISC (US$/oz)	Strategic Financial External Operational
Our people Our people are our core asset and we are focused on creating a high-performance culture where our people are held accountable, but are given the tools to succeed. In order to achieve this we have significantly reduced the levels of management, restructured our corporate offices, rightsized the workforce and promoted local talent.	• Completed the roll out of behavioural safety programme (WeCare) • Undertook significant right-sizing of workforce • 20% reduction in TRIFR rate • Further reduction in proportion of international workers	• Roll out of first line leader training programme • Further improve TRIFR rates with ambition of zero injuries • Continue to enhance Accountable Management System	0.68 SAFETY – TRIFR (Frequency rate) 95.6% LOCALISATION (% of operational workforce Tanzanian)	Strategic Operational
Our relationships We have focused on improving our relationships with the communities around our mines and with the Government. We have engaged more actively with the community, the media and our broader stakeholders. We have also worked hard to strengthen our relationships with local and national authorities to ensure that we receive the appropriate support for our business in order for us to continue to be a key economic development driver for our host countries.	• Successfully operated through country-wide general election • Maintenance of improved relationship with communities at North Mara • Updated closure plan for Buzwagi	• Further reduction in intruder numbers at North Mara • Generation of alternative livelihoods and improved community well-being • Increase local content within supply base • Reduce overall level of community grievances	US$12.9m COMMUNITY SPEND (US$m)	Strategic External Operational
Our future We believe that exploration is a significant driver of value for the business over the long term and now is the time to invest, which is a contrarian view to many in the market. As a result, we are focused on building a significant land package across Africa in the most geologically prospective belts to provide our exploration group the best opportunity to discover our next mines, as well as other opportunities to drive shareholder value over the long term.	• Delivered encouraging initial results from drilling on Liranda Corridor in Kenya • Increased resource base on South Houndé JV in Burkina Faso • Expanded footprint in Burkina Faso • Acquired licences in Mali	• Follow-up drilling programmes on Liranda Corridor to delineate the extent and continuity of mineralisation • Test depth and satellite targets on the South Houndé JV • Undertake grassroots exploration on newly acquired licences • Continue to expand footprint in most prospective areas	28.6 RESERVES AND RESOURCES (Moz)	Strategic Financial External Operational

16 ACACIA MINING PLC ANNUAL REPORT & ACCOUNTS 2015

ACACIA MINING PLC ANNUAL REPORT & ACCOUNTS 2015 17

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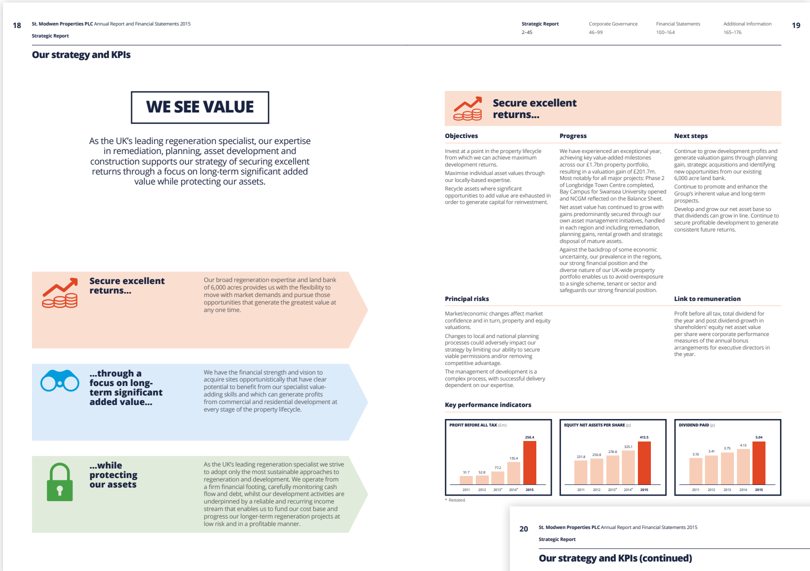
Example 6.15

[St Modwen Properties PLC Annual Report and Financial Statements 2015 (p18-21)]

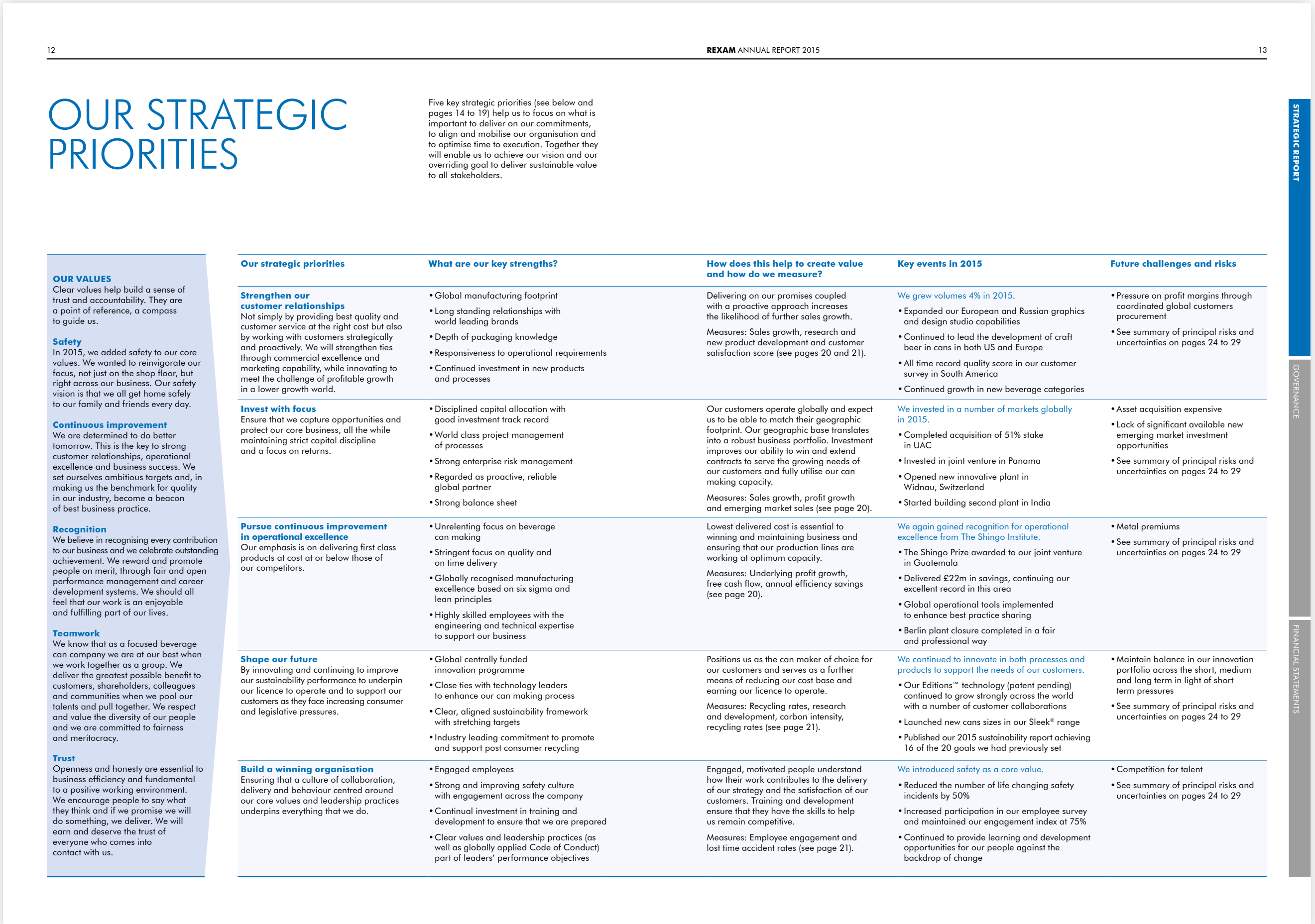
Logical linkage of risks and strategy.



Example 6.16

Rexam plc Annual Report 2015 (p12-13)

Company's corporate responsibility priorities embedded in the strategy.



12 REXAM ANNUAL REPORT 2015 13

STRATEGIC REPORT GOVERNANCE FINANCIAL STATEMENTS

OUR STRATEGIC PRIORITIES

Five key strategic priorities (see below and pages 14 to 19) help us to focus on what is important to deliver on our commitments, to align and mobilise our organisation and to optimise time to execution. Together they will enable us to achieve our vision and our overriding goal to deliver sustainable value to all stakeholders.

OUR VALUES
Clear values help build a sense of trust and accountability. They are a point of reference, a compass to guide us.

Safety
In 2015, we added safety to our core values. We wanted to reinvigorate our focus, not just on the shop floor, but right across our business. Our safety vision is that we all get home safely to our family and friends every day.

Continuous improvement
We are determined to do better tomorrow. This is the key to strong customer relationships, operational excellence and business success. We set ourselves ambitious targets and, in making us the benchmark for quality in our industry, become a beacon of best business practice.

Recognition
We believe in recognising every contribution to our business and we celebrate outstanding achievement. We reward and promote people on merit, through fair and open performance management and career development systems. We should all feel that our work is an enjoyable and fulfilling part of our lives.

Teamwork
We know that as a focused beverage can company we are at our best when we work together as a group. We deliver the greatest possible benefit to customers, shareholders, colleagues and communities when we pool our talents and pull together. We respect and value the diversity of our people and we are committed to fairness and meritocracy.

Trust
Openness and honesty are essential to business efficiency and fundamental to a positive working environment. We encourage people to say what they think and if we promise we will do something, we deliver. We will earn and deserve the trust of everyone who comes into contact with us.

Our strategic priorities	What are our key strengths?	How does this help to create value and how do we measure?	Key events in 2015	Future challenges and risks
Strengthen our customer relationships Not simply by providing best quality and customer service at the right cost but also by working with customers strategically and proactively. We will strengthen ties through commercial excellence and marketing capability, while innovating to meet the challenge of profitable growth in a lower growth world.	• Global manufacturing footprint • Long standing relationships with world leading brands • Depth of packaging knowledge • Responsiveness to operational requirements • Continued investment in new products and processes	Delivering on our promises coupled with a proactive approach increases the likelihood of further sales growth. Measures: Sales growth, research and new product development and customer satisfaction score (see pages 20 and 21).	We grew volumes 4% in 2015. • Expanded our European and Russian graphics and design studio capabilities • Continued to lead the development of craft beer in cans in both US and Europe • All time record quality score in our customer survey in South America • Continued growth in new beverage categories	• Pressure on profit margins through coordinated global customers procurement • See summary of principal risks and uncertainties on pages 24 to 29
Invest with focus Ensure that we capture opportunities and protect our core business, all the while maintaining strict capital discipline and a focus on returns.	• Disciplined capital allocation with good investment track record • World class project management of processes • Strong enterprise risk management • Regarded as proactive, reliable global partner • Strong balance sheet	Our customers operate globally and expect us to be able to match their geographic footprint. Our geographic base translates into a robust business portfolio. Investment improves our ability to win and extend contracts to serve the growing needs of our customers and fully utilise our can making capacity. Measures: Sales growth, profit growth and emerging market sales (see page 20).	We invested in a number of markets globally in 2015. • Completed acquisition of 51% stake in UAC • Invested in joint venture in Panama • Opened new innovative plant in Widnau, Switzerland • Started building second plant in India	• Asset acquisition expensive • Lack of significant available new emerging market investment opportunities • See summary of principal risks and uncertainties on pages 24 to 29
Pursue continuous improvement in operational excellence Our emphasis is on delivering first class products at cost at or below those of our competitors.	• Unrelenting focus on beverage can making • Stringent focus on quality and on time delivery • Globally recognised manufacturing excellence based on six sigma and lean principles • Highly skilled employees with the engineering and technical expertise to support our business	Lowest delivered cost is essential to winning and maintaining business and ensuring that our production lines are working at optimum capacity. Measures: Underlying profit growth, free cash flow, annual efficiency savings (see page 20).	We again gained recognition for operational excellence from The Shingo Institute. • The Shingo Prize awarded to our joint venture in Guatemala • Delivered £22m in savings, continuing our excellent record in this area • Global operational tools implemented to enhance best practice sharing • Berlin plant closure completed in a fair and professional way	• Metal premiums • See summary of principal risks and uncertainties on pages 24 to 29
Shape our future By innovating and continuing to improve our sustainability performance to underpin our licence to operate and to support our customers as they face increasing consumer and legislative pressures.	• Global centrally funded innovation programme • Close ties with technology leaders to enhance our can making process • Clear, aligned sustainability framework with stretching targets • Industry leading commitment to promote and support post consumer recycling	Positions us as the can maker of choice for our customers and serves as a further means of reducing our cost base and earning our licence to operate. Measures: Recycling rates, research and development, carbon intensity, recycling rates (see page 21).	We continued to innovate in both processes and products to support the needs of our customers. • Our Editions™ technology (patent pending) continued to grow strongly across the world with a number of customer collaborations • Launched new cans sizes in our Sleek® range • Published our 2015 sustainability report achieving 16 of the 20 goals we had previously set	• Maintain balance in our innovation portfolio across the short, medium and long term in light of short term pressures • See summary of principal risks and uncertainties on pages 24 to 29
Build a winning organisation Ensuring that a culture of collaboration, delivery and behaviour centred around our core values and leadership practices underpins everything that we do.	• Engaged employees • Strong and improving safety culture with engagement across the company • Continual investment in training and development to ensure that we are prepared • Clear values and leadership practices (as well as globally applied Code of Conduct) part of leaders' performance objectives	Engaged, motivated people understand how their work contributes to the delivery of our strategy and the satisfaction of our customers. Training and development ensure that they have the skills to help us remain competitive. Measures: Employee engagement and lost time accident rates (see page 21).	We introduced safety as a core value. • Reduced the number of life changing safety incidents by 50% • Increased participation in our employee survey and maintained our engagement index at 75% • Continued to provide learning and development opportunities for our people against the backdrop of change	• Competition for talent • See summary of principal risks and uncertainties on pages 24 to 29

Section 3. Corporate Responsibility

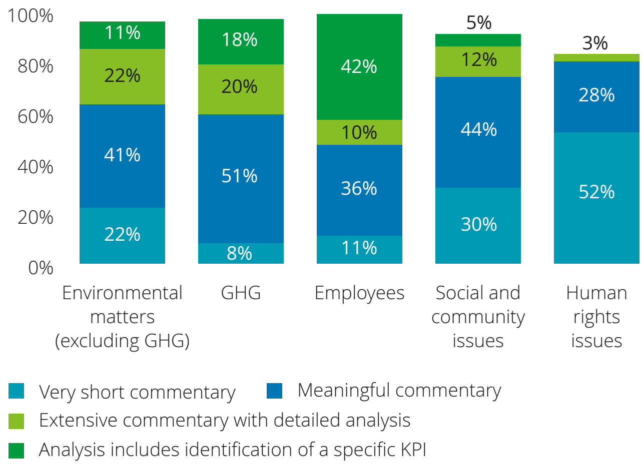
Information on environmental, employee, social, community and human rights matters is required to be included in the strategic report to the extent necessary for an understanding of the development, performance or position of the company's business.[50]

> **<IR> CR considerations**
>
> Embedding integrated thinking into an organisation's activities requires better connection of external reporting and the information used for management reporting, analysis and decision-making. For entities operating in silos, the preparation and presentation of separate sustainability or corporate responsibility reports can often be seen as bolt-on processes to other reporting. In this way, integrated reporting often initiates processes to integrate sustainability or corporate responsibility information into business management and reporting systems, and, where necessary, to identify and develop smarter non-financial information and KPIs. An integrated report would therefore naturally weave into its discussion of strategy, business model and performance the impact upon all relevant stakeholders, therefore eliminating the common standalone CR sections.

The best annual reports incorporated CR considerations throughout their strategic report as opposed to having a 'bolt-on' CR section at the end of the strategic report. This reflects the idea that broader environmental and social issues should be embedded into the strategy and business model of an organisation. How a company interacts with its various stakeholders should be a key theme of the strategic report, which is linked to the premise of <IR> that a company should be managing all of its various capitals (e.g. human, social and relationship, natural) in an integrated fashion. A good example of this was **Fresnillo plc (Example 6.4)** which incorporated sustainability directly into its business model (see example in business model section above). **Mitie Group plc** and **Rotork plc (Example 6.17)** also provided good examples of integrated CR content by incorporating these directly into their strategic priorities. A minority of companies also provided some linkage by including a CR KPI as part of their main KPIs, the most popular choice being an employee measure as shown in Figure 6.6. Companies should however aim to avoid having specifically designated 'sustainability/CR' KPIs in addition to their 'main' company KPIs as this suggests that such sustainability KPIs are not integral to the business as a whole. The KPIs presented should be those measures used to manage the business and demonstrate how the company is creating value for shareholders and their wider stakeholders.

If a company does have sustainability KPIs they should ensure that the measurement and description of the KPI indicates how that measure demonstrates the value creation processes in place within the company. For example a KPI of 'number of workplace injuries' does not in itself demonstrate how the company creates value, whereas providing an assessment of the value lost to the company per each workplace injury and a decrease in the KPI year-on year does indicate how value is being created/preserved.

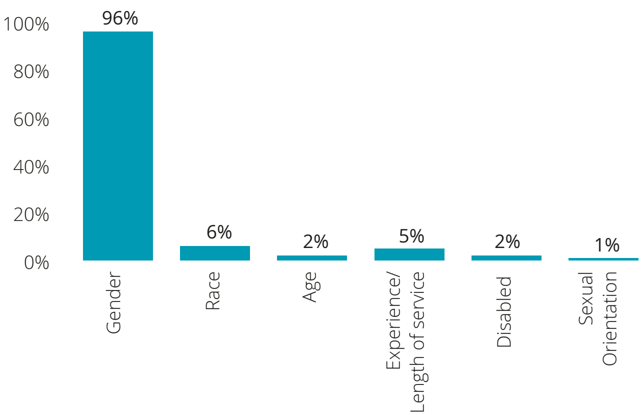
Figure 6.6 To what extent is CSR information included within the annual report?



50 FRC Guidance on the Strategic Report, *Section 7.29*

As disclosed in Figure 6.7, with the exception of the required gender disclosures, very few companies currently disclose wider diversity figures. CR disclosure, in particular diversity, is expected to gain increasing prominence given the EU Non-Financial Reporting Directive which will extend the level of diversity disclosures for periods beginning on or after 1 January 2017[51] (see chapter 3 Regulatory overview for further discussion).

Figure 6.7 What diversity information was disclosed by companies?

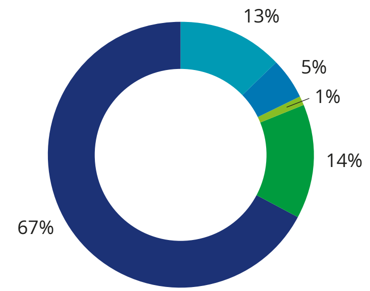


Companies need to strike a balance in determining the amount of CR information included in their annual report in order to meet this requirement whilst ensuring that the report is kept clear and concise. For example it may not be necessary to include information in the annual report to solely illustrate that the company is 'doing the right thing' when this is not material to the company. A recommended means of ensuring information is kept clear and concise is to only include the CR information that is assessed to be material to shareholders in the annual report/that supports the company's value creation story and to include a reference to where further detail can be accessed e.g. on the company's website or in a separate sustainability publication. This may be particularly relevant to those companies where detailed sustainability information may be relevant to other interest groups, e.g. NGOs, but where a large quantity of this would not be considered material for the purposes of the annual report. 49% (2015: 34%) of companies surveyed provided references to where further CR information could be accessed outside the annual report, suggesting that increasing consideration is being given by companies to making their annual reports more clear and concise by not including immaterial CR disclosures.

A number of companies struggle with the concept of materiality as it relates to CR and are more comfortable in making materiality determinations when looking at their financial information. For further discussion of materiality in relation to both financial and non-financial content in annual reports see chapter 4.

In relation to materiality considerations for company's sustainability reports, there are a number of specific sustainability reporting guidelines, such as the Global Reporting Initiative (GRI) guidelines (G4)[52], that provide useful guidance for companies, though it may be the case that not everything which is material from a sustainability report perspective will be material for the purposes of the annual report. A good example of a materiality determination process with respect to sustainability was provided by **Premier Oil plc (Example 4.5)** who provided a 'materiality matrix' addressing their corporate responsibility issues. Although sustainability information is not subject to any mandatory external assurance requirements a minority of companies did gain such assurance over the figures they presented (see Figure 6.8).

Figure 6.8 Has sustainability information been assured?



*The Energy Savings Opportunity Scheme (ESOS) is a mandatory energy assessment and energy savings scheme that applies to large undertakings and groups containing large undertakings in the UK. For further guidance see the UK government's publication on the ESOS scheme.[53]

51 http://www.ukaccountingplus.co.uk/en-gb/publications/uk/need-to-know/2016/ntk-bis-non-financial-reporting-directive

52 https://www.globalreporting.org/standards/g4/Pages/default.aspx

53 Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/509835/LIT_10094.pdf

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Other observations

Report mentions the company's approach to dealing with bribery and corruption	2016	2015
In strategic report	56%	40%
Elsewhere in annual report	24%	27%
Not mentioned	20%	33%

The EU Non-financial Reporting Directive will specifically require reporting on bribery and corruption so it is encouraging to see an increase in the number of companies disclosing this overall. One company in our survey that included discussion of their approach to bribery and corruption in their strategic report was BTG plc.

Report mentions modern slavery	2016
In strategic report	30%
Elsewhere in annual report	4%
Not mentioned	66%

The Modern Slavery Act54 introduces a requirement for all entities with UK operations and turnover > £36m (with a year end on or after 31 March 2016) to publish a slavery and human trafficking statement on their website as soon as reasonably practicable after year end.[54] Although there is no requirement for companies to include information on this in their strategic report (reflected by only a minority of companies disclosing such information), thought should be given as to whether such disclosure is likely to be seen as material information on human rights given the nature of the entity's operations. The level of disclosure seen in the annual reports surveyed varied and in many cases was limited to a very brief mention.

Report mentions the company's approach to prompt payment of suppliers	2016
In strategic report	9%
Elsewhere in annual report	4%
Not mentioned	87%

There is no requirement for companies to publish information on their supplier payment policy in their annual report, although some may see it as important information as regards their stakeholder relationships. Of those companies that did mention this the majority just made a brief reference to their overall policy – a more detailed disclosure that made specific reference to the Prompt Payment Code (a voluntary UK government initiative) was provided by CLS Holdings plc.

Report discloses 'Scope 3' GHG emissions	2016	2015
Overall	36%	22%
FTSE 350	36%	28%
Others	36%	14%

There is no requirement under the Companies Act to disclose Scope 3 emissions (which relate to indirect emissions which are a consequence of the company's actions but occur at sources that are not owned or controlled by the company e.g. purchased materials). The rise in the number of companies disclosing this data suggests that an increasing number see it as providing important sustainability information as regards the company's activities. BT Group plc was one of the companies that did make such disclosure.

Report includes information on gender pay gap	2016	2015
Overall	2% (both FTSE 350)	N/A

The UK government has published draft regulations calling for pay and bonus information across genders to be reported publicly by all employers with 250 or more employees.[55] The first disclosures under the regulations will be required by April 2018. It will be interesting to see if this number grows in future as companies move toward applying the new regulations. National Grid Plc made a brief reference to their previous publication of gender pay gap data in their 2015/16 Annual Report.

54 http://www.ukaccountingplus.co.uk/en-gb/publications/corporate-governance/governance-in-brief/gib-modern-slavery-act

55 http://www.ukaccountingplus.co.uk/en-gb/publications/corporate-governance/governance-in-brief/governance-in-brief-gender-pay-gap-information

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Section 3. CR/Sustainability reporting – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 6.17
[Rotork plc Annual Report 2015 (p28)]

CR content integrated directly into company's strategic priorities.

See also **Example 4.4** in chapter 4, an extract from the Premier Oil plc 2015 Annual Report and Financial Statements (p58-59), which demonstrated disclosure of the assessment of which CR considerations are material in a sustainability context.


28

STRATEGIC PRIORITIES

Our aim is to deliver a high return on capital with strong and sustainable margins and consistent year-on-year growth in revenues and profit which, combined with our asset-light model, will deliver strong cash generation.

GROWTH

STRATEGIC PRIORITIES | ACHIEVEMENTS 2015 | OBJECTIVES 2016

SUSTAINABILITY

STRATEGIC PRIORITIES | ACHIEVEMENTS 2015 | OBJECTIVES 2016

Section 4. Other reporting trends

Dividend disclosures

In November 2015, the Financial Reporting Council's Financial Reporting Lab published a Lab project report on Disclosure of dividends – policy and practice.[56] The report found that both companies and investors agree that dividend policy and practice disclosures provide useful information that affect both investment decisions and assessment of company stewardship. However there was consensus that dividend disclosures are currently not clearly articulated and that frequently there is a disconnect between any description of the dividend policy and how that policy has been implemented in practice.

Disclosures in the annual report are frequently spread throughout the strategic report, financial statements and shareholder information sections with no inter-linkage provided. The majority of survey companies (59%) did include some detail on their dividend policy in their strategic report, generally in the chairman or CEO's statement. Such detail ranged from descriptions of how the dividend policy functioned to factors that had affected the dividend payment in the year and in the immediate future. This was far more common amongst the FTSE 350 companies surveyed with 72% providing such information compared with 40% of the smaller listed companies surveyed.

Disclosure of dividend policy in the annual report should be done in a way that makes it clear to the reader how the policy actually operates in practice e.g. 'for 2016 and 2017 we will increase the annual dividend by a minimum of 4%'. Only 56% of the companies surveyed that included disclosure of their dividend policy were assessed as doing this, with the FTSE 350 companies surveyed providing clearer disclosure (64% of disclosures judged to be clear) compared to the smaller listed companies (35%). **Persimmon PLC (Example 6.18)** provided a clear discussion of the future dividend payments they intended to make under their Capital Return Plan. Chapter 15 looks at the level of disclosure about distributable reserves given by companies in their financial statements.

The topic of dividend disclosures is still the subject of much public comment. It will be interesting to follow how practice in this area develops in future.

Other observations

Strategic report includes some disclosure of dividend resources (either cash or distributable reserves)	2016
Overall	13%
FTSE 350	17%
Others	7%

Disclosure of dividend resources was only given by a small minority of companies in their strategic report (this statistic also includes consideration of any cross-references to the back half of the report). See chapter 14 for an analysis of disclosure in this area in the financial statements.

Strategic report includes disclosure regarding cash available to pay dividends	2016
Overall	9%
FTSE 350	14%
Others	2%

Strategic report includes disclosure regarding level of distributable reserves	2016
Overall	4%
FTSE 350	3%
Others	5%

56 http://www.ukaccountingplus.co.uk/en-gb/publications/uk/need-to-know/need-to-know-frcs-financial-reporting-lab-issues-report-on-disclosure-of-dividend-policy-and-practice

Tax disclosures

The 2016 Finance Act includes revised legislation on tax transparency which will require certain large businesses to publish their tax strategy in relation to UK taxation on their website before their financial year-end. Companies required to do this are those multinational businesses with UK operations and consolidated turnover > €750 million, in addition to UK registered companies, partnerships and permanent establishments with turnover > £200 million or gross assets > £2 billion. For December year ends this will mean publication of the UK tax strategy before the end of December 2017 for such entities.[57] This legislation highlights the growing impetus on UK companies to be transparent in how they approach paying taxes following intense media scrutiny of certain large companies. Another example of this is the new statutory requirements for those UK headed multinational enterprises where consolidated group turnover is £750 million or more in a twelve month accounting period, or UK subgroups of these, to make an annual country-by-country report to HMRC.[58] There are also EU proposals to require similar information to be reported publicly.[59]

From an assessment of companies in our survey it is clear that the majority currently do not include detail of their tax governance policies or, indeed, a statement as to where such information can be accessed on their company website (as will be required for larger companies post-December 2017). 23% (2015: 9%) of the companies surveyed did provide some disclosure of their tax governance policy in their strategic report. However, of these only 10% gave detailed disclosure, with the remaining 13% of disclosures in this area being boilerplate. **Mondi Group (Example 6.19)** provided a good example of a tax governance disclosure in the front half of their annual report.

The majority of companies surveyed (59%) did include some explanation of the tax charges or payments that they had made to tax authorities in the year in their strategic report. However the majority of these were boilerplate statements as to the company's effective tax rate for the year with a minority giving more detailed information as to specific issues affecting their tax charge in the year. Companies might want to include disclosure on this in order to demonstrate to their shareholders that they are not undertaking any aggressive tax planning that may later be open to challenge.

Although not a statutory requirement, companies may want to include some disclosure of the quantification of their tax payments made in the year in their strategic report to demonstrate that they are fulfilling their role as good corporate citizens. A minority of companies did make some sort of disclosure in the front half of their annual report as to the quantification of their tax charge in the year. However the vast majority of such disclosures were boilerplate statements as to the company's effective tax rate for the year with only a minority giving more detailed information as to specific issues affecting their tax charge in the year.

57 http://www.ukaccountingplus.co.uk/en-gb/publications/corporate-governance/governance-in-brief/gib-tax-strategy

58 http://www.ukaccountingplus.co.uk/en-gb/news/2016/03/hmrc-cbcr-rules

59 http://www.ukaccountingplus.co.uk/en-gb/news/2016/04/ec-proposes-public-tax-transparency

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Section 4. Other emerging issues – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 6.18

[Persimmon PLC Annual Report 2015 (p22)](#)

Clear disclosure of future dividend policy.

PERFORMANCE REVIEW

Strategic update
(continued)

21.9%
underlying operating margin**

32%
Return on average capital employed

Returns

Persimmon's return on average capital employed* ("ROACE") for 2015 of 32.1% improved by 30% from 24.6% in 2014.

The 19% growth in underlying operating margin** to 21.9% in 2015 (from 18.4% in 2014) supported this significant improvement in returns. Underlying operating profits** for the year increased by 34% to £634.5m (2014: £473.3m). The Group's strong focus on securing improvements in site construction programmes resulted in the continuation of our industry leading asset turn, with work in progress representing just 18% of 2015 revenues, again supporting the higher levels of returns.

The Group's disciplined capital efficiency delivers strong liquidity. Including land creditor extension, free cash generated before capital return in 2015 was £483m, or 158 pence per share (2014: £388m, or 127 pence per share). Since the launch of the new strategy the Group has generated over £1.28bn, or c. 420 pence per share, of free cash before capital returns.

Surplus capital

On 2 April 2015 Persimmon paid a third, accelerated, instalment under the Capital Return Plan of 95 pence per share, amounting to £291m.

As explained in the Chairman's Statement the Directors are further accelerating payment of £1.10 per share, or c. £338m to be paid on 1 April 2016. This payment will be an interim dividend for the 2015 financial year. We will not be paying a final dividend for the 2015 financial year.

In addition, the Directors are increasing the Capital Return Plan by £2.80 per share, or c. £860m, a c. 45% increase in total value. This will leave £5.50 per share to be paid over the last five years of the Capital Return Plan to 2021. It is currently intended to deliver this value in equal instalments over the remaining five years of the Plan period commencing in 2017.

The revised schedule of payments under the Capital Return Plan will now be as follows:

Original Plan	New Plan	Original Plan Pence Per Share	New Plan Pence Per Share
28 June 2013	28 June 2013	75 paid	75 paid
	4 July 2014	–	70 paid
30 June 2015	2 April 2015	95 paid	95 paid
	1 April 2016	–	110
30 June 2017	6 July 2017	110	110*
	6 July 2018	–	110*
30 June 2019	5 July 2019	110	110*
30 June 2020	6 July 2020	115	110*
30 June 2021	6 July 2021	115	110*
Total		620	900

* Current anticipated profile of payments.

We will continue to review future payments in the context of market conditions and the performance of the business.

Over and above this short term outperformance the Board has also assessed the longer term prospects of the Group and the effectiveness of its strategy. The Board's conclusions are explained within the Viability Statement.

* 12 month rolling average and stated before goodwill impairment.
** Stated before goodwill impairment.

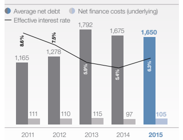
22 Persimmon Plc
Annual Report – December 2015

Example 6.19

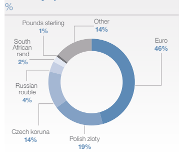
[Mondi Group Integrated report and financial statements 2015 (p29-30)]

Disclosure of company's tax governance policy.

Net debt and finance costs
€ million



Currency split of net debt
%



Gearing at 31 December 2015 was 32.0% and our net debt to 12-month trailing EBITDA ratio was 1.1 times, well within our key financial covenant requirement of 3.5 times.

Net finance costs of €105 million were €8 million higher than the previous year. Average net debt of €1,650 million was similar to the prior year and our effective interest rate increased to 6.3% (2014: 5.4%), primarily as a result of certain one-off effects and sharply higher interest rates in Russia.

Currencies

Our multinational presence results in exposure to foreign exchange risk in the ordinary course of business. Currency exposures arise from commercial transactions denominated in foreign currencies, financial assets and liabilities denominated in foreign currencies and translational exposure on our net investments in foreign operations.

Our policy is to fund subsidiaries in their local functional currency. External funding is obtained in a range of currencies and, where required, translated into the subsidiaries' functional currencies through the swap market.

We hedge material net balance sheet exposures and forecast future capital expenditure. We do not hedge our exposures to projected future sales or purchases. We do not take speculative positions on derivative contracts and only enter into contractual arrangements relating to financial instruments with counterparties that have investment grade credit ratings.

Volatility in foreign exchange rates had a significant impact on the performance of the different divisions, although the net impact on the Group was minimal. The 34% weakening of the rouble against the euro had a net negative impact on translation of the profits of our domestically focused Russian uncoated fine paper business, although this was more than offset by domestic selling price increases and the transactional benefits from our export oriented Russian packaging paper operations. The stronger US dollar had a net positive impact on US dollar denominated sales, particularly in our Fibre and Consumer Packaging businesses and our South Africa Division. Going into the new year, our export oriented businesses in emerging Europe and South Africa are benefiting from margin expansion as a result of the recent weakness in emerging market currencies.

Tax

We aim to manage our tax affairs conservatively, consistent with our approach to all aspects of financial risk management. Our objective is to structure our operations tax efficiently, taking advantage of available incentives and exemptions. We endeavour to comply with all applicable laws and regulations and to maintain constructive dialogue with taxation authorities. Arm's length principles are applied in the pricing of all intra-group transactions, in accordance with Organisation for Economic Cooperation and Development guidelines.

We have dedicated internal tax resources throughout the organisation, supported by a centralised Group tax department that takes overall responsibility for management of the Group's tax affairs. We maintain a detailed set of operational guidelines aimed at ensuring a sound tax control environment.

Mondi operates in a number of countries, each with a different tax system. In addition, there have been significant developments within the global tax environment to achieve greater tax transparency. The Group is routinely subject to tax audits and reviews which may take a considerable period of time to conclude. Provision is made for known issues and the expected outcomes of any negotiations or litigation.

Tax risks are monitored on a continuous basis and are more formally reviewed on a half-yearly basis by the audit committee as part of our half-yearly reporting process. We seek regular professional advice to ensure that we remain up to date with changes in tax legislation, disclosure requirements and best practices.

Based on the Group's geographic profit mix and the relevant tax rates applicable, we would expect our tax rate to be around 22%. However, we benefited from tax incentives related to our capital investments in Slovakia, Poland and Russia. In addition, we

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Chief financial officer's review

recognised deferred tax assets related to previously unrecognised tax losses which we now expect to be able to utilise in the coming years. As such, our tax charge for 2015 of €161 million reflects an effective tax rate for 2015 of 19%, consistent with 2014.

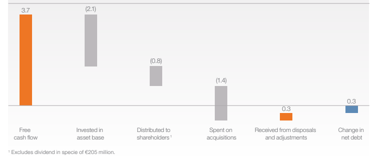
Tax paid in 2015 was €160 million (2014: €106 million) as a result of the increased profitability and the timing of final tax payments for the 2014 and earlier financial years.

Going forward, in the absence of further investment related tax incentives and assuming a similar profit mix, we would anticipate marginal upward pressure on the tax rate over the next three years as it moves towards the expected tax rate of 22%.

Cash flow priorities

We are well positioned as a leading international packaging and paper group with a strong platform for growth. In pursuing opportunities to grow, we are committed to maintaining discipline around expansionary capital expenditure and acquisitions.

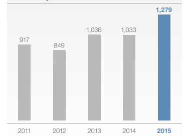
Five-year cumulative cash flow
€ billion



Our cash flow priorities

Cash flows from operating activities
€ million

€1,279m



Strong cash flow generation

In 2015, the cash generated from our operations was €1,279 million. On average over the last five years, our cash generated from operations has increased by 8.7% per year.

Working capital as a percentage of revenue was 11.6%, marginally below our revised targeted range of 12-14% and down on the prior year (12.3%). We have increased our targeted average working capital range to reflect the increased contribution from our more working capital intensive Industrial Bags and Consumer Packaging businesses as we continue to grow our downstream packaging interests. The net cash inflow from movements in working capital during the year was €9 million (2014: outflow of €87 million).

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07

Key performance indicators

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Key performance indicators

Top Tips

- Explain why a KPI has been chosen – 59% (2015: 58%) did. Demonstrating how the KPIs link to the company's strategy and objectives is a good way of doing this, though only 41% of companies provided this linkage in some way. A cross reference from the KPIs to the section that sets out the company's strategy is a helpful first step, but even better is to provide a mapping of KPIs against strategy using the various methods discussed later in this chapter.

- Give future targets for KPIs – only 25% (2015: 26%) did. Targets for KPIs help investors assess future prospects of the company and the success of the strategy. They can be shown as numerical values (or a range of numerical values) or a narrative discussion of next year's targets or those over a longer term.

- Consider the principles of integrated reporting when identifying KPIs. KPIs should be identified based on a holistic assessment of the way a company creates value for its stakeholders, not just a narrow focus on financial performance.

- When identifying KPIs, keep in mind the measures that are used to determine directors' performance-related pay. 74 (2015: 67) of the companies in our sample identified at least some of these measures as KPIs. See chapter 4 for more details.

Keep an eye on

- The ESMA Guidelines on Alternative Performance Measures (i.e. non-GAAP measures). These are now effective, so listed companies will need to bear them in mind when preparing their next annual report. The use of non-GAAP measures is on the rise – for 97% (2015: 81%) of the 95 companies that identified financial KPIs at least one of them was a non-GAAP measure. The ESMA Guidelines will make many of the disclosure elements recommended below mandatory for APMs – for more detail see chapter 3.

- How well KPIs measure all aspects of business performance, not just the financial ones. The Act requires non-financial KPIs to be included in the strategic report where relevant but 26% (2015: 28%) of the companies that clearly identified their KPIs did not include any non-financial measures.

Introduction

The Companies Act 2006 requires that, to the extent necessary for an understanding of the development, performance or position of the company's business, a company's strategic report must include an analysis using financial and, unless the company qualifies as medium-sized, where appropriate, non-financial key performance indicators (KPIs).

The FRC's Guidance on the Strategic Report and the <IR> Framework both include guidance for companies on how to identify appropriate KPIs and the information that should be given in relation to them. Although the law does not specifically require it, it is generally accepted practice for companies to identify explicitly the measures that they consider to be their KPIs.

Used properly, KPIs can be hugely effective in showing investors how the company has performed against its objectives and how effectively it has implemented its strategy. However, there is also potential for them to mislead users and as a result disclosure of KPIs is an area of focus for regulators. In their Corporate Reporting Review Annual Report 2015[60], the FRC highlighted that companies should consider whether ratios that are discussed prominently in the strategic report should be identified as KPIs. They also challenged companies where KPIs could not be reconciled to IFRS information, an area that is likely to receive an even higher level of scrutiny this year with ESMA's Guidelines on Alternative Performance Measures (APMs) coming into force – see chapter 3 for more detail on these. For APMs (also known as non-GAAP measures) that are identified as KPIs, many of the disclosures discussed throughout this chapter that were previously 'best practice' will now be mandatory.

Choice of KPIs

95 (2015: 90) out of the 100 annual reports surveyed clearly identified their KPIs. Unless otherwise stated the statistics quoted in this chapter are percentages of those 95 companies.

As the name suggests, KPIs should be those metrics which really are 'key' to assessing a company's performance, both in terms of progress in achieving its objectives and in implementing its strategy. The FRC's Guidance on the Strategic Report also looks to those metrics used to monitor exposure to the company's principal risks (see chapter 8 Principal risks and uncertainties for details on linkage between KPIs and risks).

60 http://www.iasplus.com/en-gb/news/2015/10/corporate-reporting-review-2015

KPIs and the <IR> Framework

The <IR> Framework does not prescribe specific KPIs or other measurement methods, instead acknowledging that those responsible for the preparation and presentation of the integrated report need to exercise judgement to determine which matters are material and how they are disclosed. It also acknowledges that KPIs could be helpful in explaining how a company creates value, as well as demonstrating how the company has performed during the period.

The concept of integrated reporting requires management to take a holistic view of the company when determining which measures are most appropriate (or 'key') to monitor value creation and performance. This would include considering all relevant aspects of the company's business model, including the material capitals that impact or are affected by the company's activities (i.e. the inputs, outputs and outcomes). Naturally, this would drive the consideration of a range of non-financial metrics.

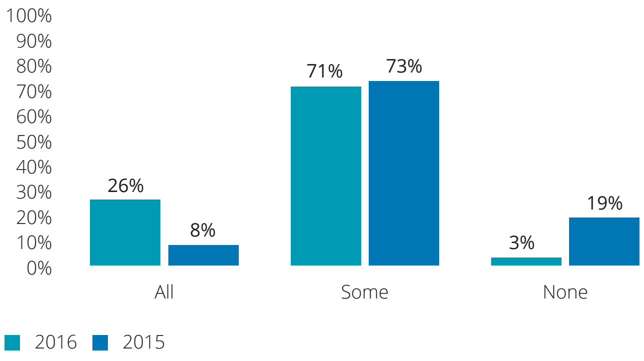
While most companies identified a combination of both financial and non-financial KPIs, and some linked KPIs to their strategy, many companies are not necessarily looking holistically at their business when determining their KPIs. For example, a number of companies made positive statements regarding the importance of their employees, describing them in some cases as the company's "greatest asset", yet there were no KPIs in place that appeared to measure, for example, employee engagement or employee retention. Applying integrated thinking would challenge this, as human capital would have been identified as a material resource in the company's business model.

Non-GAAP measures

In terms of financial KPIs, which were presented by all of the 95 companies that included KPIs, the FRC Guidance encourages the use of generally accepted measures to aid comparability. At the same time it acknowledges that comparability should not override the need for KPIs to effectively assess the performance of the company's own business. Such effectiveness can often be achieved by the use of non-GAAP measures, i.e. numerical measures that adjust the most directly comparable ones determined in accordance with GAAP. Non-GAAP measures often eliminate the impacts of 'exceptional' items, FX movements, acquisitions and so on, to allow a like-for-like comparison on progress made in the core business. They are often industry specific too.

It is perhaps surprising to see in Figure 7.1 that just over a quarter of the companies surveyed had financial KPIs that were all non-GAAP measures. In the current year this was assessed by reference to the ESMA Guidelines on APMs, thus capturing items such as return on capital employed. Such metrics for the purposes of our survey would not historically have been regarded as non-GAAP measures and the comparative figures in figure 7.1 have not been restated. In light of the ESMA guidelines, now effective, companies should ensure they are on top of the requirements which apply to any non-GAAP measures e.g. EBITDA, not just to those measures that have various 'exceptional' items stripped out. For more details, see the regulatory overview in chapter 3.

Figure 7.1 Are the financial KPIs identified by companies non-GAAP measures?



Non-financial KPIs

As discussed later in this chapter, it is common for companies to use non-financial metrics within their Corporate Responsibility information, when assessing the progress in certain areas. Where these were not labelled explicitly as KPIs, they were not considered as non-financial KPIs in our survey.

Figure 7.2 shows the most common non-financial KPIs identified by companies that included such measures in their annual report. Largely consistent with last year, companies surveyed mostly identified non-financial KPIs under one of five common categories, namely customer related, employee related[61], health & safety, environmental (excluding GHG) and GHG/carbon footprint. However, a significant proportion of them had 'other' non-financial KPIs, which covered a wide range and many of which were industry specific. Common examples included production level, market share, and inventory turns.

61 According to the recent study published by the FRC 'Corporate Culture and the Role of Boards', healthy corporate culture promotes long-term business success and corporate culture is usually assessed by employee related measures.

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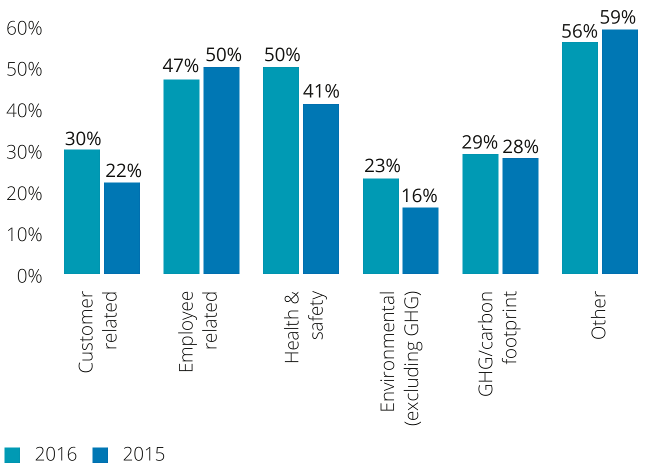
Surprisingly, we only saw a marginal increase (from 72% to 74%) in the percentage of companies that included non-financial KPIs in their annual report. With increasing investor focus on corporate responsibility and integrated reporting we would expect to see increasing pressure on companies to present non-financial as well as financial KPIs.

Figure 7.2 What types of non-financial KPIs are presented?



Other observations

Average number of financial KPIs included in reports surveyed that included financial KPIs	2016	2015
Overall	6	5

The same average number of KPIs was observed across companies surveyed in different sizes.

Average number of non-financial KPIs included in reports surveyed that included non-financial KPIs	2016	2015
Overall	4	3

The average for FTSE 100 companies surveyed jumped from three in 2015 to six in 2016. Though six does not seem excessive, it is useful to keep in mind that while it can be insightful to link various aspects of the business to KPIs, identifying too many KPIs undermines the identification of them as ‘key’.

Percentage of reports that disclosed a change in selected KPIs from prior year	2016	2015
Overall	6%	7%
FSTE 350	9%	9%
Others	3%	5%

A change in strategy is likely to give rise to a corresponding change in KPIs and this is what was seen in the survey.

Six companies disclosed a change in selected KPIs from prior year and one mentioned a potential change of KPIs. Five out of the six companies discussed the reasons for the change, and they were mainly to do with changes in strategy. A good example of disclosing the change with an explanation was provided by **Intermediate Capital Group PLC (Example 7.5)**.

<IR> Measurement of dual benefits

As noted above, the <IR> Framework does not specify how KPIs should be identified, but it is clear that a company which embarks on a journey of integrated thinking would consider a broad range of relationships and resources when determining appropriate measures to capture the value created by or performance of an entity.

The <IR> Framework introduces the notion of ‘dual benefit’ measures. These are measures (not necessarily needing to be KPIs) that combine financial measures with other components (e.g. the ratio of greenhouse gas emissions to sales) or narrative that explains the financial implications of significant effects on other capitals and other causal relationships (e.g. expected revenue growth resulting from efforts to enhance human capital). Such measures may be used to demonstrate the connectivity of financial performance with performance regarding other capitals. In some cases, this may also include monetising certain effects on the capitals (e.g. carbon emissions and water use).

In short, a measure that demonstrates dual benefit can be used to demonstrate to investors the financial value creation of the company while implementing strategic decisions around non-financial capitals in which other stakeholders have material interests

LINKAGE

The FRC Guidance suggests the business model is a good place to demonstrate linkage existing between key elements of the strategic report e.g. strategy, risks and KPIs. This is discussed in more detail in chapter 6. The Guidance also suggests that the use of KPIs that also form part of directors' current or future incentive plans in the analysis of principal risks, strategy and performance will provide a clearer indication of how these matters might affect or have affected executive remuneration

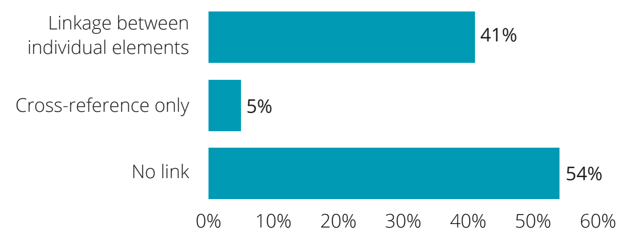
Linkage between KPIs and strategy

As mentioned above, a KPI is likely to be 'key' if it is used to measure progress against the company's strategy and objectives. The best annual reports illustrate this linkage so users can understand why a KPI is particularly relevant to the business and so they can assess the performance of management.

A basic way for a company to help a user navigate the annual report is to provide a cross-reference between the KPIs and the section that sets out strategy, i.e. by giving a page reference to the strategy section within the KPIs section. However, such a general reference by itself does not illustrate linkage between the sections.

As shown in Figure 7.3, the majority of companies do not provide any sort of link between their KPIs and strategy. A few provide just a basic cross reference and some go further, illustrating the linkage on a deeper level.

7.3 How well do companies link the KPI section of the report to the section that sets out strategy?

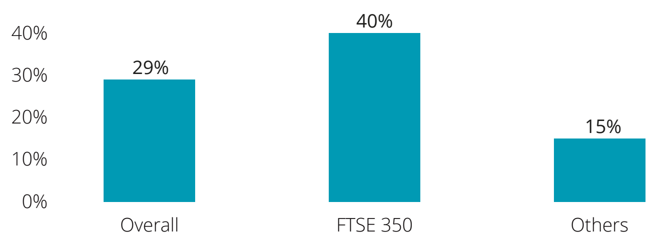


Rather than just a cross-reference, it is more helpful for companies to specifically illustrate the links that exist between individual elements of their strategy and individual KPIs. There are no specific rules about how to present this linkage and, ignoring which way round it went and whether it was presented more than once, 41% of the companies surveyed provided linkage between some or all of their KPIs and strategy elements. 17% of those surveyed demonstrated linkage in both their strategy section and their KPIs section. As indicated in chapter 6, only 27% of the companies surveyed provided linkage in the strategy section.

Per Figure 7.4, nearly a third of companies[62] clearly linked some or all of their KPIs to elements of the company's strategy, i.e. users of the annual report could tell from looking at the KPI section which element(s) of the company's strategy were measured by which KPI.

Effective ways of achieving this were by showing the strategy and KPIs in one section (i.e. strategy and KPIs presented next to each other in one table) or by putting icons that represent strands of the strategy next to individual KPIs. Another alternative was to discuss the linkage to strategy within the narrative given for each KPI - a number of companies did this. This makes the linkage more meaningful by explaining why and how it works in words. **Acacia Mining PLC (Example 7.1)**, **G4S PLC (Example 7.3)**, **Gresham Computing plc (Example 7.4)** and **The Unite Group plc (Example 7.2)** demonstrated linkage through the use of icons; **Intermediate Capital Group PLC (Example 7.5)** presented their KPIs and strategy together in one table. **Mondi Group (Example 7.6)** discussed such linkage within the narrative given for their KPIs.

Figure 7.4 What proportion of companies provided a link between some or all KPIs and the strategy of the business?



62 Out of the 100 companies surveyed this year, 22 of them clearly linked all KPIs to elements of strategy; six did this for some of their KPIs.

Reports where linkage between KPIs and elements of the strategy makes sense	All	Some
Overall	79%	21%
FSTE 350	73%	27%
Others	100%	0%

These figures are stated as percentages of the companies that provided such linkage per figure 7.4.

We assessed that linkages 'made sense' when it was clear how the KPIs linked to each strategy element actually made sense as a measure of progress towards achieving that strategic target.

Common pitfalls include mapping too many strategy elements to each KPI. A less focused mapping can often lead to weaker, less convincing linkage.

Please note that the above discussion is looking at linkage from KPIs to elements of strategy. See chapter 6 for details on linkage from elements of strategy to KPIs and chapter 5 where overall linkage throughout the annual reports surveyed is discussed.

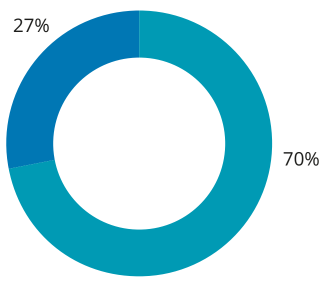
Presentation of KPIs

As seen in Figure 7.5, although not required to, a majority of the companies surveyed presented KPIs in a clear separate section of the annual report. A similar pattern is seen across FTSE 350 and other companies, though FTSE 100 companies had a higher percentage of 89%. Although presenting KPIs in a separate section is helpful for users, it is also important to integrate KPIs appropriately into narrative discussions to illustrate the linkage between them and other aspects of the annual report and to identify the purpose of selected KPIs.

Indeed we would expect that the measures discussed most prevalently throughout the annual report would be those that are identified as the company's KPIs.

It is also interesting to note that three companies had separate KPI sections for each of their core business areas, unlike most of the companies where KPIs were given for the business as a whole.

Figure 7.5 Where are KPIs shown in the narrative reporting section of the annual report?



Understanding KPIs

The FRC Guidance recommends that a company should identify and disclose all relevant information necessary to enable users to understand each KPI presented in the strategic report. It indicates that, for each KPI, this information should include, at a minimum:

- its definition and calculation method;
- its purpose;
- the source of underlying data;
- any significant assumptions made; and
- any changes in calculation method or relevant accounting policies compared to the previous financial year.

The ESMA Guidelines on APMs, which are now effective and will apply to next year's annual reports, will require that all of this information, and more, is given for any APMs (non-GAAP measures) used as KPIs. For more details, see the regulatory overview in chapter 3 and also discussion of the presentation of APMs in companies' summary sections in chapter 5.

Report gives numerical values for KPIs	All	Some
Overall	91%	9%
FSTE 350	85%	15%
Others	98%	2%

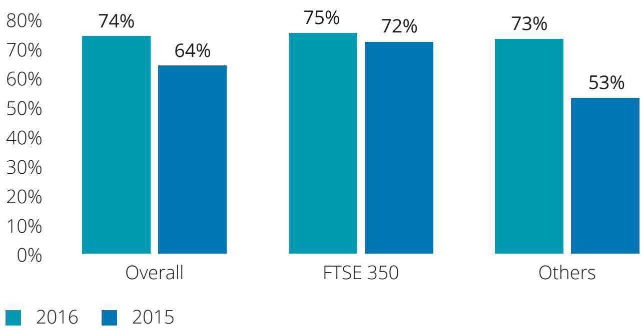
The majority of the KPIs without numerical values were non-financial KPIs. Companies tended to discuss if target was achieved or if there was an improvement from prior year, though no numbers were given.

As shown by Figure 7.6, more companies defined their KPIs this year and explained the calculation method for them. Such a disclosure can be relatively brief in some circumstances and may even be unnecessary for commonly-used GAAP measures such as revenue or gross profit margin, which are self-explanatory and have a generally understood calculation method.

It is much more important for companies using industry or company-specific non-GAAP measures to give a clear definition of the measure and explain the adjustments made to GAAP figures to obtain it. The same is also often the case for non-financial measures, which are often quite company-specific. A few companies found a good way to do this without over-crowding the KPIs section by presenting all definitions and calculation methods within an appendix or glossary and cross-referencing that to the KPIs section.

Intermediate Capital Group PLC (Example 7.5) gave a good example of presenting their definitions within a Glossary.

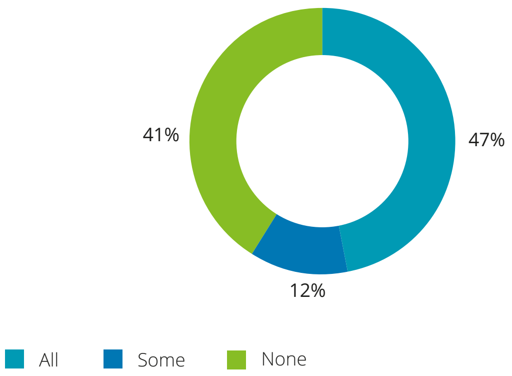
Figure 7.6 Are all KPIs defined and the calculation method explained?



59% (2015: 58%) of the companies surveyed gave the purpose of at least one KPI, as illustrated by Figure 7.7. Explanations were more common among the larger companies surveyed, with 78% of FTSE 100 companies giving them compared to 65% of the FTSE 250 and 45% of other companies.

Acacia Mining PLC (Example 7.1), Gresham Computing plc (Example 7.4) and **Rexam Plc (Example 7.7)** are good examples of how companies can disclose the purpose of their KPIs effectively.

Figure 7.7 Is the purpose of each KPI given?



The source of numbers used for financial KPIs is usually the financial statements (or a reconciliation to them for a non-GAAP measure). However, for non-financial KPIs the data sources can be much more varied.

The FRC Guidance suggests that companies should give a reconciliation between the financial KPIs and the financial statements where the financial KPIs cannot be directly identified in the accounts. Such reconciliations are now required by the ESMA Guidelines on APMs (non-GAAP measures). Including such reconciliations means that users of annual reports have sufficient information to recalculate the measures themselves, without having to resort to guesswork regarding their 'components' or spending a significant amount of time hunting around to find them.

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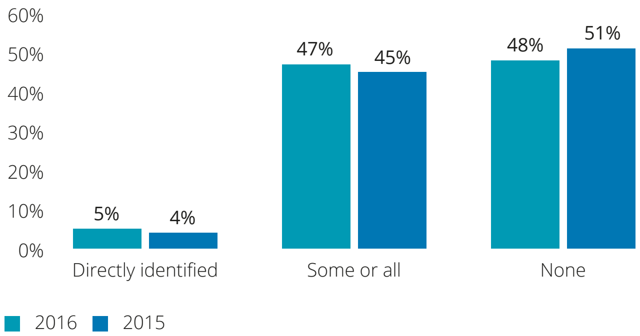
Figure 7.8 shows how transparently the non-GAAP measures used as KPIs by companies are reconciled to the financial statements. With the EMSA Guidelines on APMs now in force, we would expect a significant increase in the level of reconciliations being given in next year's reports.

Where financial KPIs can be identified directly from the financial statements, some companies found a good way of directing users to the relevant part in the financial statements by giving each KPI a page reference to the relevant note.

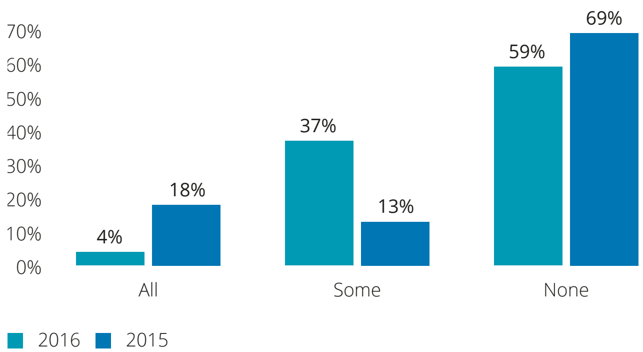
FIgure 7.8 Are non-GAAP KPIs reconciled to the financial statements?



Where a reconciliation was shown elsewhere in the annual report, a number of companies gave a page reference to the reconciliation in the KPIs section. The **G4S PLC Integrated Report and Accounts 2015 (Example 7.3)** and **Gresham Computing plc Annual Financial Report 2015 (Example 7.4)** give good examples of such reconciliations.

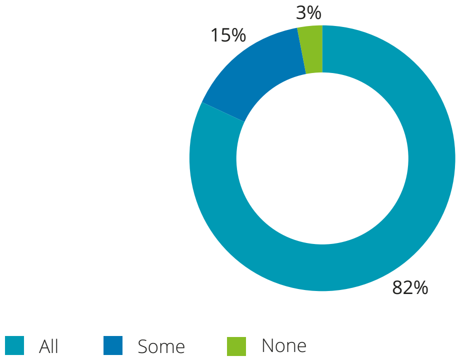
Despite the increase in the average number of non-financial KPIs, a higher percentage of companies surveyed disclosed the source of the underlying data used to determine at least some of these KPIs, as shown in Figure 7.9. Most of the underlying data came from employee or customer satisfaction surveys. **The Unite Group plc Annual Report and Accounts 2015 (Example 7.2)** gives a good example of including such information. Reporting systems specifically designed for health and safety purposes were also mentioned. The source of underlying data for other types of non-financial KPIs was rarely given.

Figure 7.9 Is the source of the underlying data used in the non-financial KPIs disclosed?



As seen in Figure 7.10 the vast majority (82%, 2015: 78%) of companies surveyed gave prior year comparatives for all KPIs, especially financial KPIs.

Figure 7.10 How many KPIs have any prior year comparative(s) given for them?



Inclusion of comparatives helps investors to understand how the company's current year performance compares to its historical track record – the more years of comparatives given, the clearer the picture. Figure 7.11 shows the number of years of comparatives given and the result is largely in line with last year.

Figure 7.11 How many years of comparatives are shown?

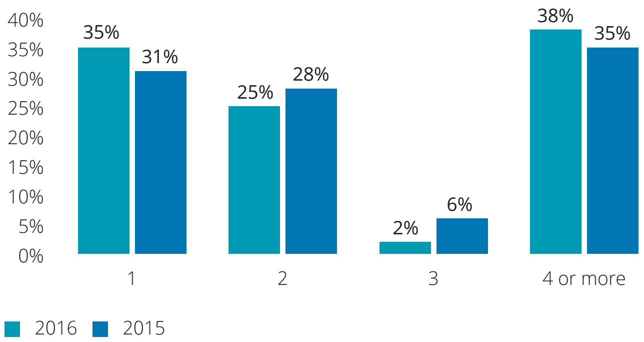
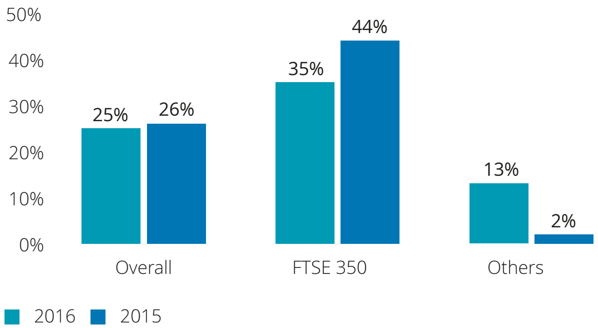


Figure 7.12 Are future targets given for KPIs?



Comparatives were sometimes missing for non-financial KPIs. This was the case in particular for those ones discussed in a different part of the annual report (e.g. corporate responsibility statement), where a different format and style of writing to the stand-alone KPIs section tended to be used or where a KPI was new in the year.

Even where a new KPI is adopted because of a change in strategy (for example), where possible companies should give a prior year comparative for the new measure. This is something that the ESMA Guidelines specify should be provided when a company starts presenting a new APM.

Quantifying business objectives is one of the most efficient ways of helping investors to assess the future prospects of the company and the success of strategic implementation. However per Figure 7.12, less than one third of the companies surveyed commented on future targets for KPIs, i.e. numerical targets and/or narrative explaining the target was provided. This is consistent with last year and is possibly due to perceived commercial sensitivity as well as caution in setting targets that may prove unachievable in today's unstable economic and political environment. The most commonly seen form for a target was a numerical value (or a range of numerical values) or a narrative discussion of next year's targets or those over a longer term.

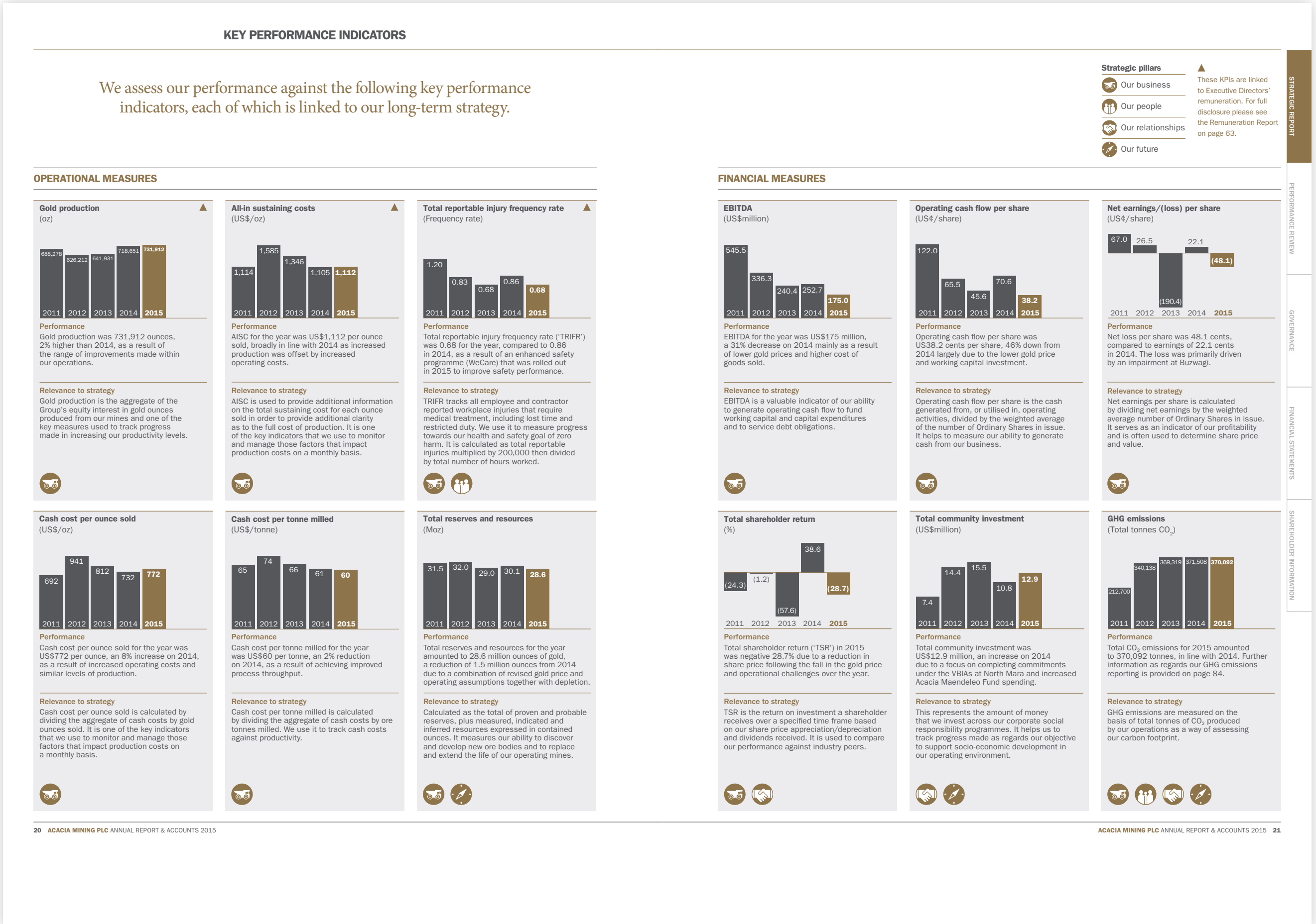
A good example of how commentaries on future targets can be presented are given by **Rexam Plc (Example 7.7)** and **The Unite Group plc (Example 7.2)**.

Good practice examples

Example 7.1

Acacia Mining PLC Annual Report and Accounts 2015 (p20-21)

- Clear linkage between KPIs and strategy through the use of icons.
- Providing the purpose of KPIs and their relevance to strategy.



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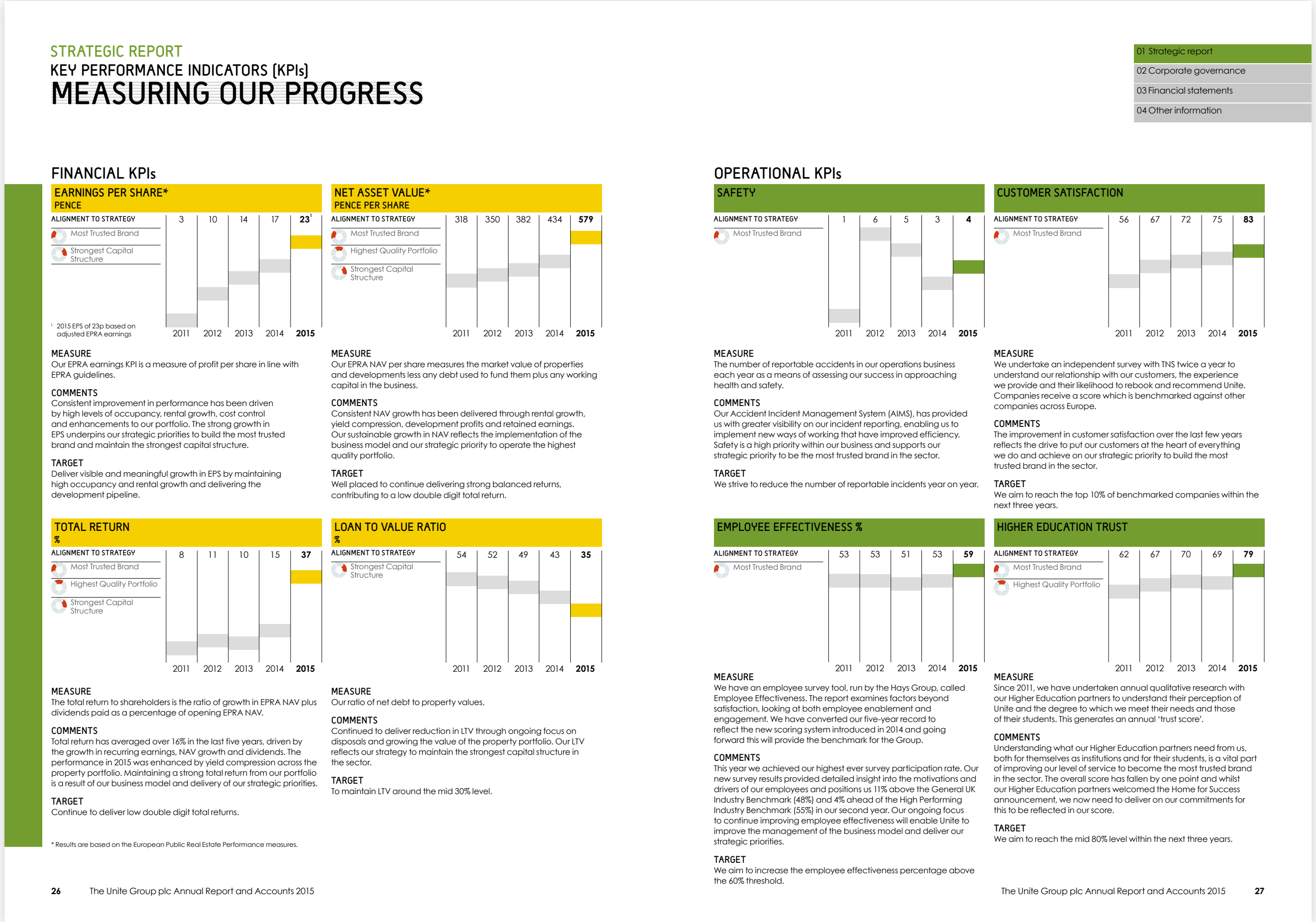
Example 7.2

[The Unite Group plc Annual Report and Accounts 2015 (p26-27)]

- Clear linkage between KPIs and strategy through the use of icons.
- Commentary on future targets for each KPI.
- Disclosure of the source of underlying data (surveys) used in the non-financial KPIs.



STRATEGIC REPORT
KEY PERFORMANCE INDICATORS (KPIs)

MEASURING OUR PROGRESS

FINANCIAL KPIs

EARNINGS PER SHARE*
PENCE

ALIGNMENT TO STRATEGY: Most Trusted Brand; Strongest Capital Structure

2011	2012	2013	2014	2015
3	10	14	17	23[1]

[1] 2015 EPS of 23p based on adjusted EPRA earnings

MEASURE
Our EPRA earnings KPI is a measure of profit per share in line with EPRA guidelines.

COMMENTS
Consistent improvement in performance has been driven by high levels of occupancy, rental growth, cost control and enhancements to our portfolio. The strong growth in EPS underpins our strategic priorities to build the most trusted brand and maintain the strongest capital structure.

TARGET
Deliver visible and meaningful growth in EPS by maintaining high occupancy and rental growth and delivering the development pipeline.

NET ASSET VALUE*
PENCE PER SHARE

ALIGNMENT TO STRATEGY: Most Trusted Brand; Highest Quality Portfolio; Strongest Capital Structure

2011	2012	2013	2014	2015
318	350	382	434	579

MEASURE
Our EPRA NAV per share measures the market value of properties and developments less any debt used to fund them plus any working capital in the business.

COMMENTS
Consistent NAV growth has been delivered through rental growth, yield compression, development profits and retained earnings. Our sustainable growth in NAV reflects the implementation of the business model and our strategic priority to operate the highest quality portfolio.

TARGET
Well placed to continue delivering strong balanced returns, contributing to a low double digit total return.

TOTAL RETURN
%

ALIGNMENT TO STRATEGY: Most Trusted Brand; Highest Quality Portfolio; Strongest Capital Structure

2011	2012	2013	2014	2015
8	11	10	15	37

MEASURE
The total return to shareholders is the ratio of growth in EPRA NAV plus dividends paid as a percentage of opening EPRA NAV.

COMMENTS
Total return has averaged over 16% in the last five years, driven by the growth in recurring earnings, NAV growth and dividends. The performance in 2015 was enhanced by yield compression across the property portfolio. Maintaining a strong total return from our portfolio is a result of our business model and delivery of our strategic priorities.

TARGET
Continue to deliver low double digit total returns.

LOAN TO VALUE RATIO
%

ALIGNMENT TO STRATEGY: Strongest Capital Structure

2011	2012	2013	2014	2015
54	52	49	43	35

MEASURE
Our ratio of net debt to property values.

COMMENTS
Continued to deliver reduction in LTV through ongoing focus on disposals and growing the value of the property portfolio. Our LTV reflects our strategy to maintain the strongest capital structure in the sector.

TARGET
To maintain LTV around the mid 30% level.

* Results are based on the European Public Real Estate Performance measures.

OPERATIONAL KPIs

SAFETY

ALIGNMENT TO STRATEGY: Most Trusted Brand

2011	2012	2013	2014	2015
1	6	5	3	4

MEASURE
The number of reportable accidents in our operations business each year as a means of assessing our success in approaching health and safety.

COMMENTS
Our Accident Incident Management System (AIMS), has provided us with greater visibility on our incident reporting, enabling us to implement new ways of working that have improved efficiency. Safety is a high priority within our business and supports our strategic priority to be the most trusted brand in the sector.

TARGET
We strive to reduce the number of reportable incidents year on year.

CUSTOMER SATISFACTION

ALIGNMENT TO STRATEGY: Most Trusted Brand

2011	2012	2013	2014	2015
56	67	72	75	83

MEASURE
We undertake an independent survey with TNS twice a year to understand our relationship with our customers, the experience we provide and their likelihood to rebook and recommend Unite. Companies receive a score which is benchmarked against other companies across Europe.

COMMENTS
The improvement in customer satisfaction over the last few years reflects the drive to put our customers at the heart of everything we do and achieve on our strategic priority to build the most trusted brand in the sector.

TARGET
We aim to reach the top 10% of benchmarked companies within the next three years.

EMPLOYEE EFFECTIVENESS %

ALIGNMENT TO STRATEGY: Most Trusted Brand

2011	2012	2013	2014	2015
53	53	51	53	59

MEASURE
We have an employee survey tool, run by the Hays Group, called Employee Effectiveness. The report examines factors beyond satisfaction, looking at both employee enablement and engagement. We have converted our five-year record to reflect the new scoring system introduced in 2014 and going forward this will provide the benchmark for the Group.

COMMENTS
This year we achieved our highest ever survey participation rate. Our new survey results provided detailed insight into the motivations and drivers of our employees and positions us 11% above the General UK Industry Benchmark (48%) and 4% ahead of the High Performing Industry Benchmark (55%) in our second year. Our ongoing focus to continue improving employee effectiveness will enable Unite to improve the management of the business model and deliver our strategic priorities.

TARGET
We aim to increase the employee effectiveness percentage above the 60% threshold.

HIGHER EDUCATION TRUST

ALIGNMENT TO STRATEGY: Most Trusted Brand; Highest Quality Portfolio

2011	2012	2013	2014	2015
62	67	70	69	79

MEASURE
Since 2011, we have undertaken annual qualitative research with our Higher Education partners to understand their perception of Unite and the degree to which we meet their needs and those of their students. This generates an annual 'trust score'.

COMMENTS
Understanding what our Higher Education partners need from us, both for themselves as institutions and for their students, is a vital part of improving our level of service to become the most trusted brand in the sector. The overall score has fallen by one point and whilst our Higher Education partners welcomed the Home for Success announcement, we now need to deliver on our commitments for this to be reflected in our score.

TARGET
We aim to reach the mid 80% level within the next three years.

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Example 7.3

[G4S plc Integrated Report and Accounts 2015 (p36-37)](#)

- Page reference to the section that set out the strategy.
- Clear linkage between KPIs and strategy through the use of icons.
- Page reference to reconcilations for non-GAAP measures.

Key performance indicators

KPIs

Our progress in implementing our strategic objectives is measured using key performance measures aligned to those objectives and the group values:

- People & values
- Growth
- Innovation
- Service excellence
- Operational excellence
- Financial discipline

FINANCIAL KPIs

Underlying revenue[1] (£bn)

£6.4bn

Description: We have an organic growth strategy based on strong market positions in structural growth markets. We are investing in improved customer service, innovation and sales and business development capabilities. We believe there is also great potential to sell more complex solutions which tend to have longer contract terms and higher margins.

Performance: In 2015, revenues grew 4.0% to £6.4bn (2014 restated: £6.2bn), with emerging markets growing 8.6% with broad growth across all three regions and developed markets growing 1.6%, with strong growth in North America and a return to growth in Europe offsetting a decline in the UK.

Underlying PBITA[1] (£m)

£427m

Description: The group has a number of productivity programmes to drive efficiency and operational improvement across the group. These include efficient organisation design, management delayering, lean operating processes, efficient reporting and assurance processes, upgraded IT systems and efficient procurement.

Performance: In 2015, PBITA grew 5.7% to £427m (2014 restated: £404m) as a result of these initiatives starting to have some benefit. PBITA in emerging markets was up 9.2% and in developed markets PBITA decreased by 1.0%.

Underlying operating cash flow[1]

£460m

Description: A key priority for the group is to drive improved cash generation, through leaner working capital management and capital discipline and embedding a "cash matters" culture throughout the group as outlined in more detail on pages 28 and 29. An even greater emphasis has been placed on cash in management incentive plans from 2016.

Performance: Underlying operating cash flow was £460m (2014 restated: £528m), down 13% mainly due to a temporary increase in working capital associated with strong revenue growth in the second half of 2015 and transition to a UK financial shared service centre.

Underlying EPS[1] (pence per share)

14.7p

Description: G4S is looking to deliver sustainable growth in earnings over the long term. EPS growth is a component of both the annual and long term management incentive plans.

Performance: Helped by revenue growth, improved PBITA margins and lower interest costs underlying earnings increased 14% to £227m (2014 restated: £199m) in 2015. Underlying EPS also increased 14% to 14.7p (2014 restated: 12.9p).

Link to strategic objectives

NON-FINANCIAL KPIs

In addition to the financial KPIs, the group has a set of performance measures aligned to its strategic priorities. A description of these performance measures and our progress against them is shown on pages 10 and 11.

[1] For details of the basis of preparation of underlying results see page 97.

For more detail on the group's strategic priorities please see pages 10 and 11. For more detail on 2015 financial performance please see the Chief Financial Officer's review on pages 96 to 105.

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Integrated Report and Accounts 2015 G4S plc 37

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Example 7.4

[Gresham Computing plc Annual Financial Report 2015 (p11, 16)]

- Clear linkage between KPIs and strategy through the use of icons.
- Providing the purpose of KPIs.
- Showing a reconciliation between financial KPIs and the financial statements within the financial review.

Key performance indicators ("KPIs")

The Group's KPIs have been selected as the most appropriate measures of strategy execution and progress towards achievement of our overall objective.

Clareti revenue

Clareti revenue
£5.3m

Link to strategy

1 2 3 4 5

Description

The Clareti revenue KPI provides a measure of our progress in the overall execution of the Group's Clareti-led growth strategy. Clareti revenue is high margin and delivers a strong contribution to profitability.

Clareti recurring revenue
£1.9m

1 2 3 4 5

This KPI is an important component of our overall strategy as we pursue long-term, high margin revenue to provide high visibility of revenue into future years and a basis from which to drive profitable growth.

Revenue

Total revenue
£14.8m

1 2 3 4 5

This measure constitutes a high level indicator of Group performance. In particular it recognises the continued importance to the Group of retaining and growing non-Clareti revenues.

Total recurring revenue
£7.8m

1 2 3 4 5

This KPI provides a measure of the underlying performance of the Group's business on a run-rate basis, which is an indicator of the level of visibility of all revenues into future years and in particular it takes into account the underlying strength of non-Clareti revenue.

Earnings

Profit before tax
£1.6m

Link to strategy

1 2 3 4 5

Description

In addition to adjusted EBITDA, this earnings-based KPI provides a further measure of our performance in delivering profitable growth in the year at a statutory reporting level.

EBITDA/total revenue

Adjusted EBITDA
£2.7m

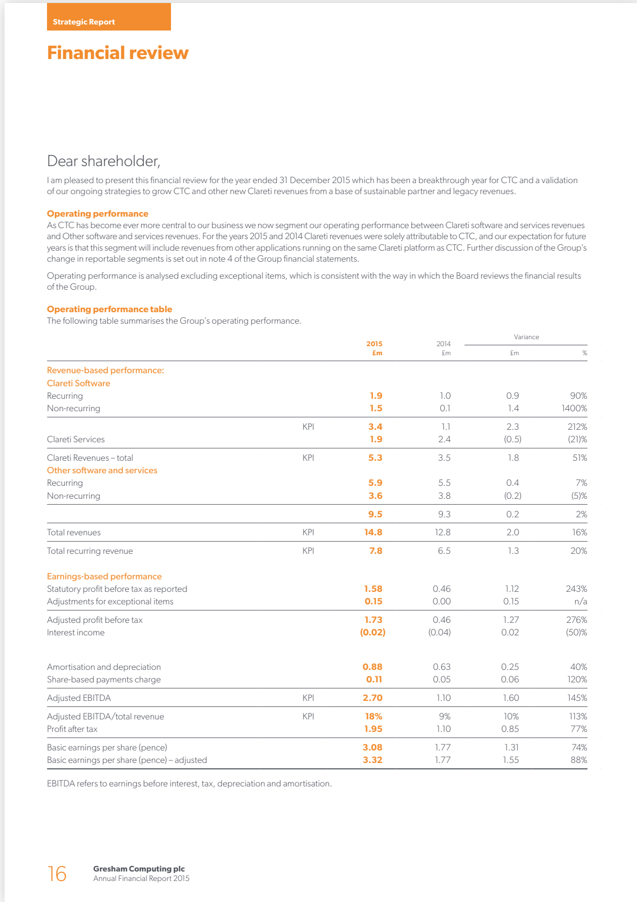
1 2 3 4 5

This earnings-based KPI provides a measure of our progress towards delivering profitable growth. Adjustments are made for share-based payment charges and exceptional items.

Adjusted EBITDA/ total revenue
18%

1 2 3 4 5

This measures our core profitability by presenting earnings in the context of revenues. We believe a target ratio of 30% or more provides a good benchmark measure of return for a product-based software company.



Financial review

Dear shareholder,

I am pleased to present this financial review for the year ended 31 December 2015 which has been a breakthrough year for CTC and a validation of our ongoing strategies to grow CTC and other new Clareti revenues from a base of sustainable partner and legacy revenues.

Operating performance

As CTC has become ever more central to our business we now segment our operating performance between Clareti software and services revenues and Other software and services revenues. For the years 2015 and 2014 Clareti revenues were solely attributable to CTC, and our expectation for future years is that this segment will include revenues from other applications running on the same Clareti platform as CTC. Further discussion of the Group's change in reportable segments is set out in note 4 of the Group financial statements.

Operating performance is analysed excluding exceptional items, which is consistent with the way in which the Board reviews the financial results of the Group.

Operating performance table

The following table summarises the Group's operating performance.

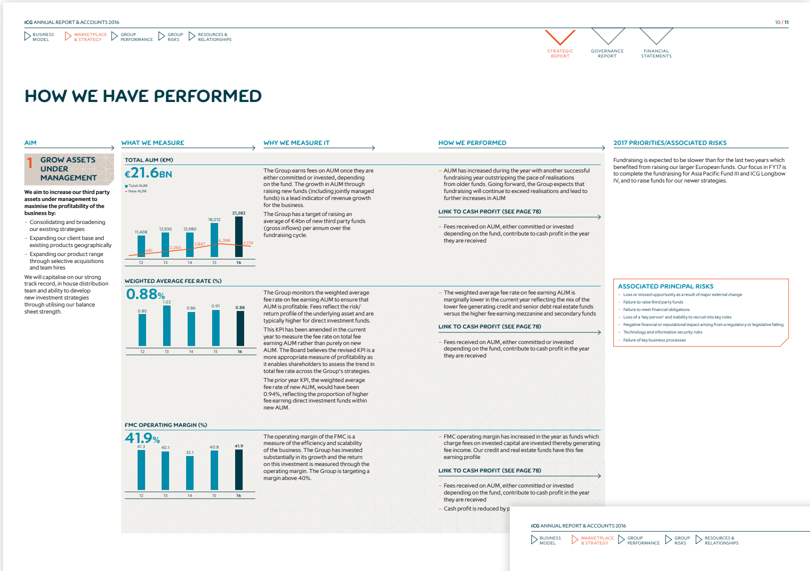
		2015 £m	2014 £m	Variance £m	Variance %
Revenue-based performance:					
Clareti Software					
Recurring		1.9	1.0	0.9	90%
Non-recurring		1.5	0.1	1.4	1400%
	KPI	3.4	1.1	2.3	212%
Clareti Services		1.9	2.4	(0.5)	(21)%
Clareti Revenues – total	KPI	5.3	3.5	1.8	51%
Other software and services					
Recurring		5.9	5.5	0.4	7%
Non-recurring		3.6	3.8	(0.2)	(5)%
		9.5	9.3	0.2	2%
Total revenues	KPI	14.8	12.8	2.0	16%
Total recurring revenue	KPI	7.8	6.5	1.3	20%
Earnings-based performance					
Statutory profit before tax as reported		1.58	0.46	1.12	243%
Adjustments for exceptional items		0.15	0.00	0.15	n/a
Adjusted profit before tax		1.73	0.46	1.27	276%
Interest income		(0.02)	(0.04)	0.02	(50)%
Amortisation and depreciation		0.88	0.63	0.25	40%
Share-based payments charge		0.11	0.05	0.06	120%
Adjusted EBITDA	KPI	2.70	1.10	1.60	145%
Adjusted EBITDA/total revenue	KPI	18%	9%	10%	113%
Profit after tax		1.95	1.10	0.85	77%
Basic earnings per share (pence)		3.08	1.77	1.31	74%
Basic earnings per share (pence) – adjusted		3.32	1.77	1.55	88%

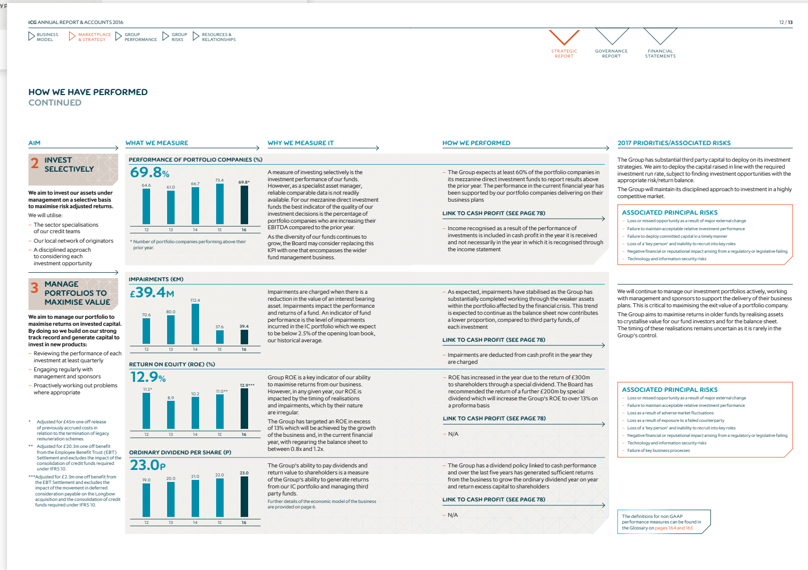
EBITDA refers to earnings before interest, tax, depreciation and amortisation.

Example 7.5

[Intermediate Capital Group PLC Annual Reports and Accounts 2016 (p10-13)]

- Clear linkage between KPIs and objectives.
- Discussion of change and potential change of KPIs and why.
- Page reference to the Glossary for definitions of non-GAAP measures.


HOW WE HAVE PERFORMED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Example 7.6

[Mondi Group Integrated report and financial statements 2015 (p18)]

- Linkage to strategy discussed within the narrative for KPIs.
- Page reference to the section that sets out the strategy.

Our key performance indicators

Tracking our progress

Read more about the performance of each of our businesses on pages 52 to 69

We track our long-term performance against strategic, financial and sustainable development key performance indicators (KPIs).

These KPIs are intended to provide a broad measure of the Group's performance. We set individual targets for each of our business units in support of these Group KPIs.

Our Remuneration report, on pages 115 to 131, describes how our executive directors and senior management are remunerated in line with these KPIs. In particular, the executive directors are set specific targets relating to ROCE, EBITDA and safety for purposes of the Bonus Share Plan (BSP) incentive and on Total Shareholder Return (TSR) and ROCE for the Long-Term Incentive Plan (LTIP).

Strategic

Read more in our Chief executive's review and in Our strategy on pages 20 to 25 and 34 and 35

Growth in packaging
% of capital employed

We have a clear strategic objective to grow our packaging interests, while investing appropriately to maintain and improve the competitiveness of our uncoated fine paper operations.

Our strategic value drivers provide a framework for pursuing value-creating growth opportunities.

2015 performance
We invested €595 million in capital expenditure, of which 82% was allocated to packaging.

Our packaging interests represent 78% of the Group's capital employed.

Total shareholder return (TSR)
%

TSR provides a market-related measure of the Group's progress against our objective of delivering long-term value for our shareholders.

TSR measures the total return to Mondi's shareholders, including both share price appreciation and dividends paid.

2015 performance
Mondi declared a dividend of 52.0 euro cents per share and realised a TSR of 37%.

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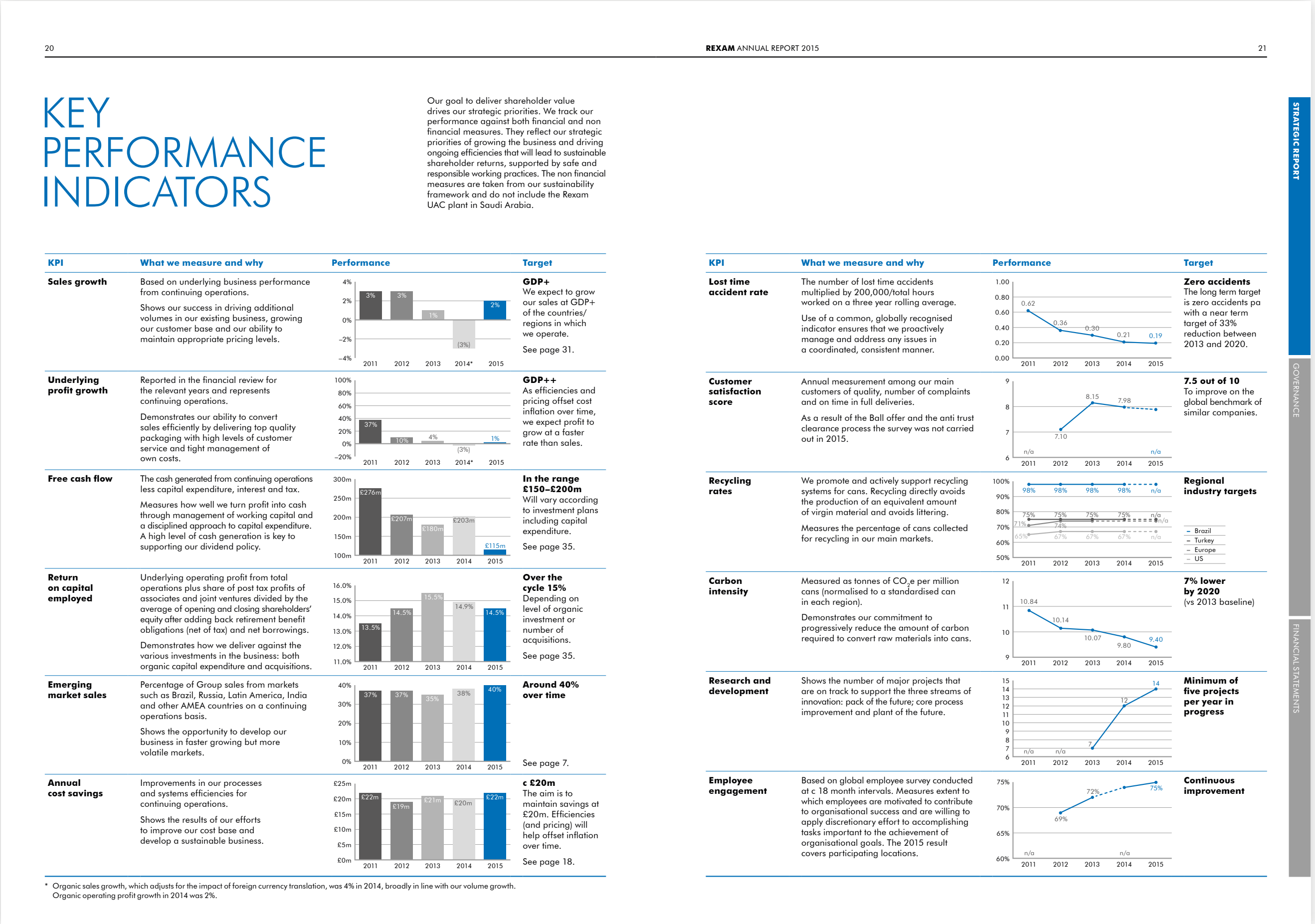
Example 7.7

[Rexam PLC Annual Report 2015 (p20-21)]

- Providing the purpose of each KPI.
- Commentary on future targets for each KPI.
- Page reference to further information.



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KEY PERFORMANCE INDICATORS

Our goal to deliver shareholder value drives our strategic priorities. We track our performance against both financial and non financial measures. They reflect our strategic priorities of growing the business and driving ongoing efficiencies that will lead to sustainable shareholder returns, supported by safe and responsible working practices. The non financial measures are taken from our sustainability framework and do not include the Rexam UAC plant in Saudi Arabia.

KPI	What we measure and why	Performance	Target
Sales growth	Based on underlying business performance from continuing operations. Shows our success in driving additional volumes in our existing business, growing our customer base and our ability to maintain appropriate pricing levels.	2011: 3%; 2012: 3%; 2013: 1%; 2014*: (3%); 2015: 2%	**GDP+** We expect to grow our sales at GDP+ of the countries/regions in which we operate. See page 31.
Underlying profit growth	Reported in the financial review for the relevant years and represents continuing operations. Demonstrates our ability to convert sales efficiently by delivering top quality packaging with high levels of customer service and tight management of own costs.	2011: 37%; 2012: 10%; 2013: 4%; 2014*: (3%); 2015: 1%	**GDP++** As efficiencies and pricing offset cost inflation over time, we expect profit to grow at a faster rate than sales.
Free cash flow	The cash generated from continuing operations less capital expenditure, interest and tax. Measures how well we turn profit into cash through management of working capital and a disciplined approach to capital expenditure. A high level of cash generation is key to supporting our dividend policy.	2011: £276m; 2012: £207m; 2013: £180m; 2014: £203m; 2015: £115m	**In the range £150–£200m** Will vary according to investment plans including capital expenditure. See page 35.
Return on capital employed	Underlying operating profit from total operations plus share of post tax profits of associates and joint ventures divided by the average of opening and closing shareholders' equity after adding back retirement benefit obligations (net of tax) and net borrowings. Demonstrates how we deliver against the various investments in the business: both organic capital expenditure and acquisitions.	2011: 13.5%; 2012: 14.5%; 2013: 15.5%; 2014: 14.9%; 2015: 14.5%	**Over the cycle 15%** Depending on level of organic investment or number of acquisitions. See page 35.
Emerging market sales	Percentage of Group sales from markets such as Brazil, Russia, Latin America, India and other AMEA countries on a continuing operations basis. Shows the opportunity to develop our business in faster growing but more volatile markets.	2011: 37%; 2012: 37%; 2013: 35%; 2014: 38%; 2015: 40%	**Around 40% over time** See page 7.
Annual cost savings	Improvements in our processes and systems efficiencies for continuing operations. Shows the results of our efforts to improve our cost base and develop a sustainable business.	2011: £22m; 2012: £19m; 2013: £21m; 2014: £20m; 2015: £22m	**c £20m** The aim is to maintain savings at £20m. Efficiencies (and pricing) will help offset inflation over time. See page 18.

* Organic sales growth, which adjusts for the impact of foreign currency translation, was 4% in 2014, broadly in line with our volume growth. Organic operating profit growth in 2014 was 2%.

KPI	What we measure and why	Performance	Target
Lost time accident rate	The number of lost time accidents multiplied by 200,000/total hours worked on a three year rolling average. Use of a common, globally recognised indicator ensures that we proactively manage and address any issues in a coordinated, consistent manner.	2011: 0.62; 2012: 0.36; 2013: 0.30; 2014: 0.21; 2015: 0.19	**Zero accidents** The long term target is zero accidents pa with a near term target of 33% reduction between 2013 and 2020.
Customer satisfaction score	Annual measurement among our main customers of quality, number of complaints and on time in full deliveries. As a result of the Ball offer and the anti trust clearance process the survey was not carried out in 2015.	2011: n/a; 2012: 7.10; 2013: 8.15; 2014: 7.98; 2015: n/a	**7.5 out of 10** To improve on the global benchmark of similar companies.
Recycling rates	We promote and actively support recycling systems for cans. Recycling directly avoids the production of an equivalent amount of virgin material and avoids littering. Measures the percentage of cans collected for recycling in our main markets.	Brazil: 98%, 98%, 98%, 98%, n/a; 75%, 75%, 75%, 75%, n/a; 71%, 74%, n/a; 65%, 67%, 67%, 67%, n/a (2011–2015). Brazil, Turkey, Europe, US	**Regional industry targets**
Carbon intensity	Measured as tonnes of CO_2e per million cans (normalised to a standardised can in each region). Demonstrates our commitment to progressively reduce the amount of carbon required to convert raw materials into cans.	2011: 10.84; 2012: 10.14; 2013: 10.07; 2014: 9.80; 2015: 9.40	**7% lower by 2020** (vs 2013 baseline)
Research and development	Shows the number of major projects that are on track to support the three streams of innovation: pack of the future; core process improvement and plant of the future.	2011: n/a; 2012: n/a; 2013: 7; 2014: 12; 2015: 14	**Minimum of five projects per year in progress**
Employee engagement	Based on global employee survey conducted at c 18 month intervals. Measures extent to which employees are motivated to contribute to organisational success and are willing to apply discretionary effort to accomplishing tasks important to the achievement of organisational goals. The 2015 result covers participating locations.	2011: n/a; 2012: 69%; 2013: 72%; 2014: n/a; 2015: 75%	**Continuous improvement**

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08

Principal risks and uncertainties

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Principal risks and uncertainties

Top Tips

- Provide a clear statement that the directors have carried out a robust assessment of the principal risks facing the company - only 85% of the companies surveyed clearly made this newly required statement. To avoid any regulatory challenge companies should also consider using the full wording set out in Code provision C.2.1.
- Explain the specific processes undertaken to robustly assess the principal risks - of those companies surveyed providing a robust assessment statement 12% of the accompanying risk management process disclosures appeared insufficient to demonstrably corroborate the directors' assertion.
- Avoid any perception that risk disclosures are treated as an 'afterthought' or a compliance exercise and make them easy for investors to find by making sure that they are given sufficient prominence within the annual report – 78% of companies surveyed discussed principal risks or risk management in the first 20% of their report.
- Meet investor demands by tailoring risk descriptions to the specific circumstances of the company. Only 60% (2015: 61%) of companies surveyed provided risk descriptions that were all clearly specific to the company.
- Improve the quality of information provided by disclosing changes in the level of risks, their respective likelihoods and the magnitude of potential impacts – only 51% (2015: 35%), 8% (2015: 7%) and 12% (2015: 11%) of companies surveyed respectively provided these.

Keep an eye on

- Whether there is sufficient linkage between principal risks and strategy in order to create a more cohesive and integrated annual report. Of the companies surveyed, only 38% (2015: 27%) linked some or all of their principal risks to their strategy. Alternatively, provide a signpost cross reference from the risk section to strategy.
- Whether the linkages illustrated between principal risks and strategy elements are logical and clear, rather than superficial. We considered that the linkage obviously made sense for 47% of the companies including such linkage in their risks section.
- The FRC's current focus to address the quality of financial reporting by smaller listed companies. A recent FRC report[63] highlights that reporting of principal risks and uncertainties is one of the areas where smaller listed companies are lagging behind in terms of the quality of disclosures – this is borne out by our findings.

Introduction

In its strategic report, a company is required by the Companies Act 2006 to give a description of the principal risks and uncertainties facing the company. However, companies applying the UK Corporate Governance Code are expected to give more than just a description of the risks themselves – they are also expected to disclose how the risks are managed and mitigated and increasingly to give a detailed description of the company's process for determining which are its principal risks and what the appropriate mitigating activities are.

In September 2014 the FRC published the 2014 version of the UK Corporate Governance Code, which, as well as governance more widely, has changed the requirements around risk reporting. The modifications to the Code and the issuance of the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[64] (FRC Risk Guidance) have increased the emphasis on the directors' responsibilities relating to the company's risk management and internal control systems, with the board needing to be comfortable that the operation of these allows them to confirm that they have "carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity". As well as making this statement, many companies have also increased the level of narrative disclosure to demonstrate how the directors are able to confirm this.

The FRC's Guidance on the Strategic Report and the <IR> Framework also include further guidance on effective risk reporting.

63 https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b-File.pdf

64 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf

Risk reporting is a perennial focus area for the FRC in its reviews of annual reports and the change in the reporting requirements is likely to mean that it moves even further up the agenda. In their most recent Corporate Reporting Review Annual Report, they noted that companies should ensure that the risks and uncertainties disclosed are genuinely principal and make sure they discuss how risks are managed or mitigated – this is a problem area for smaller companies in particular.

Of the companies surveyed, one company did not, in our view, include a clear description of principal risks and uncertainties within its annual report. References in this chapter to 'the companies surveyed' therefore are to the 99 companies that did disclose principal risks and uncertainties.

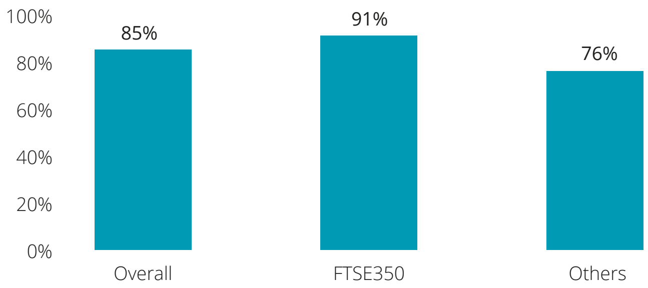
Assessment and monitoring of principal risks

A new Code provision, C.2.1, came into force in October 2014, requiring the directors to confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity.

As indicated in Figure 8.1, only 85% of the companies surveyed clearly made this statement. Whilst the boards of the remaining 15% may well have undertaken robust assessments, the fact that they had done so was not clearly stated in their annual reports. With the increasing regulatory focus on how companies are identifying and managing risks, such companies should ensure that they provide an explicit statement, bearing in mind that it demonstrates good governance in addition to complying with the Code's requirements.

Companies may also look to avoid any risk of regulatory challenge by following the full wording set out in Code provision C.2.1. For 76% of those companies that did provide a clear statement, this was the approach that they followed. The remaining 24% of statements tended to be curtailed versions, indicating that the board had undertaken a robust assessment but omitting an explicit statement that they included those risks that would threaten the business model, solvency or liquidity.

Figure 8.1 How many companies clearly included a statement that a robust assessment of principal risks had been carried out?



Of those companies that did provide a clear statement, this was typically provided as part of the longer term viability statement or in the principal risks section of the strategic report. These are both logical places to incorporate the directors' statement.

Indeed, disclosure in the viability statement helps to demonstrate the linkage between these two areas (see the linkage section later in this chapter) and how the board has considered the assessment of principal risks in informing its longer-term viability statement (for more on going concern and longer-term viability see chapter 9). In deciding on a location directors may also want to bear in mind the fact that they are afforded protection under safe harbour provisions for material included in, or scoped into, the strategic report or the directors' report (or the directors' remuneration report).

A few of the companies that provided the statement chose to provide the statement in more than one location. There were a variety of combinations that were chosen by these companies; the most popular being in both the viability statement and the risk section of the strategic report, or in the risk section of the strategic report and the risk management section of the corporate governance section. This likely reflects the fact that the statement can be seen as relevant to multiple sections of the report, although preparers should consider whether such duplication is really necessary. On occasion the statement was also incorporated into broader directors' responsibility statements, with directors perhaps feeling it was helpful to gather together all the confirmations they now have to make in a single place.

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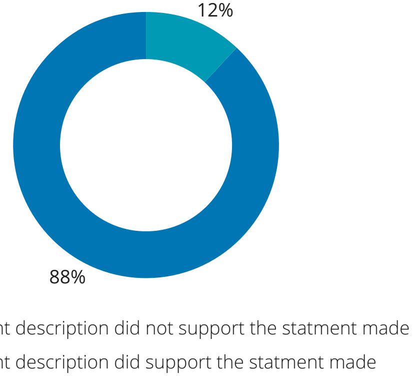
As shown by Figure 8.2, of those 84 companies presenting a statement that the board had made a robust assessment of the principal risks, 12% of the accompanying disclosures setting out risk management processes appeared insufficient to demonstrably corroborate the board's assertion.

Figure 8.2 Did companies' description of their risk management process support the statement that they had made a robust assessment of principal risks?



In the absence of suitably comprehensive disclosure (including options such as those set out in the table to the right), users will not have enough information to fully understand the company's risk management process and this could cause them to question whether they agree with the board's assertion that a robust assessment of the principal risks has been undertaken.

For those looking to improve their disclosure around risk management and identification, **National Grid Plc (Example 8.5)** provided a comprehensive description of its bottom-up and top-down risk process, supported by a diagram of the risk management process and description of a three lines of defence model. Other good examples include Pearson plc, Capita plc, Mitie Group plc, Cobham plc, Thomas Cook Group PLC and Fresnillo plc.

54% of the companies surveyed included diagrams to help users understand their risk management process. Of those companies that did present a diagram, the most common approaches were a responsibilities structure (29 companies) or a diagram summarising the risk management framework (25 companies). These types of diagrams are best when they complement or incorporate any narrative text.

Companies whose risk management process descriptions would demonstrably support a statement that there had been a robust assessment of principal risks*	2016
Overall	86%
FTSE 350	97%
Others	71%

Process descriptions varied but the better ones made references to 'top-down'/'bottom-up' risk assessments, three lines of defence models, continuous assessments and narrative around how risks are collated into risk registers and reviewed at various levels including ultimately by the board.

The lower results for smaller companies may reflect a lack of resources available to develop comprehensive risk management frameworks.

Companies that explicitly stated they had refreshed their assessment of principal risks in the year	2016	2015
Overall	32%	25%
FTSE 350	41%	33%
Others	20%	14%

Whilst not a requirement, this information, typically found at the beginning of the risk management section, can help a reader to understand the outcome of the risk assessment process and reasons for adding/removing risks in the current year. It can also help evidence that a robust assessment has been undertaken. In the absence of an explicit statement other companies may have felt that indicators of change in the level of risk in their risk table (51% of companies surveyed provided this information – see later) or their descriptions of the risks themselves made it self-evident that the risk assessment had been refreshed.

*Including those that did not provide a clear robust assessment statement from the board.

Risk appetite

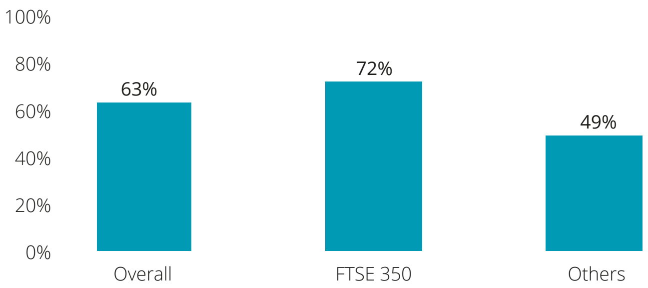
As set out in the FRC's guidance on risk management and internal control, an important part of a robust risk assessment process entails the board defining and setting an appropriate risk appetite. An effective risk appetite framework can help directors to identify and determine the relative positions of the company's risk capacity, risk profile and risk appetite when evaluating and pursuing strategy and to take corrective action where necessary. There is no mandatory requirement to discuss risk appetite in the annual report, although it would typically be expected of those in the financial services sector.

As shown by Figure 8.3, 63% of the companies surveyed disclosed that risk appetite had been incorporated into the risk assessment process. However only 39% of those companies provided more than a brief mention. Brief mentions typically included generic statements around the board responsibilities for setting risk appetite or highlighting that the board uses a risk appetite framework to determine the nature and extent of the risks that it is prepared to accept.

The better disclosures on risk appetite constituted a specific section on it and some companies even identified risk appetite per principal risk (11% of those mentioning risk appetite).

Cobham plc (Example 8.1) and **Marks and Spencer Group plc (Example 8.2)** provided good discussions of risk appetite and how it is used in the decision making process. Both **Marks and Spencer Group plc (Example 8.2)** and **The Weir Group plc (Example 8.6)** provided an example of a risk appetite statement. There were a variety of ways that risk appetite per principal risk was demonstrated – good examples were **Halma plc (Example 8.4)**, which provided risk appetite for each specific risk, and **Intermediate Capital Group PLC (Example 8.12)** and **Mothercare plc (Example 8.13)**, which both chose to show risk appetite per specific risk separately from the main disclosures of principal risks and uncertainties. Other good examples included Capita plc, LSL Property Services plc and Fresnillo plc.

Figure 8.3 What proportion of companies mentioned risk appetite?



How risk appetite was described for those that did mention it	2016
Very brief/in passing	61%
Clear description of how risk appetite is assessed	8%
Clear description of how risk appetite is assessed and used in decision making	31%

A number of companies mentioned that risk appetite was in the process of being formally documented and set and risk appetite statements prepared.

Number of principal risks

Companies should not be disclosing every risk that may have been identified in their risk assessment process and included in their risk register. As indicated in the FRC Risk Guidance, the board should only be focusing on those risks that it has assessed as 'principal' risks. These are defined in the FRC's Guidance on the Strategic Report as risks or a combination of risks "that can seriously affect the performance, future prospects or reputation of the entity" and include "those risks that would threaten its business model, future performance, solvency or liquidity".

Risks and uncertainties explicitly labelled as 'principal' risks and uncertainties	2016	2015
Overall	98%	95%
FTSE 350	98%	98%
Others	98%	91%

	2016	2015
Median number of principal risks	10	9
Number of companies that chose to discuss 'other' risks in addition to their 'principal' risks	5	4

Figure 8.4 shows the number of risks identified by companies surveyed, split by FTSE 350 and others (those outside of the FTSE 350), plotted on a cumulative basis. There is very little difference in the number of risks identified between FTSE 350 and others, suggesting that the size of the company has minimal impact upon the number of risks that it identifies. These results are broadly consistent with the results of our 2015 survey.

Whilst the size of the company may not change the number of risks that it faces, it is clear that it does affect the types of risks that it identifies, as discussed in the next section.

Types of risks identified by companies

Year on year comparison

Figure 8.5 shows the types of risks most commonly identified by companies that we surveyed.

Figure 8.4 How many risks were identified by companies in 2016?

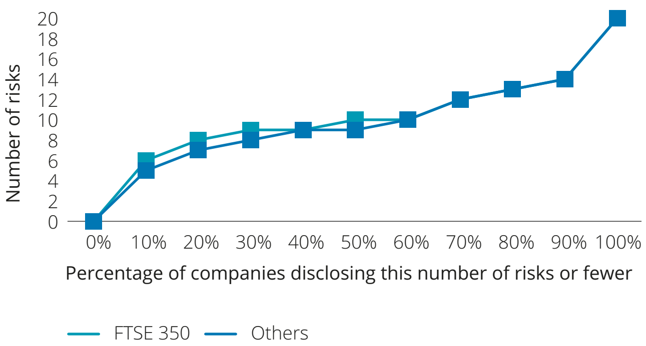
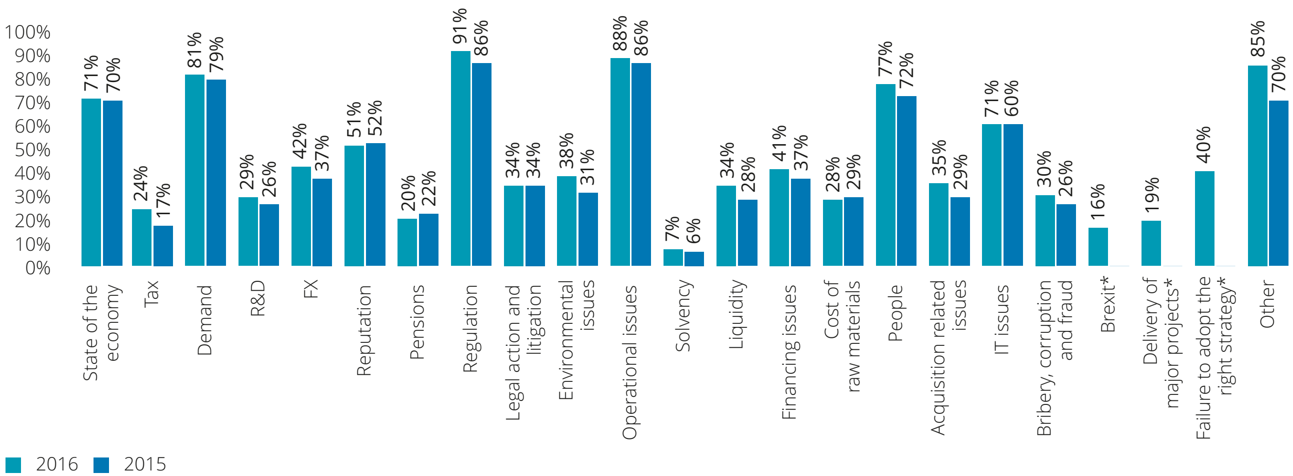


Figure 8.5 What are the main categories of risk disclosed (year-on-year)?



* Not identified as a separate category in 2015.

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Types of risks identified by companies

There is a great deal of consistency between the types of risks disclosed in 2015 and 2016. However, with the provisions of the Code now requiring directors to consider those risks that would "threaten its business model, future performance, solvency or liquidity" it is perhaps surprising that only 7% (2015: 6%) and 34% (2015: 28%) of the companies surveyed discussed risks relating to solvency and liquidity respectively.

IT issues continue to show a significant increase with 71% (2015: 60%) of companies surveyed indicating that these are considered a principal risk. The increase in the current year has likely been driven by more companies identifying principal risks in relation to cyber and data security. In the current year we saw 51% of companies surveyed identifying cyber risks and 41% data protection risks. This trend is expected, with cyber-attacks, data losses and cyber-security dominating many boardroom discussions at present.

As shown by Figure 8.6 on the next page, a higher proportion of the FTSE 350 companies surveyed disclosed risks in relation to cyber and data security compared to the smaller companies surveyed. In December 2015 the FRC published[65] year-end advice to larger listed companies which specifically suggested that they should consider whether data protection or cyber security should be principal risks, which might explain the comparatively higher proportion of FTSE 350 companies that identified these compared to those in the 'other' group. On a related note, in May 2016 the government published the FTSE 350 Cyber Governance Health Check Report 2015[66].

Other observations are summarised in the table to the right.

Risk category	2016	2015
Brexit	16%	Not surveyed
Only 16% of companies surveyed explicitly indicated that 'Brexit' or the result of the UK referendum on EU membership was a principal risk in their annual report. Although the longer-term political and economic effects of the decision to leave the EU are still unclear, recent FRC guidance[67] suggests that additional principal risks may be identified as a result of the vote to leave. Additionally, a number of companies' half-yearly financial reports have, subsequent to the referendum result, made clear that they are in the process of assessing the potential effects on their business.		
Other	85%	70%
A large majority of the companies surveyed included a number of 'other' risks that did not fall within any of the other categories. The most popular of these were health and safety, counter-party credit risk and adverse movements in interest rates. This category also includes risks specific to the operations of those companies surveyed.		

65 https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Year-end-advice-to-preparers-larger-listed-compa.pdf

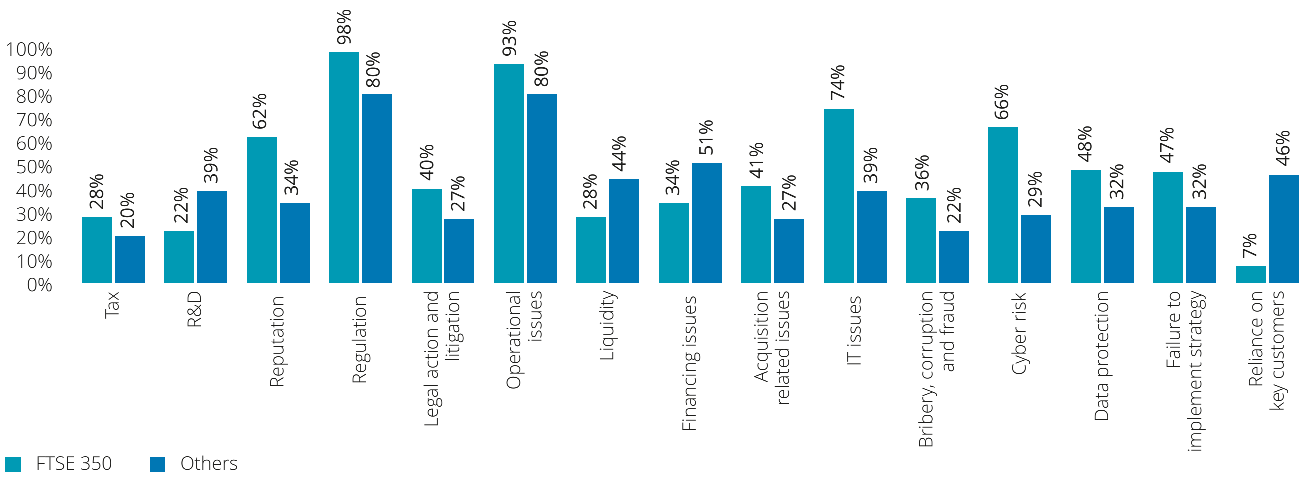
66 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/521484/Cyber_Governance_Health_Check_report_2015.pdf

67 https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/July/Reminders-for-half-yearly-and-annual-financial-rep.aspx

By size of company

Although the size of the company does not have a significant impact upon the number of principal risks that it identifies, Figure 8.7 shows that it does have an impact upon the types of risks that it faces. Possible explanations for some of the most significant differences are given in the accompanying table.

Figure 8.6 What are the main categories of risk disclosed (by size of company)?



Risk category	FTSE 350	Others
IT issues*	74%	39%
Cyber risk	66%	29%
Data protection	48%	32%

As noted previously, FRC advice in December 2015 to larger listed companies might explain the comparatively higher proportion of FTSE 350 companies that identified these risks compared to those in the 'other' group. Hackers may also be more likely to target larger, more high-profile businesses.

Risk category	FTSE 350	Others
Tax	28%	20%

As larger companies often operate in multiple jurisdictions and can be exposed to more tax regulations than smaller companies we would expect this risk to have been identified by a higher proportion of FTSE 350 companies.

Risk category	FTSE 350	Others
R&D	22%	39%

Smaller companies may be at the 'start up' phase of their operations and might be performing research and development activities to develop new products. Many larger companies will have already completed research and development activities and, in most cases, will have products that are under patent and are actively being sold.

* Excluding cyber risk and data protection shown separately

Risk category	FTSE 350	Others
Liquidity	28%	44%
Financing	34%	51%

Smaller companies might face more working capital issues and difficulties in raising finance when compared to larger companies, including more challenging lending covenants.

Risk category	FTSE 350	Others
Acquisition related	41%	27%

Larger companies tend to be more acquisitive and due to their size may find it more difficult to integrate systems and strategies.

Risk category	FTSE 350	Others
Reliance on key customers	7%	46%

Smaller companies might be expected to rely on a number of key customers for trading and working capital. It is more likely that larger companies will have a sufficiently diverse customer base to not have to rely on any one customer.

Presentation and description of risks

Prominence of risk disclosures

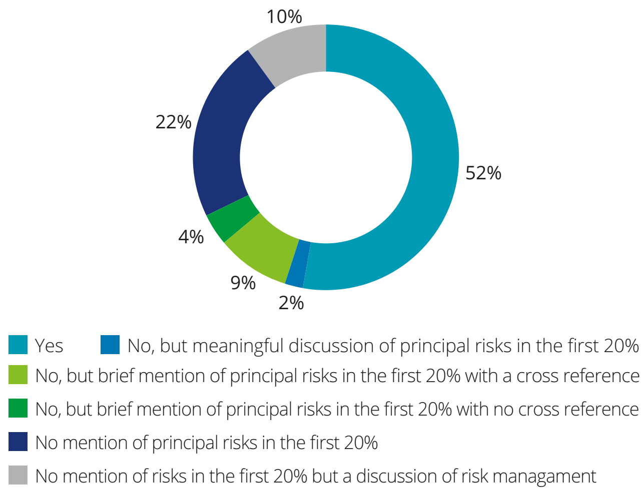
With the increasing focus on how risks are identified and managed, companies should look to avoid any perception that risk disclosures are treated as an 'afterthought' or a compliance exercise. One of the obvious ways this can be done, which also reflects the importance many investors place on such information, is to give it suitable prominence and make sure that it isn't buried in, what nowadays tend to be, very lengthy reports. Of the companies surveyed only 22% did not discuss their principal risks or risk management in the first 20% of their annual report.

As indicated in Figure 8.7, 53% of the companies surveyed included their principal risks and uncertainties section in the first 20% of their annual report. The earliest and latest that this disclosure was provided was 6% of the way into and 48% of the way into the annual report respectively, indicating varying degrees of prominence which companies are giving to risk disclosures.

Where the principal risks and uncertainties section was not included within the first 20% we then assessed whether, and to what degree, the company had mentioned principal risks or risk management within the first 20% of the report. As indicated in Figure 8.7 most did still provide some disclosure early on. This was typically in the form of a section which linked principal risks to areas such as strategy and KPIs.

A good example of this was provided by **Marks and Spencer Group plc (see Example 8.7)** who provided a section linking the business model to related risk factors with a cross reference to the principal risks and uncertainties section. Other good examples were provided by Acacia Mining plc, Cobham plc and IP Group plc.

Figure 8.7 Is the principal risks and uncertainties section within the first 20% of the annual report?



Descriptions of risks

When making disclosures around principal risks and uncertainties in the annual report, the FRC Risk Guidance indicates that the board should ensure that risk descriptions are tailored to the company's specific circumstances and should avoid using standardised or 'boilerplate' language "which may be long on detail but short on insight". Some risks may be specific to the entity, for instance related to the industry in which they operate, others may be more generic. Where risks fall into the latter category, it is even more important that the risk description makes it clear how the risk might affect the company specifically.

It is slightly disappointing, therefore, that only 60% (2015: 61%) of companies surveyed provided risk descriptions that were all clearly specific to the company – the remainder provided risk descriptions that were either generic (7%, 2015: 4%) or a mixture of generic and specific (33%, 2015: 35%). Certain companies provided very generic, boilerplate descriptions. Examples would include 'failures of information security', 'legal/regulatory risk', 'health and safety' and 'people' as a description without further providing insights to enable the reader to understand why such risks are applicable to the company.

Looking at the proportion of specific risk descriptions given by those companies surveyed within the FTSE 350 (60%, 2015: 56%) and those companies surveyed outside of the FTSE 350 (59%, 2015: 67%) it is evident that the descriptions of risk have become less company-specific for those outside of the FTSE 350. This finding resonates with some of the concerns the FRC has expressed over risk reporting by smaller listed companies.

The FRC Risk Guidance suggests that the description of a risk could include possible impacts of that risk on the company. Of the companies surveyed, 71% provided a clear indication of the impact of all of the risks on the company. Typically, for the majority of companies surveyed, this was included either within the risk description itself or in a separate column entitled 'impact'. For 26% of companies, however, it was not entirely clear what the impact of all of the principal risks was. Companies following the guidance should look to include a clear description of the impact of each risk. A columnar approach might be the best way to achieve this clarity, although a narrative approach would be equally acceptable. **Halma plc**, which provided information about the general impact for all principal risks, **(Example 8.4)** is an example of a columnar approach which clearly distinguishes the impact of the risk. Another good example is Xaar plc.

Mitigating actions

With regards to mitigating actions, the FRC's risk management guidance indicates that it expects companies to provide a "high-level explanation of how the principal risks and uncertainties are being managed or mitigated". Such an explanation is also required by provision C.2.1 of the Code. In line with the overall spirit of the FRC's risk management guidance it would be expected that the mitigating actions are, as well as the risk descriptions, specific to the company.

Of those companies surveyed, a significantly higher proportion (89%) provided specific descriptions of the mitigating actions that they were taking in relation to the principal risks identified compared to only 60% providing company-specific descriptions of the risks themselves.

This is unsurprising, since by their nature mitigating activities are describing what the company is doing and will therefore tend to be company-specific rather than generic.

Companies setting out mitigating actions addressing some or all of their principal risks	2016	2015
Overall	100%	96%

Companies not making it clear that there were mitigating actions for all risks	2016
Overall	3%
FTSE 350	2%
Others	5%

A columnar approach where mitigating actions are provided separately from the risk description can help ensure all risks are addressed.

Presentation of risks

Of the companies surveyed, the majority tended to present their principal risks and uncertainties disclosure in a tabular format (i.e. columns for items such as risk description, impact, mitigating actions, link to strategy, link to KPIs) although there were companies who presented risks in just a narrative format. Either approach is acceptable provided that the information required by the Code is included and the FRC Risk Guidance has been considered. **Halma plc (Example 8.4)** provided an example of a tabular format whilst **Cobham plc (Example 8.3)** provided an example of a narrative format.

The FRC Risk Guidance indicates that disclosures should highlight and explain significant changes in principal risks – such as a change in the likelihood or possible impact, or the inclusion of new risks.

Only 51% (2015: 35%) of the companies surveyed provided evidence of the overall change in the level of individual risks from the prior year. Whilst this proportion has shown an increase, it is still disappointingly low in light of the guidance provided by the FRC, which says that such information should be provided. The proportion of FTSE 350 companies surveyed who disclosed such a change (60%, 2015: 44%) was considerably higher than the other companies surveyed (37%, 2015: 23%). Evidencing the change in the level of risk, in the absence of an explicit statement from the directors as highlighted above, will also demonstrate that the company has refreshed their assessment of principal risks in the year.

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Approaches used where changes in risk were disclosed	2016
Up/down arrows	94%
Fuller narrative	46%
Both arrows and narrative	40%

Of those that did provide evidence of the change in the level of risk, the majority used up/down arrows which was also the most popular method noted from last year's survey findings. An example of this was provided by **Halma plc (Example 8.4).** Equally acceptable is to provide the disclosure in narrative form as disclosed by **Johnson Matthey Plc (Example 8.9)**.

As in the previous year, few companies provided any indication of either the likelihood (8%, 2015: 7%) or the magnitude of the potential impact (12%, 2015: 11%) of principal risks, despite the FRC Risk Guidance suggesting these might be included. Where information on likelihood was provided it was usually in the form of a heat map. This was similarly the case for disclosing magnitude, with both these attributes sometimes being reflected on separate axes in a combined heat map. However, **Johnson Matthey Plc (Example 8.9)** chose to indicate the magnitude in the form of a traffic light system whilst **Halma plc (Example 8.4)** and **Rexam PLC (Example 8.10)** provided narrative alongside each principal risk.

Whilst the FRC Risk Guidance seeks to improve the level and quality of disclosures, these statistics show that limited progress has been made in this area. In order to provide better quality information to investors on the risk environment affecting the company, these might be areas that companies, especially those outside of the FTSE 350, may wish to focus on over the following year.

Linkage of principal risks to the rest of the annual report

Strategy and KPIs

The FRC's Guidance on the Strategic Report encourages companies to provide linkages between pieces of information presented within the annual report, particularly the strategic report, such as between principal risks and uncertainties, strategy and business model and KPIs. The ability of a company to achieve its strategy will be linked to the principal risks that it faces and how it is managing and mitigating these to an acceptable level.

The best risk disclosures are those that illustrate this linkage, for example linking specific risks and elements of a company's strategy. Failing that, a simple cross-reference between sections does aid a user somewhat.

There are no specific rules about where this linkage could be provided and, ignoring which way round it went and whether it was presented more than once, 38% of the companies surveyed provided linkage between some or all of their principal risks and strategy. 12% of those surveyed demonstrated linkage in both their strategy section and their principal risks and uncertainties section. As indicated in chapter 6, only 18% of the companies surveyed provided linkage in the strategy section.

In terms of linkage presented in the risks section, 29% (2015: 27%) of the companies surveyed provided linkages from each of their principal risks to elements of the company's strategy, with the proportion of those outside the FTSE 350 rising from 16% last year to 24%. A small minority of companies surveyed (3%) only provided linkages to strategy in their risks section for some of the principal risks. Whilst this only shows a moderate increase on the prior year, it is pleasing that more companies are attempting to display such linkages to provide investors with a fuller understanding of the current performance and future prospects of the company and produce more cohesive and integrated annual reports.

Linkages to strategy were typically achieved through the use of a key (such as numbers, a symbol or diagram). Many companies such as **Rexam PLC (Example 8.10), Halma plc (Example 8.4)** and **AO World plc (Example 8.11)** followed this somewhat 'traditional' approach. **Johnson Matthey Plc (Example 8.14)** chose a slightly more interesting, and equally acceptable, grid-based approach.

Whilst not all companies surveyed provided linkage between individual risks and strategy, 4% did at least attempt to connect the two by providing a cross-reference from the risks section to the strategy section.

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Less obvious, but still useful, is linking principal risks and KPIs, with 8% of those companies surveyed (2015: 7%) providing linkage for all or some of their principal risks (either in the risk section or the KPIs section or both). This linkage can help to show the impact of risks on the performance of the business, as well as the extent to which mitigation strategies are effective in managing risk, in order to deliver the business' strategic objectives. We would expect this statistic to increase as investors' expectations for more 'integrated' reports advance.

<IR> Risk reporting

The <IR> Framework requires companies to discuss the specific risks and opportunities that affect an organisation's ability to create value and how they impact the availability, quality and affordability of relevant capitals in the short, medium and long term. (Please refer to the Regulatory overview at chapter 3 and Overall impressions at chapter 4 for more background on <IR>). The requirements of UK Company Law and the Code mean UK Companies already discuss the principal risks affecting the business, and whilst not required by law, the FRC's Guidance for the Strategic Report does encourage the discussion of opportunities arising from internal or external factors (see chapter 6 for information on how companies have discussed opportunities in their annual reports). However, the concept of 'integrated thinking' is a new concept introduced in the <IR> Framework. This is more than just linking sections of the report through cross referencing; it's about providing a holistic picture of the combination, inter-relatedness and dependencies between the factors that affect the business' ability to create value over time.

Where linkage between principal risks and strategy was provided in the risks section (32 companies), was it logical?	2016
Completely	47%
In part	53%

Just under half of those companies that provided linkage between risks and elements of the company's strategy, provided linkage where the relationship between the two obviously made sense. For others the linkage seemed superficial as it was unclear how a logical relationship could exist. When providing linkages companies should evaluate whether a logical relationship exists and whether it will be obvious to the reader. Intermediate Capital Group PLC provided a good example of logical linkage between all principal risks and elements of strategy.

Where linkages were provided (8 companies), was the linkage between principal risks and KPIs logical?	2016
All links appear logical	75%
Some links do not appear logical	25%

Although only a small number of companies provided linkages between principal risks and KPIs, the majority of these obviously made sense. As with linkages to strategy above, companies should evaluate whether a logical relationship exists for disclosed linkages and, if it does, should consider whether the linkage will be obvious to the reader. Intermediate Capital Group PLC provided a good example of logical linkage between principal risks and KPIs.

Proportion of companies who provided linkage between the risk section of the report and further information	2016	2015
Overall	30%	15%
FTSE 350	36%	23%
Other	22%	5%

Linking risks to other areas of the annual report (by providing linkages between specific risks and further information) can be an effective way of ensuring a concise report where relevant information which is specific to the risks can be clearly signposted to avoid repetition. A good example of this was provided by **Rexam PLC (Example 8.10)**.

Going concern and longer-term viability statement

The best companies provide a clear link between the principal risks and the directors' viability statement (see chapter 9) indicating how risks (especially those related to solvency and liquidity) have been considered in making that statement, insight that investors will welcome.

The majority (61%) of companies surveyed provided either a cross a reference between the risks section of the report and the viability statement or included the viability statement within the principal risks and uncertainties section. Only 46% of those companies surveyed outside of the FTSE 350 did this, compared to 71% of those companies surveyed in the FTSE 350.

There is also likely to be a degree of overlap between the disclosure on principal risks and any material uncertainties related to the going concern basis of accounting, and companies should consider how best to link these too.

Good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 8.1

[Cobham plc Annual Report and Accounts 2015 (p33)]

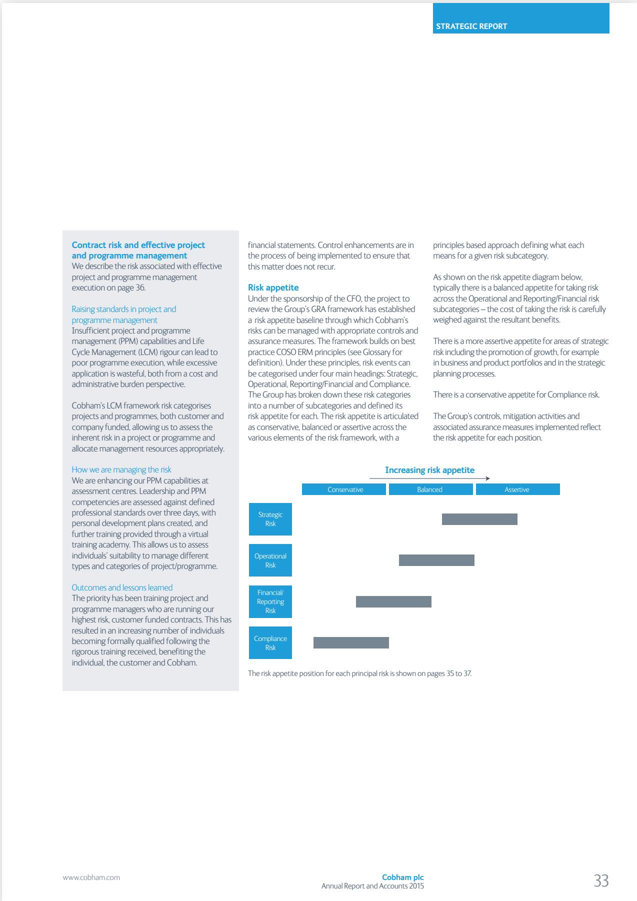
- Comprehensive discussion of risk appetite and how it is used in the decision making process.
- Shows risk appetite for each category of risk.

Example 8.2

[Marks and Spencer Group plc Annual Report & Financial Statements 2016 (p48)]

- Comprehensive discussion of the approach to determining risk appetite and how it is used in the decision making process.
- Inclusion of an example risk appetite statement.

Example 8.1



Example 8.2

Example 8.3

[Cobham plc Annual Report and Accounts 2015 (p35)]()

Narrative way of presenting principal risks.

Example 8.4

[Halma plc Annual Report and Accounts 2016 (p30)]()

- Example of risk appetite being set against each specific principal risk.
- Clearly distinguishes the impact of the risk from the risk description itself.
- Clearly distinguishes the mitigating activities from the risk description itself.
- Example of a tabular way to present principal risks.
- Linkage to strategic objectives through diagrammatic means that corresponds to the diagrams used in the strategy section.
- Indication of the level of magnitude of the risk in the form of narrative against each principal risk.
- Change in the level of risk denoted by up/down arrow.

Example 8.3

STRATEGIC REPORT

1. Deterioration in the macroeconomic environment adversely impacting our markets

Risk
The Group's revenue is derived from commercial and global defence/security markets. Underlying customer demand is dependent on a complex mix of macroeconomic, fiscal, and strategic defence and security imperatives.

Variations in government/customer demand levels or other external factors resulting from changes in these macroeconomic factors could lead to programme/contract terminations or delays, or changes in market growth rates.

Impact
Deterioration in demand affecting shorter cycle businesses or a fundamental shift in how customers procure products or services could have an adverse effect on the Group's future results leading to:
– Missed growth targets
– Reduced earnings
– Failure to win new business, resulting in adverse performance against the Group's strategic plan

Mitigation
A review of near and long term market trends is conducted as part of the Group's annual strategic planning process to ensure that actual and anticipated impacts from macroeconomic risks are minimised and managed effectively.

Regular reviews of externally sourced market demand data, with the re-forecasting and adjustment of internal planning in line with market demand.

Increased emphasis is being placed on identifying adjacent markets in which the Group's proven and transferable technologies can be applied.

The Group has achieved more balance in its portfolio towards commercial markets, with the aim to achieve sustainable growth through economic cycles.

A culture of continuous improvement will enable Cobham to have market leading operating performance, while reducing costs. This will enable Cobham to grow market share and remain competitive in the face of volume declines or price pressures, and while retaining flexibility to adjust the cost base appropriately to changing market conditions.

Link to KPIs
– Organic revenue growth
– Underlying EPS growth
– Cash conversion
– Return on invested capital

Risk appetite
Assertive

Risk status indicator
Global macroeconomic conditions remain uncertain.

2. Failure to execute strategy, to deliver performance in line with financial plans supported by effective value creating M&A activity

Risk
The Group's ability to generate profitable organic revenue growth consistently is a key strategic objective and driver of value creation. Insightful, complementary and well executed M&A activity in line with the Group's strategic objectives has supplemented this value creation.

Failure to define and execute the Group's growth strategy effectively will lead to impaired business performance.

Impact
Failure to grow leads to an impaired competitive position and can also result in reduced trading margins and a declining return on invested capital.

The Group will experience an impact on employee recruitment and retention, potential reputational damage and a reduced ability to invest for future growth.

Mitigation
Carry out effective strategic planning – maintain robust and dynamic processes to ensure the Group is exposed to growth markets and creates value through business cycles.

A continued focus on and investment in programme management to ensure customer expectations are met, which underpins the Group's ability to grow. Continued appropriate investment in future technologies with alignment to identified market growth areas and customer needs.

A cycle of budgets and forecasts together with tracking of actual performance including reasons for variances against plans.

Rigorous M&A disciplines (both pre- and post-transaction), aligned with the Group's strategic planning process, improves the ability to successfully execute and deliver value from transactions.

Link to KPIs
– Organic revenue growth
– Underlying EPS growth
– Group PV investment
– Cash conversion
– Return on invested capital
– Voluntary staff turnover

Risk appetite
Balanced

Risk status indicator
The Group's portfolio is being actively managed to optimise the total performance in continued challenging market conditions.

3. Failure to comply with laws and regulations

Risk
Cobham operates in a highly regulated environment and is subject to the laws, regulations and restrictions of many jurisdictions, notably including those of the US and the UK.

These include anti-bribery provisions, import and export controls, tax, government contracting rules, US DoD regulations regarding conduct of business under the Group's SSA, human rights, environmental, and health and safety regulation.

A lack of understanding of legal and regulatory restrictions in force in the jurisdictions in which it operates could lead to the Group being in contravention of laws or regulations.

Impact
Sanctions for failure by the Group, its sales intermediaries, or others acting on its behalf to comply with laws, regulations and restrictions could include fines, penalties, legal claims, suspension or debarment of the Group from future government contracts for a period of time, as well as having a potentially significant impact on the Group's reputation. Such sanctions could also have an impact on the Group's financial position and future operations.

Mitigation
Cobham employs rigorous procedures to ensure it remains in compliance with all legal requirements and regulations, and continues to drive a culture that ensures that ethical, environmental, and health and safety considerations are embodied in all that it does.

Policies and procedures are included in the Group's corporate framework to ensure all of the Group's compliance requirements are met. This is regularly reviewed and audited, including procedures related to the use of sales and marketing representatives, anti-bribery and anti-corruption, gifts and hospitality, whistleblowing, and investigation of ethics and compliance concerns, along with Cobham's Code of Business Conduct.

Mandatory training is undertaken by all employees on a variety of compliance related subjects including US Government contracting and anti-bribery and corruption.

See the CR&S section on pages 38 to 41 for information on human rights, environmental, and health and safety actions.

Link to KPIs
– Underlying EPS growth
– Return on invested capital
– Staff safety

Risk appetite
Conservative

Risk status indicator
The regulatory landscape remains broadly unchanged. However, increased scrutiny in certain areas has been noted.

Unchanged Increasing risk Decreasing risk Emerging new risk

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Annual Report and Accounts 2015
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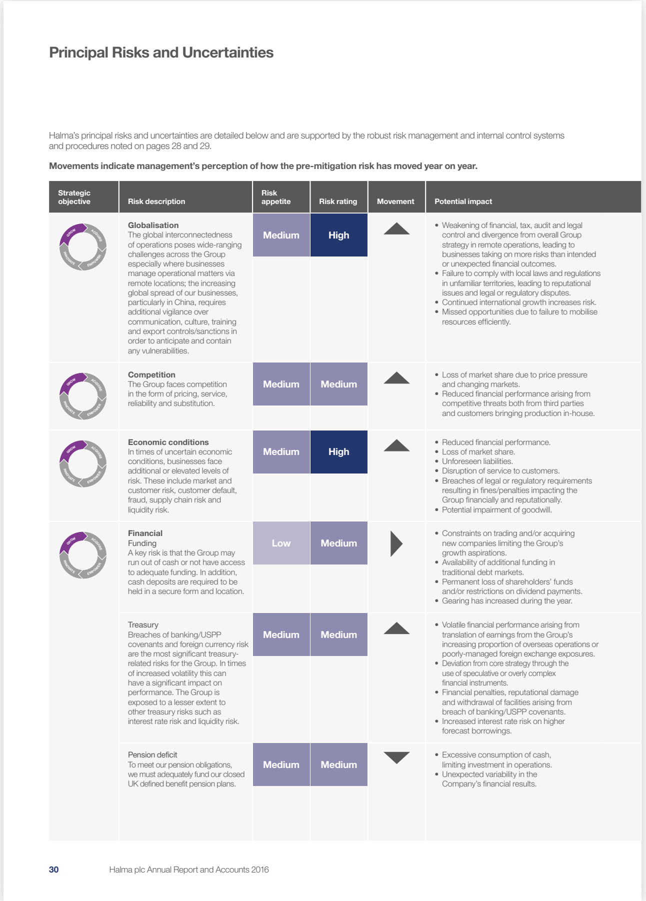
Example 8.4



Principal Risks and Uncertainties

Halma's principal risks and uncertainties are detailed below and are supported by the robust risk management and internal control systems and procedures noted on pages 28 and 29.

Movements indicate management's perception of how the pre-mitigation risk has moved year on year.

Strategic objective	Risk description	Risk appetite	Risk rating	Movement	Potential impact
GROW ACQUIRE EMPOWER INNOVATE	**Globalisation** The global interconnectedness of operations poses wide-ranging challenges across the Group especially where businesses manage operational matters via remote locations; the increasing global spread of our businesses, particularly in China, requires additional vigilance over communication, culture, training and export controls/sanctions in order to anticipate and contain any vulnerabilities.	Medium	High	▲	• Weakening of financial, tax, audit and legal control and divergence from overall Group strategy in remote operations, leading to businesses taking on more risks than intended or unexpected financial outcomes. • Failure to comply with local laws and regulations in unfamiliar territories, leading to reputational issues and legal or regulatory disputes. • Continued international growth increases risk. • Missed opportunities due to failure to mobilise resources efficiently.
GROW ACQUIRE EMPOWER INNOVATE	**Competition** The Group faces competition in the form of pricing, service, reliability and substitution.	Medium	Medium	▲	• Loss of market share due to price pressure and changing markets. • Reduced financial performance arising from competitive threats both from third parties and customers bringing production in-house.
GROW ACQUIRE EMPOWER INNOVATE	**Economic conditions** In times of uncertain economic conditions, businesses face additional or elevated levels of risk. These include market and customer risk, customer default, fraud, supply chain risk and liquidity risk.	Medium	High	▲	• Reduced financial performance. • Loss of market share. • Unforeseen liabilities. • Disruption of service to customers. • Breaches of legal or regulatory requirements resulting in fines/penalties impacting the Group financially and reputationally. • Potential impairment of goodwill.
GROW ACQUIRE EMPOWER INNOVATE	**Financial** Funding A key risk is that the Group may run out of cash or not have access to adequate funding. In addition, cash deposits are required to be held in a secure form and location.	Low	Medium	▶	• Constraints on trading and/or acquiring new companies limiting the Group's growth aspirations. • Availability of additional funding in traditional debt markets. • Permanent loss of shareholders' funds and/or restrictions on dividend payments. • Gearing has increased during the year.
	Treasury Breaches of banking/USPP covenants and foreign currency risk are the most significant treasury-related risks for the Group. In times of increased volatility this can have a significant impact on performance. The Group is exposed to a lesser extent to other treasury risks such as interest rate risk and liquidity risk.	Medium	Medium	▲	• Volatile financial performance arising from translation of earnings from the Group's increasing proportion of overseas operations or poorly-managed foreign exchange exposures. • Deviation from core strategy through the use of speculative or overly complex financial instruments. • Financial penalties, reputational damage and withdrawal of facilities arising from breach of banking/USPP covenants. • Increased interest rate risk on higher forecast borrowings.
	Pension deficit To meet our pension obligations, we must adequately fund our closed UK defined benefit pension plans.	Medium	Medium	▼	• Excessive consumption of cash, limiting investment in operations. • Unexpected variability in the Company's financial results.

30 Halma plc Annual Report and Accounts 2016

Example 8.5

[National Grid Plc Annual Report and Accounts 2015/16 (p26)](#)

Comprehensive description of a risk management process including bottom-up and top-down risk process, supported by a diagram of the risk management process and description of a three lines of defence model.

Example 8.6

[The Weir Group PLC Annual Report and Financial Statements 2015 (p21)](#)

Example of a risk appetite statement.

Example 8.5

Internal control and risk management

The Board is committed to protecting and enhancing our reputation and assets, while safeguarding the interests of our shareholders. It has overall responsibility for the Group's system of risk management and internal control.

National Grid is exposed to a variety of uncertainties that could have a material adverse effect on the Group's financial condition, our operational results, our reputation, and the value and liquidity of our shares.

The Board oversees risk management, and, as part of this role, it sets and monitors the amount of risk the Company is prepared to seek or accept at any given time in pursuing our strategic objectives (our risk appetite). The Board also regularly monitors and reviews our internal controls and risk management processes. You can read more about this on page 29.

This year we refined our risk management processes as a result of changes implemented by the UK Corporate Governance Code 2014 (the Code). Most notably, we now specifically test the impact of our principal risks on a reasonable worst case basis, alone and in clusters, over a five-year assessment period. The aim of this is to establish their impact on the Group's ability to continue operating and meet its liabilities over the assessment period. The reason for selecting a five-year assessment period and the results of this exercise are described in the viability statement on page 30.

Risk management approach
Our Group-wide corporate risk management process provides a framework through which we can consistently identify, assess and prioritise, manage, monitor and report risks, as shown in the diagram below. The process is designed to support the delivery of our vision and strategy, as described on pages 16–17.

Our process involves a continuous cycle of bottom-up review and reporting and top-down review and feedback.

All our business functions participate in the bottom-up risk management process. They identify the main risks to our business model and to achieving their business objectives and the actions being taken to manage and monitor them. They assess each risk by considering the financial and reputational impacts, and how likely the risk is to materialise. The identified risks are collated in risk registers and reported at functional and regional levels of the Group. The risk registers also describe the adequacy of our existing risk controls.

An important feature of our risk management process is our three lines of defence model. Each business function owns and is responsible for managing its own particular risks (the first line of defence). A central risk management team (the second line of defence) acts as an advisory function and also provides independent challenge and review. This team partners with the business functions through nominated risk liaisons and collaborates with assurance teams and specialists, such as safety and compliance management. Our internal audit function then audits selected controls and mitigation activities (the third line of defence).

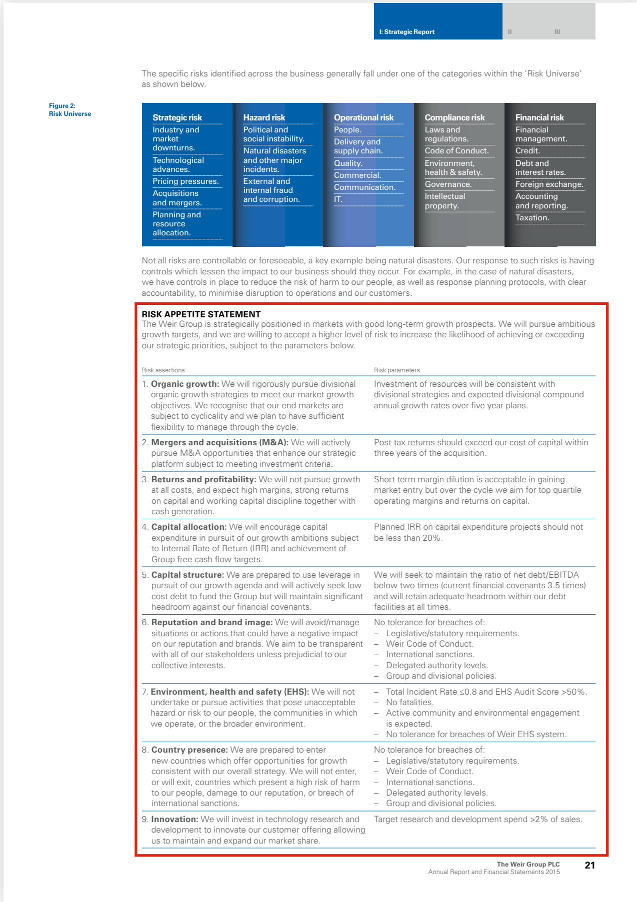
Regional senior management regularly reviews and debates the outputs of the bottom-up risk management process and agrees the prioritisation of the risks. The main risks for the UK and US businesses are highlighted in regional risk profiles and reported to the CEO.

Our main strategic uncertainties or 'principal risks' for the Company are developed through discussing the Group risk profile with the Executive leadership team and the Board. These risks are reported and debated with the Executive Committee and Board every six months.

The Board participates in risk workshops to make sure that the principal risks remain closely aligned to our strategic aims and that no important risks (or combination of risks) are being overlooked. This year, several sessions were conducted to discuss our principal risks and to assess the potential of those risks to impact the Company's

26 National Grid Annual Report and Accounts 2015/16 **Strategic Report**

Example 8.6



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The specific risks identified across the business generally fall under one of the categories within the 'Risk Universe' as shown below.

Figure 2:
Risk Universe

Strategic risk	Hazard risk	Operational risk	Compliance risk	Financial risk
Industry and market downturns.	Political and social instability.	People.	Laws and regulations.	Financial management.
Technological advances.	Natural disasters and other major incidents.	Delivery and supply chain.	Code of Conduct.	Credit.
Pricing pressures.	External and internal fraud and corruption.	Quality.	Environment, health & safety.	Debt and interest rates.
Acquisitions and mergers.		Commercial.	Governance.	Foreign exchange.
Planning and resource allocation.		Communication.	Intellectual property.	Accounting and reporting.
		IT.		Taxation.

Not all risks are controllable or foreseeable, a key example being natural disasters. Our response to such risks is having controls which lessen the impact to our business should they occur. For example, in the case of natural disasters, we have controls in place to reduce the risk of harm to our people, as well as response planning protocols, with clear accountability, to minimise disruption to operations and our customers.

RISK APPETITE STATEMENT
The Weir Group is strategically positioned in markets with good long-term growth prospects. We will pursue ambitious growth targets, and we are willing to accept a higher level of risk to increase the likelihood of achieving or exceeding our strategic priorities, subject to the parameters below.

Risk assertions	Risk parameters
1. **Organic growth:** We will rigorously pursue divisional organic growth strategies to meet our market growth objectives. We recognise that our end markets are subject to cyclicality and we plan to have sufficient flexibility to manage through the cycle.	Investment of resources will be consistent with divisional strategies and expected divisional compound annual growth rates over five year plans.
2. **Mergers and acquisitions (M&A):** We will actively pursue M&A opportunities that enhance our strategic platform subject to meeting investment criteria.	Post-tax returns should exceed our cost of capital within three years of the acquisition.
3. **Returns and profitability:** We will not pursue growth at all costs, and expect high margins, strong returns on capital and working capital discipline together with cash generation.	Short term margin dilution is acceptable in gaining market entry but over the cycle we aim for top quartile operating margins and returns on capital.
4. **Capital allocation:** We will encourage capital expenditure in pursuit of our growth ambitions subject to Internal Rate of Return (IRR) and achievement of Group free cash flow targets.	Planned IRR on capital expenditure projects should not be less than 20%.
5. **Capital structure:** We are prepared to use leverage in pursuit of our growth agenda and will actively seek low cost debt to fund the Group but will maintain significant headroom against our financial covenants.	We will seek to maintain the ratio of net debt/EBITDA below two times (current financial covenants 3.5 times) and will retain adequate headroom within our debt facilities at all times.
6. **Reputation and brand image:** We will avoid/manage situations or actions that could have a negative impact on our reputation and brands. We aim to be transparent with all of our stakeholders unless prejudicial to our collective interests.	No tolerance for breaches of: – Legislative/statutory requirements. – Weir Code of Conduct. – International sanctions. – Delegated authority levels. – Group and divisional policies.
7. **Environment, health and safety (EHS):** We will not undertake or pursue activities that pose unacceptable hazard or risk to our people, the communities in which we operate, or the broader environment.	– Total Incident Rate ≤0.8 and EHS Audit Score >50%. – No fatalities. – Active community and environmental engagement is expected. – No tolerance for breaches of Weir EHS system.
8. **Country presence:** We are prepared to enter new countries which offer opportunities for growth consistent with our overall strategy. We will not enter, or will exit, countries which present a high risk of harm to our people, damage to our reputation, or breach of international sanctions.	No tolerance for breaches of: – Legislative/statutory requirements. – Weir Code of Conduct. – International sanctions. – Delegated authority levels. – Group and divisional policies.
9. **Innovation:** We will invest in technology research and development to innovate our customer offering allowing us to maintain and expand our market share.	Target research and development spend >2% of sales.

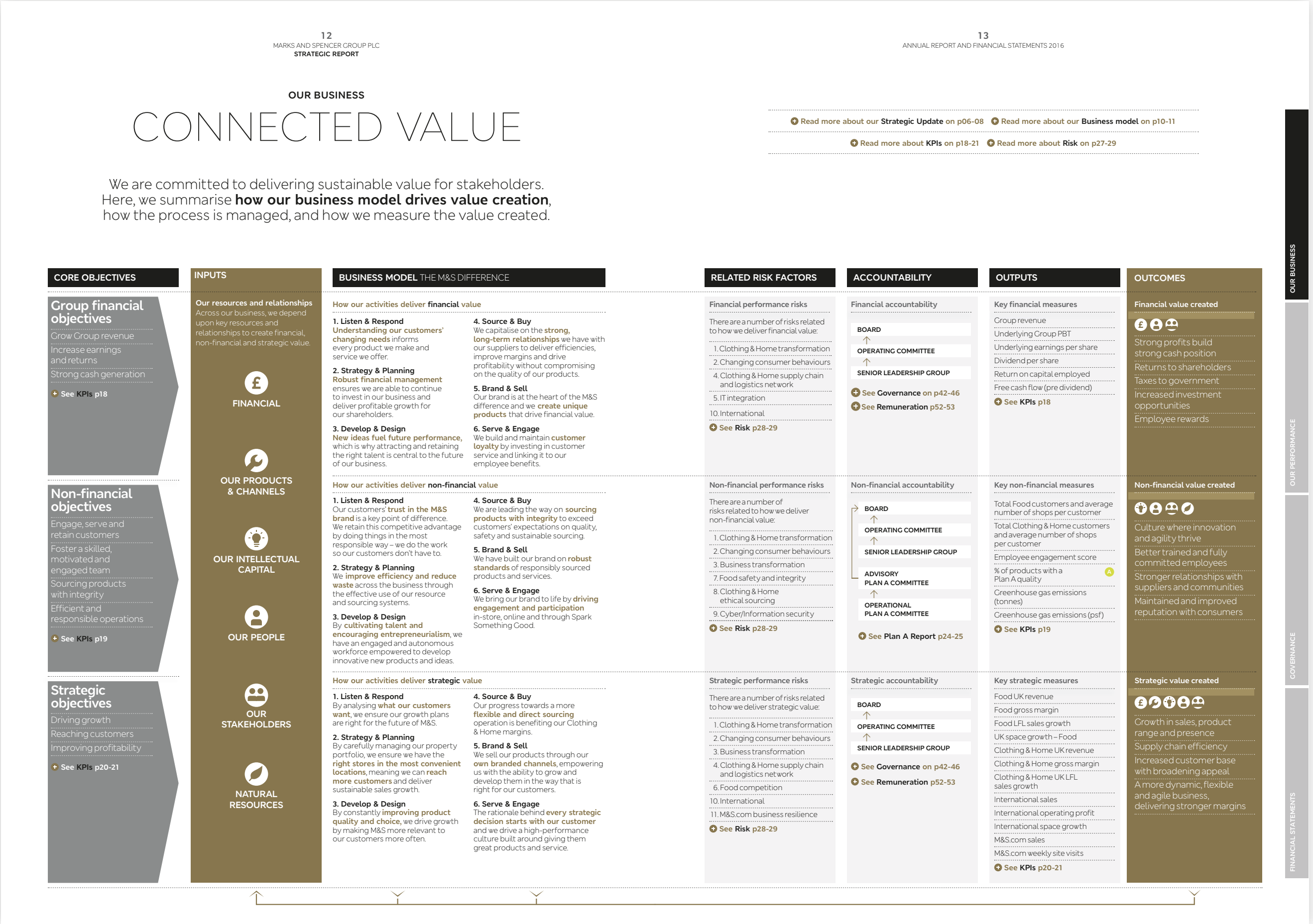
The Weir Group PLC
Annual Report and Financial Statements 2015 **21**

Example 8.7

[Marks and Spencer Group plc Annual Report & Financial Statements 2016 (p12-13)]

- Example of how principal risks can be displayed prominently within the annual report even though the actual principal risks and uncertainties section might be further on.

- This links the business model to related risks and provides a cross reference where further information on those risks (i.e. the actual principal risks and uncertainties section) can be found.



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Example 8.8

[Thomas Cook Group PLC Annual Report & Accounts 2015 (p59)]

Linkage of principal risks that were taken into account in making the longer-term viability statement.

Example 8.9

[Johnson Matthey Plc Annual Report and Accounts 2015 (p31)]

- Indication of the magnitude of the risk in the form of a traffic light system.
- Change in the level of risk indicated by narrative description.

Example 8.8

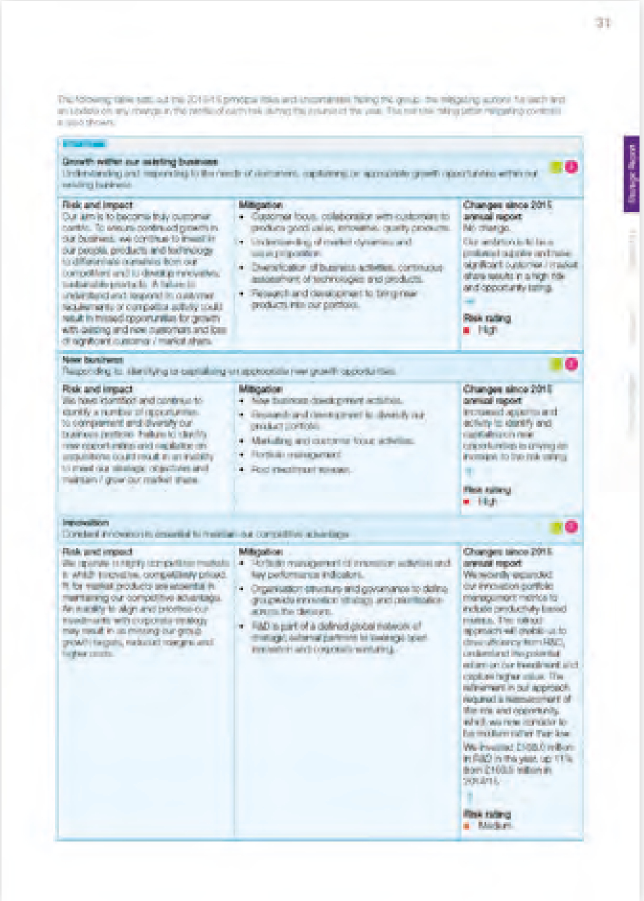
THOMAS COOK GROUP PLC ANNUAL REPORT & ACCOUNTS 2015 59

	Principal risks	Mitigation	Opportunities
6	Information security and cyber threats are currently a priority across all industries and remain a key Government agenda item. The Group recognises that we have high risk exposure in this area and has added this as a new principal risk.	› Our Information Security Steering Group has been established to provide oversight of the cyber risk framework and ensure appropriate mitigations are in place. › Our Security Improvement programme is underway and aims to provide the following mitigations: – Group Security Policies – Security Awareness Training – Detect and Respond Monitoring Service for websites, data centres and critical systems – Vulnerability Management service to test website and system security	To become thought leaders in developing a strategy to combat emerging cyber threats.
7	A decision or a course of action is perceived negatively by the media, investors and/or general public, which in turn impacts the corporate reputation of the Group and its share price*.	› As part of our risk management process, we identify all events that may have a potential reputational impact to the Group and ensure that controls are in place to manage these risks. › We have a clear plan in place to respond to the potential reputational consequences of an event which includes close cooperation between investor relations, public relations, HR and legal teams to identify and prepare responses to incidents and potential issues. The plan has been strengthened this year based on the lessons learnt during the Corfu Inquest. › We monitor stakeholder and governmental reactions to ensure we respond to emerging political and regulatory developments.	Promotion of the business and enhancement of brand value through positive media attention.
8	Cash generation limits the ability to strategically manage debt repayment and/or dividend payment*.	› We proactively monitor our short, medium and long-term cash requirements and liquidity headroom. › Our cost-out and profit improvement initiatives are successfully contributing to cash availability. › We continue to monitor all opportunities to manage liquidity requirements and maintain an adequate level of contingency as well as seeking to lower the average cost of debt over the medium term.	Sufficient cash to implement optimal financing strategies.
9	Due to the nature of its business, the Group will always be exposed to a risk of a health and safety incident that may impact our customers or colleagues together with associated reputational damage.	› We operate a robust safety management system (SMS) to ensure the implementation of our Health and Safety Policies and procedures. › The Group Health, Safety, and Security team implement the SMS, which is further supported by a reputable external specialist (SGS). › The Group regularly reviews and updates its safety and security training programmes to ensure they continue to reflect best practice. › Our Health and Safety Audit programme, which is delivered by external specialists, measures standards and includes a clear escalation and decision process. The programme also includes a robust follow-up process. › The assessment of Health and Safety risks is inbuilt into daily management routines and is monitored by a structure of health and safety committees that are in turn overseen by a corporate Health, Safety & Environmental Committee with Board level oversight. The report of the Health, Safety & Environmental Committee can be found on page 83.	To provide class leading health and safety programmes for the benefit of our customers and employees.
10	Increasing security threats and general socio/political uncertainties negatively impacting our key markets and reduce the demand for travel related products*.	› Our flexible business model allows us to align our committed capacity to fluctuating demand. › As part of our destination strategy, we continue to add new destinations to our portfolio, thereby mitigating the effect of factors which may negatively impact demand for travel to certain regions. › We actively monitor the socio/political landscape to ensure we have an early indication of emerging risk and are available to respond in an appropriate and timely manner. › We have a dedicated Crisis Management Team who have the requisite resource and skills to ensure that adequate emergency response is provided to ensure the welfare of our customers. › All of our senior management regularly participate in crisis management scenarios.	To deliver proactive capability to pre-emptively manage emerging geopolitical uncertainties.
11	Failure to comply with regulatory, legislative and corporate social responsibility requirements in the legal jurisdictions where Thomas Cook operates.	› We have a dedicated Legal Team to ensure full compliance with formal regulatory requirements which monitors all current and emerging regulatory developments in our source markets. The team receives regular training to provide awareness of critical changes in relevant legislation or case law. › Our Code of Conduct is backed by a comprehensive training programme to ensure that it is fully embedded across the Group. › Our Legal Risk Database enables communication and timely analysis of all risks related to regulatory, legislative and corporate social responsibility requirements.	Instilling values and positively influencing all of our key stakeholders.

* Principal risk with a direct link to the viability statement.

STRATEGIC REPORT GOVERNANCE FINANCIAL STATEMENTS

Example 8.9



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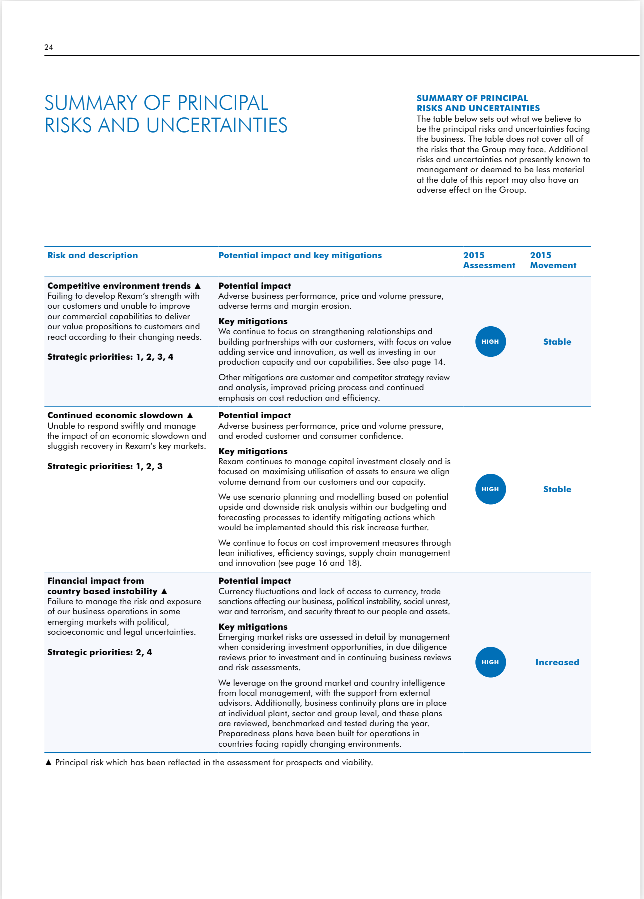
Example 8.10
Rexam PLC Annual Report 2016 (p24)

- Each strategy is numbered and then linked to each specific risk.
- Indication of the magnitude of the risk in the form of narrative against each principal risk.
- Risks are linked to other relevant areas of the annual report that relate to this risk.
- Linkage of principal risks that were taken into account in making the longer-term viability statement.

Example 8.11
AO World plc Annual Report and Accounts 2016 (p23)

- Example of linkage to strategic objectives through the use of small pictures that tie through to those used in the strategy section earlier on in the report.
- As well as showing impact on the strategic objective this also shows the impact of the principal risk on the business model.

Example 8.10



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SUMMARY OF PRINCIPAL RISKS AND UNCERTAINTIES

SUMMARY OF PRINCIPAL RISKS AND UNCERTAINTIES
The table below sets out what we believe to be the principal risks and uncertainties facing the business. The table does not cover all of the risks that the Group may face. Additional risks and uncertainties not presently known to management or deemed to be less material at the date of this report may also have an adverse effect on the Group.

Risk and description	Potential impact and key mitigations	2015 Assessment	2015 Movement
Competitive environment trends ▲ Failing to develop Rexam's strength with our customers and unable to improve our commercial capabilities to deliver our value propositions to customers and react according to their changing needs. **Strategic priorities: 1, 2, 3, 4**	**Potential impact** Adverse business performance, price and volume pressure, adverse terms and margin erosion. **Key mitigations** We continue to focus on strengthening relationships and building partnerships with our customers, with focus on value adding service and innovation, as well as investing in our production capacity and our capabilities. See also page 14. Other mitigations are customer and competitor strategy review and analysis, improved pricing process and continued emphasis on cost reduction and efficiency.	HIGH	Stable
Continued economic slowdown ▲ Unable to respond swiftly and manage the impact of an economic slowdown and sluggish recovery in Rexam's key markets. **Strategic priorities: 1, 2, 3**	**Potential impact** Adverse business performance, price and volume pressure, and eroded customer and consumer confidence. **Key mitigations** Rexam continues to manage capital investment closely and is focused on maximising utilisation of assets to ensure we align volume demand from our customers and our capacity. We use scenario planning and modelling based on potential upside and downside risk analysis within our budgeting and forecasting processes to identify mitigating actions which would be implemented should this risk increase further. We continue to focus on cost improvement measures through lean initiatives, efficiency savings, supply chain management and innovation (see page 16 and 18).	HIGH	Stable
Financial impact from country based instability ▲ Failure to manage the risk and exposure of our business operations in some emerging markets with political, socioeconomic and legal uncertainties. **Strategic priorities: 2, 4**	**Potential impact** Currency fluctuations and lack of access to currency, trade sanctions affecting our business, political instability, social unrest, war and terrorism, and security threat to our people and assets. **Key mitigations** Emerging market risks are assessed in detail by management when considering investment opportunities, in due diligence reviews prior to investment and in continuing business reviews and risk assessments. We leverage on the ground market and country intelligence from local management, with the support from external advisors. Additionally, business continuity plans are in place at individual plant, sector and group level, and these plans are reviewed, benchmarked and tested during the year. Preparedness plans have been built for operations in countries facing rapidly changing environments.	HIGH	Increased

▲ Principal risk which has been reflected in the assessment for prospects and viability.

Example 8.11

Overview
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Our risk management programme can only provide reasonable, not absolute assurance that key risks are managed at an acceptable level where possible.

Risk appetite
Overall, the Group has a "balanced" approach to risk taking; we will not be unduly aggressive with our risk taking but we may accept a limited number of significant risks at any one time in order to foster innovation and to facilitate growth. We recognise that it is not possible or necessarily desirable to eliminate some of the risks inherent in our activities. However, these must be reviewed against the assessment of other principal risks to ensure that the level of net risk remains within the overall accepted risk appetite. For example, where it has already accepted an aggressive or material risk, this would then limit the acceptance of additional material risks. The Risk Appetite Statement is reviewed annually, in line with the strategic direction of the Group, recent experience and the regulatory environment and is subject to Board approval.

This year's achievement and future actions
This year we have continued to enhance our Risk Management Framework and have allocated roles and responsibilities. Our Board has approved our Risk Appetite Statement which is clearly defined. Our aim now is to ensure that this is understood across our business, and there is a consistent approach to risk.

We have broadened our Risk Management Committee meetings to allow employees from across the Group to present on risk areas and mitigating actions. This helps to facilitate open discussion and debate about our risks and helps to foster a culture where risk management becomes part of our everyday decision making process. Additionally we have worked with our strategy team to ensure that our risk management process and assessment matrix is fully integrated into our assessment of strategic projects.

We have and will continue to embed our risk culture throughout our Group, in all territories and areas in which we operate.

Principal risks
Our principal risk categories have been defined as: Culture and People; Failure of European Expansion, Brand Recognition and Damage; IT Systems Resilience; Compliance with Laws and Regulation and Business Interruption.

The table below summarises our assessment of these risks and how we seek to mitigate them.

Key risk	Nature of the risk	Mitigating activities	Overall change during the year
Culture and People **Impact on strategic objectives:** Culture & Brand; Customers **Impact on business model:** – People	Culture is a key ingredient in the success of the business and a unique differentiator from our competitors. If we fail to maintain the culture in conjunction with our growth this could affect all areas of the business from our ability to attract customers, our dealings with suppliers and the way we deliver. We rely on members of our Group Executive Team and Senior Management Team to provide strategic direction to the business. The loss of key member(s) of the team would have a significant impact on our strategy being realised.	– Improved development plans introduced to strengthen internal succession planning – AO culture supported by a wide range of tools and events with a dedicated employee events team – Senior employees receive attractive remuneration packages including long-term share options and career structures to encourage retention – Strengthened operational management teams in each territory give the benefit of localised decision making and reduce reliance on individuals – Group Executive Team and Senior Management Team have a shared responsibility to drive culture throughout the business on the basis of AO's values	**Risk increase** Following the launch of the business in the Netherlands we now have a new team of people who are learning the culture and values. However, we have strengthened the Executive component of the Board and also the Group Executive Team over the year, which has helped to mitigate some of the increase.
Failure of European Expansion **Impact on strategic objectives:** Countries	Expanding into new territories is a key part of our strategy. Failure in these territories would limit our long-term growth and negatively impact the Group's finances.	– Expansion into new territories is only undertaken after extensive research – Expansion leverages AO's existing UK online retailing expertise and experience that has been built up over many years – Capital requirements are relatively low and investment is managed in stages – Specific targets are in place for new territories to enable focus on objectives and measurement of performance	**Risk increase** We have launched the business in the Netherlands in the year under review which has given us confidence that the model can be replicated. However in both Germany and the Netherlands there is still much to do.

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Example 8.12

[Intermediate Capital Group PLC Annual Report and Accounts 2016 (p30)]

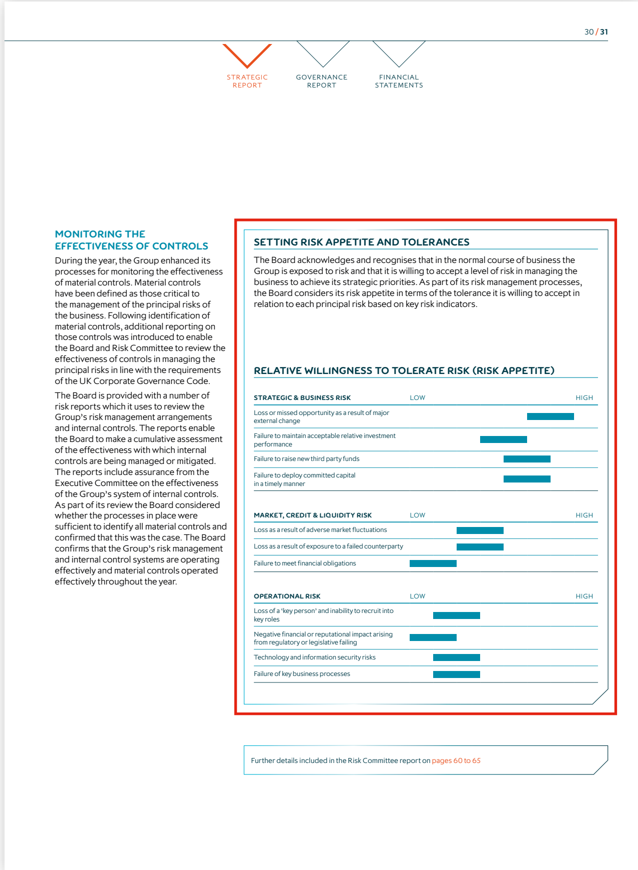
Different way of showing risk appetite per principal risk apart from inclusion against each specific risk.

Example 8.13

[Mothercare plc Annual Report and Accounts 2016 (p27)]

A variant of showing risk appetite per principal risk apart from inclusion against each specific risk.

Example 8.12



SETTING RISK APPETITE AND TOLERANCES

The Board acknowledges and recognises that in the normal course of business the Group is exposed to risk and that it is willing to accept a level of risk in managing the business to achieve its strategic priorities. As part of its risk management processes, the Board considers its risk appetite in terms of the tolerance it is willing to accept in relation to each principal risk based on key risk indicators.

RELATIVE WILLINGNESS TO TOLERATE RISK (RISK APPETITE)

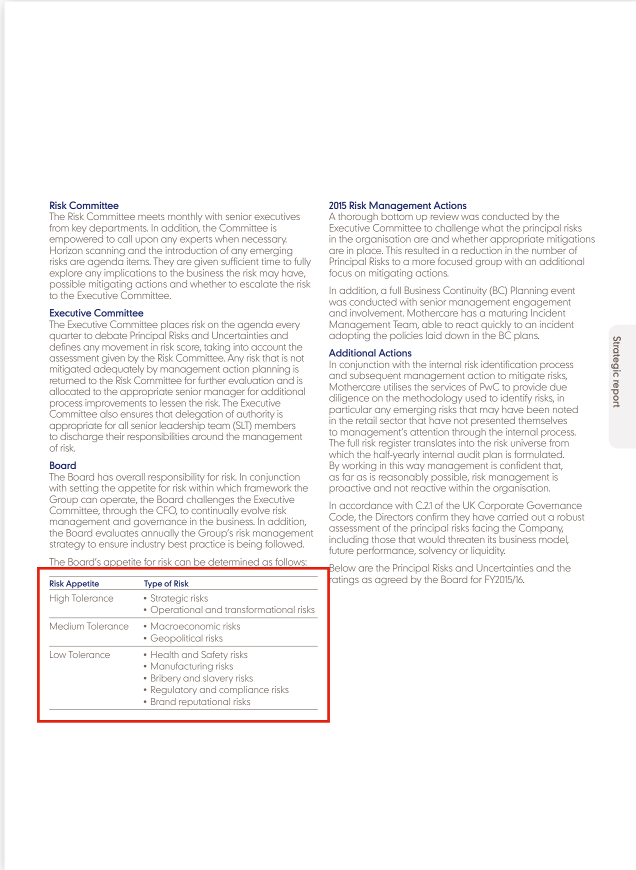
STRATEGIC & BUSINESS RISK	LOW – HIGH
Loss or missed opportunity as a result of major external change	
Failure to maintain acceptable relative investment performance	
Failure to raise new third party funds	
Failure to deploy committed capital in a timely manner	

MARKET, CREDIT & LIQUIDITY RISK	LOW – HIGH
Loss as a result of adverse market fluctuations	
Loss as a result of exposure to a failed counterparty	
Failure to meet financial obligations	

OPERATIONAL RISK	LOW – HIGH
Loss of a 'key person' and inability to recruit into key roles	
Negative financial or reputational impact arising from regulatory or legislative failing	
Technology and information security risks	
Failure of key business processes	

Further details included in the Risk Committee report on pages 60 to 65

Example 8.13



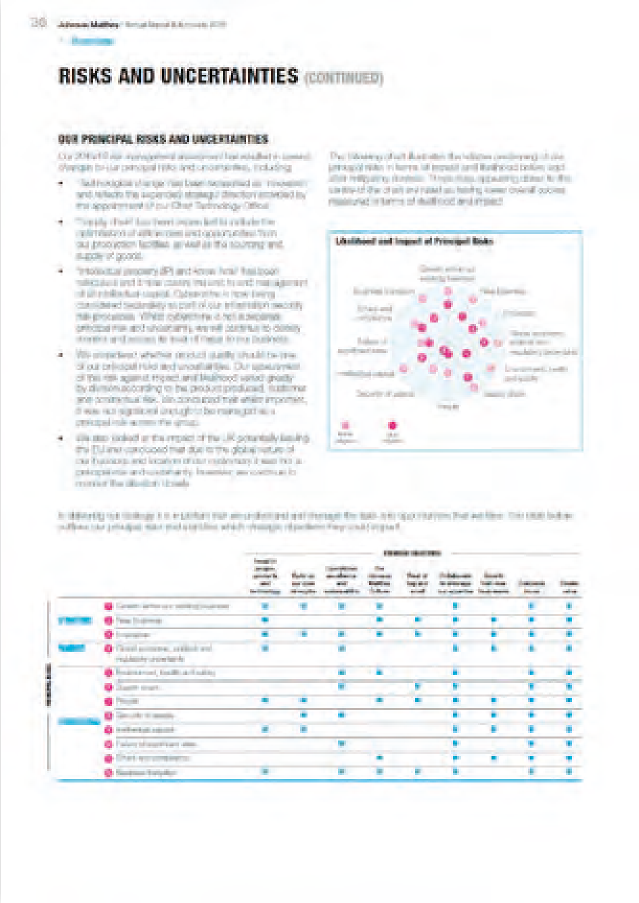
The Board's appetite for risk can be determined as follows:

Risk Appetite	Type of Risk
High Tolerance	• Strategic risks • Operational and transformational risks
Medium Tolerance	• Macroeconomic risks • Geopolitical risks
Low Tolerance	• Health and Safety risks • Manufacturing risks • Bribery and slavery risks • Regulatory and compliance risks • Brand reputational risks

Example 8.14
Johnson Matthey Plc Annual Report and Accounts 2015 (p30)
A variation on how to link principal risks to strategic objectives apart from including them in the principal risks and uncertainties table.

Example 8.15
The Weir Group PLC Annual Report and Financial Statements 2015 (p24)
Linkage of principal risks that were taken into account in making the longer-term viability statement denoted by a 'v'.

Example 8.14



RISKS AND UNCERTAINTIES (CONTINUED)

OUR PRINCIPAL RISKS AND UNCERTAINTIES

Example 8.15

Strategic Report

How We Manage Risk continued
Principal risks and uncertainties

As in any business, there are risks and uncertainties which could impact the Group's ability to achieve its objectives in the future. However, we believe the Group's risk management and assurance framework makes this less likely. The Board has conducted a robust assessment of the principal risks, alongside the risk appetite statement set out on page 21, meeting the Board's responsibilities in connection with Risk Management and Internal Control detailed in the 2014 UK Corporate Governance Code. Each of the principal risks is assigned an owner from amongst the Board or Group senior management team and is either a standing agenda item at each Board meeting or subject to formal periodic review by the Board. A summary of principal risks and the Group's mitigating controls is presented at every Board meeting.

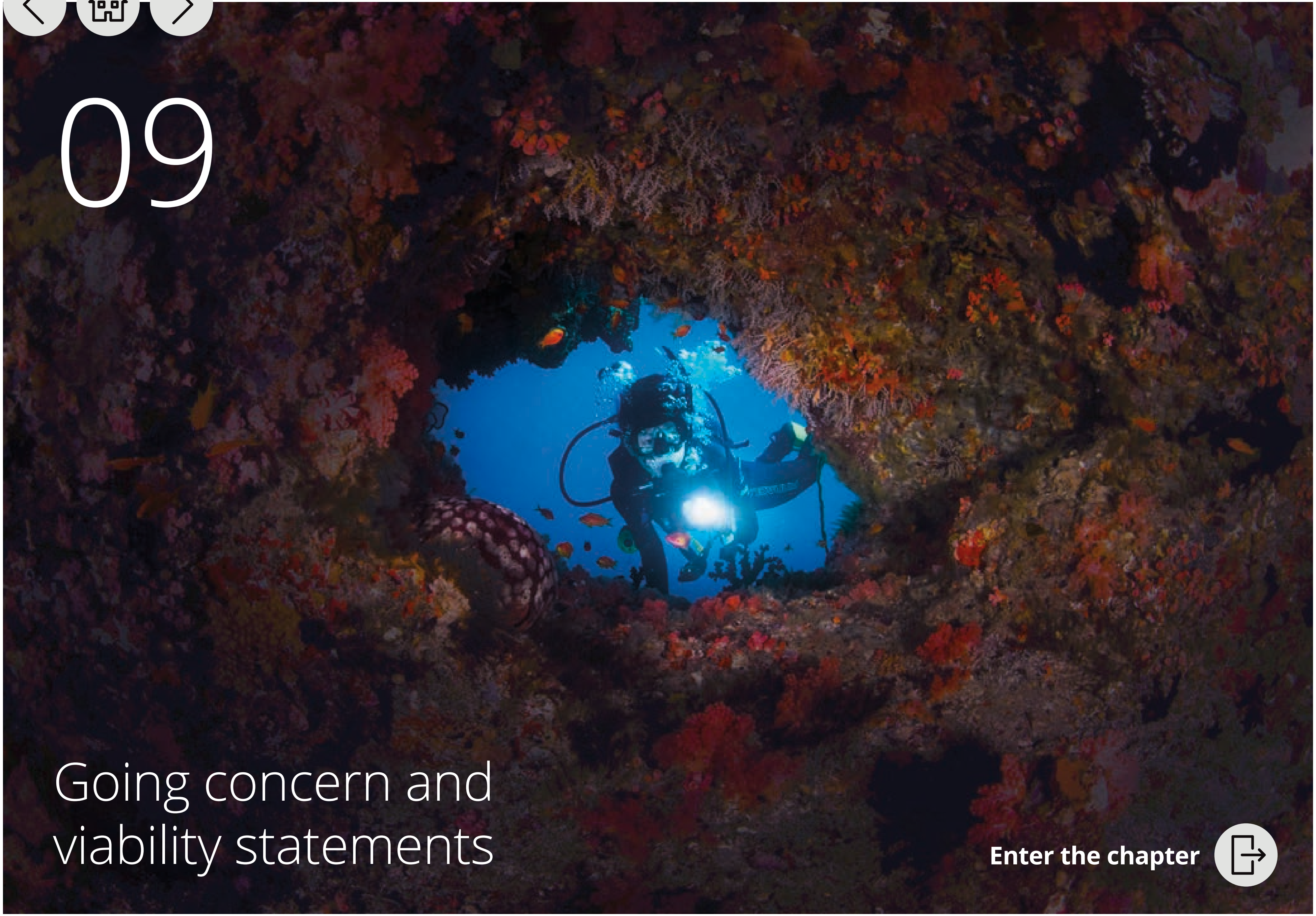
The Directors reviewed the Group's risk register, reassessed the validity of the principal risks identified in the prior year and considered whether any new principal risks have emerged or a risk is no longer considered a principal risk. The identified principal risks were subjected to a detailed assessment based on the following considerations:
– severity of each risk;
– existence and effectiveness of actions and internal controls which serve to mitigate the risk;
– the overall effectiveness of the Group's control environment, including assurance and any identified control weaknesses or failings; and
– the extent to which each of the principal risks could impact upon the Group's viability, in financial or operational terms, due to their potential effects on the business plan, solvency or liquidity.

The principal risks set out below are those which we believe to have the greatest potential to impact our ability to achieve the Group's strategic objectives or which have the greatest potential impact on the Group's solvency or liquidity.

KEY TO SYMBOLS
Risk increasing
Risk unchanged
Risk decreasing
Considered as part of Viability Statement assessment

Risk	Why we think this is important	How we are mitigating the risk	Changes during 2015
Global economic conditions **Changes in key markets, including commodity prices affecting mining and oil and gas, have an adverse impact on customers' expenditure plans. This may include delaying existing expenditure commitments.**	We need to remain sufficiently flexible to allow us to anticipate downturns, to allow us to adjust our operations accordingly, and equally to meet growth in demand when our customers' markets are buoyant and therefore capital investment is high. Otherwise, we are at risk of incurring unnecessary costs during downturns, and not maximising our potential for growth in buoyant markets. In challenging market conditions, our supply chain risks are increased. These are described in more detail on page 26.	– We maintain regular engagement with our customers to understand their needs and challenges, and ensure our business is appropriately aligned. – Our strategic planning utilises extensive market intelligence to assist in forecasting opportunities and dips in markets. – We maintain contingency plans for downturns.	Market conditions have remained challenging during 2015, with commodity prices in oil and gas joining those in minerals markets at recent historical lows. Necessary adjustments have been made to our operations to accommodate our customers' responses to these market conditions.

24 The Weir Group PLC
Annual Report and Financial Statements 2015



09

Going concern and viability statements

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Going concern and viability statements

Top tips

- Consider the most appropriate period of assessment for the longer term viability statement and explain clearly why this period was selected. 83% of companies surveyed used a three year period in this first year of longer term viability statement reporting.

- Assess whether specific qualifications or assumptions have been used in the analysis for the longer term viability statement and disclose those in the statement – in particular where there are assumptions on financing, maintaining sales prices or volumes or the success of mitigating actions. Only 48% of companies surveyed this year reported on specific qualifications or assumptions.

Keep an eye on

- The 2014 Code requirement for a board statement on going concern and another on viability. The former states whether the going concern basis of accounting was considered appropriate, and the latter explains how the board has assessed the prospects of the company (taking account of its current position and principal risks), over what period they have done so and why they consider that period to be appropriate, together with qualifications or assumptions. In order to achieve clear and concise reporting, consider whether information can best be streamlined by linking these statements, through presenting them side by side or through clear cross-referencing.
- Whether there are opportunities to further integrate reporting on risk management, principal risks, going concern and longer term viability to reduce duplication, including between the risk management section and the corporate governance section of the annual report.

Introduction

The 2014 updates to the UK Corporate Governance Code introduced changes to the way in which companies report on their future prospects, with the aim of making a clearer distinction between the meaning of going concern in the broad context meant by Lord Sharman[68] and the narrower context used in the accounting standards. They also ask companies to make a clearer link between the assessment of risks to the viability of the business and the broader risk assessment that should form part of a company's normal risk management and reporting processes. The extent to which the companies surveyed have revised their risk reporting to emphasise this link has been discussed further within chapter 8.

In establishing the new provisions with respect to going concern and viability, the FRC attempted to balance the information needs of investors with setting appropriate reporting requirements. The result of this is that directors are now required to include two statements in the annual report regarding the health of the business.

- A statement of whether they consider it appropriate to adopt the going concern basis of accounting, and any material uncertainties identified in assessing this, which should be identified in the financial statements.[69] This statement must cover a period of at least twelve months from the date of approval of the financial statements and is required in half-yearly reports as well as annual reports.

- A statement that, taking account of the company's current position and principal risks, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due, drawing attention to any qualifications or assumptions as necessary. The period covered by this assessment should also be stated, along with the reasons why that period is appropriate. It is expected that, except in rare circumstances, the period will be significantly longer than 12 months from the date of approval of the financial statements.

This chapter examines in more detail how companies have applied these requirements, with a particular focus on the second of these statements (commonly known as the 'longer term viability statement').

68 In his 2012 report on the findings of his Panel of Inquiry on Going Concern and Liquidity Risks: Lessons for companies and auditors, which was commissioned by the FRC.

69 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf

The longer term viability statement

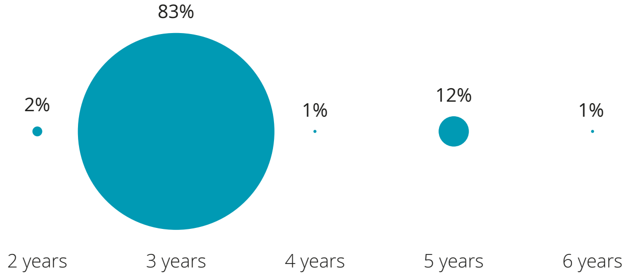
This year the focus of the board's exercise has largely changed to the new longer term viability statement, with the hurdle for the going concern statement being much easier to manage in comparison – going concern now refers exclusively to the basis of accounting and therefore not being a going concern is a very high hurdle.

The longer term viability statement was introduced as a new requirement of the 2014 Code and requires directors to state whether they have a "reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment" (Code provision C.2.2). It is also based on the directors' new confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the company (Code provision C.2.1), since the principal risks are a key element of the directors' assessment – see chapter 8.

It is encouraging that in this first year we have seen numerous examples of good disclosure covering various elements encouraged by the Code and the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.[70] 99% of companies in our survey sample produced a longer term viability statement; the company that did not do so (one of the smaller companies) had reported on compliance with the outdated 2012 version of the Code.

The FRC has encouraged companies to include their longer term viability statement in the strategic report, alongside the disclosures on principal risks. This makes sense as those principal risks are a key part of the directors' assessment and it avoids cumbersome cross-referencing. In addition, longer term viability is likely to be of strategic importance to most companies.

Figure 9.1 – What lookout period have companies used?



The FRC has also published a letter from the then Department for Business, Innovation and Skills indicating that the strategic report is within the scope of safe harbour, again making it a sensible place to include a longer term viability statement.[71] In total, 73% of our sample included their statement in the strategic report; a further 15% included the statement in the directors' report and 8% in the corporate governance statement.

Chapter 8 explains that, similarly, the directors' statement on the robust assessment of principal risks is largely to be found either in the principal risks section of the strategic report or in the longer term viability statement itself.

Despite the huge variations in industry and nature of listed companies, Figure 9.1 shows that 83% of our survey sample looked out over a three year period.

Four companies included disclosure suggesting that the lookout period might change in future. None of these companies had used a three year period – two had used a longer period due to recent forecasting over that longer period and two had looked out over only two years due to current uncertainties in their environment. **Kingfisher plc** has used a five year lookout period and expects it to reduce to three years in future (**Example 9.1**).

70 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf

71 Letter – Re: FRC Guidance on Narrative Reporting (April 2014) https://frc.org.uk/FRC-Documents/Accounting-and-Reporting/BIS-letter-guidance-on-narrative-reporting.pdf

Table 9.1 – How companies reported on the analysis performed for the longer term viability statement

The viability statement refers to the nature of the analysis undertaken	2016
Overall	91%
FTSE 350	93%
Others	88%

Smaller company disclosures are almost as comprehensive as FTSE 350 company disclosures.

The nature of the analysis undertaken	2016
Scenario planning	58%
Sensitivity analysis	63%
Detailed modelling	10%
Qualitative analysis	8%

Over 80% of companies performed a good level of analysis, in many cases combining both scenario planning and sensitivity analysis.

The viability statement indicates which principal risks have been considered	2016
Overall	55%

How have companies indicated which principal risks have been considered	2016
Specific risks named	21%
Cross-reference to the principal risks section	28%
Clear scenarios set out	23%

See **Examples 9.2**, **9.3** and **9.5**.

Risks have been considered both individually and in combination	2016
Overall	39%
FTSE 350	43%
Other	33%

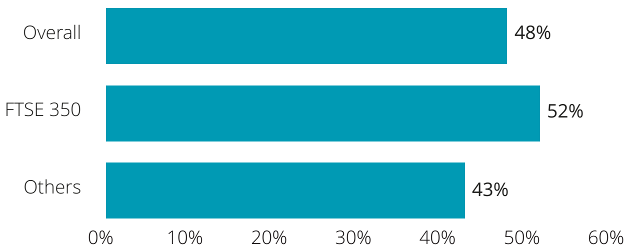
The FRC Risk Guidance anticipates that the effect of principal risks will be considered both individually and in combination. See **Example 9.2**.

92% of our survey sample met the Code requirement to report on why they considered the lookout period selected to be appropriate – this is a relatively easy requirement to meet so it is most likely that the companies that did not had simply overlooked the need to do so.

The Code provision requires companies to report on how they have assessed the prospects of the company. We looked at whether they had described the nature of the analysis they undertook, the nature of the analysis and how they explained which principal risks had been considered.

The final requirement of the Code provision is that companies should draw attention to any qualifications or assumptions as necessary. This would seem to be a great help for companies, meaning that they can explain the basis of their analysis to the reader and allow them to understand fully the exercise undertaken. Therefore, we were surprised to find that, in this first year, fewer than half of our survey sample included qualifications or assumptions. This was compounded as certain of the companies that did not include qualifications or assumptions had ongoing funding requirements that could have been captured in an assumption about availability of funding – which was the most common assumption reported, by 27% of our sample.

Figure 9.2 – How many companies have reported on qualifications or assumptions?

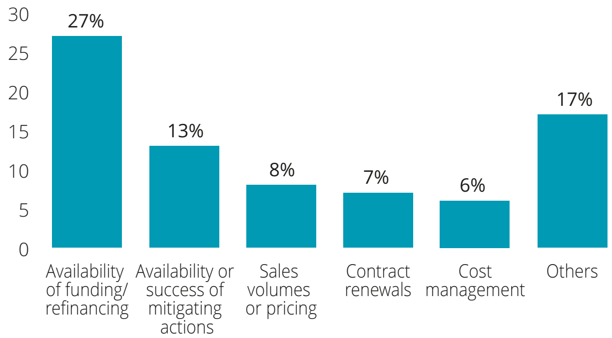


See **Examples 9.1** and **9.3**.

None of the FTSE 100 financial services companies in our sample disclosed the qualifications or assumptions underlying their analysis.

Companies providing clear reporting on qualifications or assumptions include **Shaftesbury PLC (Example 9.3)** and **Dairy Crest Group plc (Example 9.4).**

Figure 9.3 – What qualifications or assumptions were disclosed?



Other qualifications or assumptions were largely industry or company specific in nature.

The going concern statement

Last year, under the 2012 Code, we expected companies to include a going concern statement which covered the requirements of Code provision C.1.3 and also the requirements of the Listing Rules in LR 9.8.6R(3), which added the need to include "supporting assumptions or qualifications as necessary" in the statement. The statement was to be prepared in accordance with the FRC's 2009 guidance[72]. We expected the majority of companies to include their statement in the front half of the annual report and to follow the example disclosures set out in the FRC's 2009 guidance, which recommended a reasonable level of detail covering the factors the directors considered in reaching their conclusion on going concern.

The Listing Rules requirement has now changed, as has the FRC's guidance on what the disclosure should include. With the advent of the longer term viability statement, there is now a separate disclosure that requires the directors to set out their reasoning regarding viability over a longer period, which is now where directors would be expected to include assumptions or qualifications as necessary, in line with 2014 Code provision C.2.2. This year, we expected to see a change to the nature of the separate going concern statement, a reduction in detail provided by companies (to be replaced by disclosure in the longer term viability statement) and we expected fewer companies, where conclusions on going concern should be straightforward, to include a statement in the front half of the annual report. The FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting is clear that the statement referred to in Code provision C.1.3 regarding going concern and any material uncertainties should be in the financial statements.

We have not provided comparative detail for 2015 as the nature of the going concern statement was different under the 2012 Code.

The following table (overleaf) differentiates in most cases between disclosures in the front half of the annual report and those in the financial statements – each question is clear about which version of the going concern statement is considered.

72 https://www.frc.org.uk/FRC-Documents/FRC/Going-Concern-and-Liquidity-Risk-Guidance-for-Dire.aspx

Table 9.2 – The going concern statement – how did companies meet the requirements

A statement in the front half by the directors that the business is a going concern	2016
Overall	97%

The number of companies making the disclosure in the front half of their report was substantially higher than we expected under the new requirements of the 2014 Code. Last year, all companies included a going concern statement in the front half.

How detailed are the going concern disclosures in the financial statements?	2016
Not mentioned at all	7%
Prepared on a going concern basis	26%
Prepared on a going concern basis with a cross-reference to front half going concern disclosure	34%
More detailed disclosure	25%
More detailed disclosure with a cross-reference to front half going concern disclosure	8%

The significant variation in the level of disclosure in the financial statements shows that there is not yet consistency in market practice when meeting the new Code requirements, with some companies including detail in the front half, some in the back half and some in both places. We would expect, and the FRC's guidance encourages, a statement explaining the going concern basis of accounting in the financial statements.

Where is the front half statement on going concern positioned?	2016
Corporate governance statement	19%
Directors' report	42%
Strategic report	31%
Other	8%

The 'other' category here largely represents reports where the statement was in the directors' responsibilities section, or where there was no front half statement. Where there is a more complex conclusion to be reached on going concern, or material uncertainties, the importance of the disclosures could merit including them in the strategic report.

What are the main cross-references from the going concern statement (from either front half or financial statements)	2016
Principal risks	34%
Liquidity	51%
Entire strategic report	29%
Other (mainly financial risk management)	26%

How detailed is the going concern statement?	2016
'Boiler plate' disclosure	31%
Some (limited) detail with no cross-references	15%
Some detail with clear and specific references	31%
Very detailed disclosure	23%

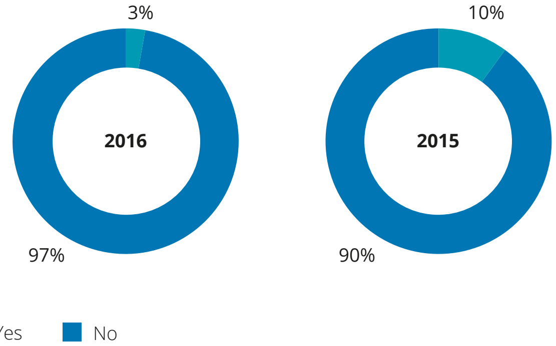
Again, there is not yet consistency in market practice when meeting the new going concern requirements. All companies in our sample with material uncertainties included a disclosure we judged to be 'very detailed'. Last year there were fewer companies with disclosure we assessed as 'boiler plate' (13%). This suggests that companies have taken the opportunity to reduce disclosure on going concern and replace with longer term viability statement disclosure.

The period for which the going concern assessment has been considered	2016
Unclear	12%
12 months	23%
Foreseeable future – no explanation	51%
Foreseeable future – with explanation	9%
Other	5%

We consider the high level of companies describing the period as the 'foreseeable future' with no further explanation is due to the prevalence of the assumption that the 'foreseeable future' is 12 months. However, under the previous version of the going concern statement, 93% did not specify the period they had considered. The change is likely to be due to companies wanting to differentiate the period for the going concern statement from that for the longer term viability statement. The 'other' category largely represents those who indicated a period other than 12 months for the statement – most commonly 15 months

We also considered material uncertainties outlined in the statement, where we would expect similar outcomes to previous years despite the change in the nature of the going concern statement. We have therefore included and assessed 2015 comparatives.

Figure 9.4 – Were material uncertainties discussed in the going concern statement?



All material uncertainty disclosures in our 2016 sample discussed concern about financing, shareholder support and potential breach of covenants. It was noticeable that the number of material uncertainties disclosed in the going concern statement had decreased markedly since 2015. This may be attributable to financing cycles as companies renegotiate funding and reconsider financing options. Several companies in our sample in 2015 that had material uncertainties in that year have undertaken rights issues or renegotiated finance during the year. In each of these cases there is no longer an emphasis of matter in the enhanced auditor's report and in some the auditor provides an explanation of why going concern is no longer a key risk.

Linking the going concern statement and the longer term viability statement

We also wanted to know about the interaction between the going concern statement and the longer term viability statement.

In line with previous surveys[73] we have undertaken, the linkage between the two is clear for just over half of our sample (with certain cross-references being for the same companies as those positioning the going concern statement next to the viability statement).

An example of a company laying out the going concern statement and the longer term viability statement side by side is **Compass Group plc (Example 9.4)** and of a company combining the two statements is **HSBC Holdings plc (Example 9.5)**.

Table 9.3 – Was there any interaction between the going concern statement and the longer term viability statement?

Was there any interaction between the going concern statement and the longer term viability statement?	2016
The going concern statement is positioned next to the viability statement	
Overall	43%
The going concern statement and viability statement are combined	
Overall	8%
The going concern statement cross-refers to the viability statement*	
Overall	17%

*Nine of these cross-references were from the front half; eight were from the financial statements

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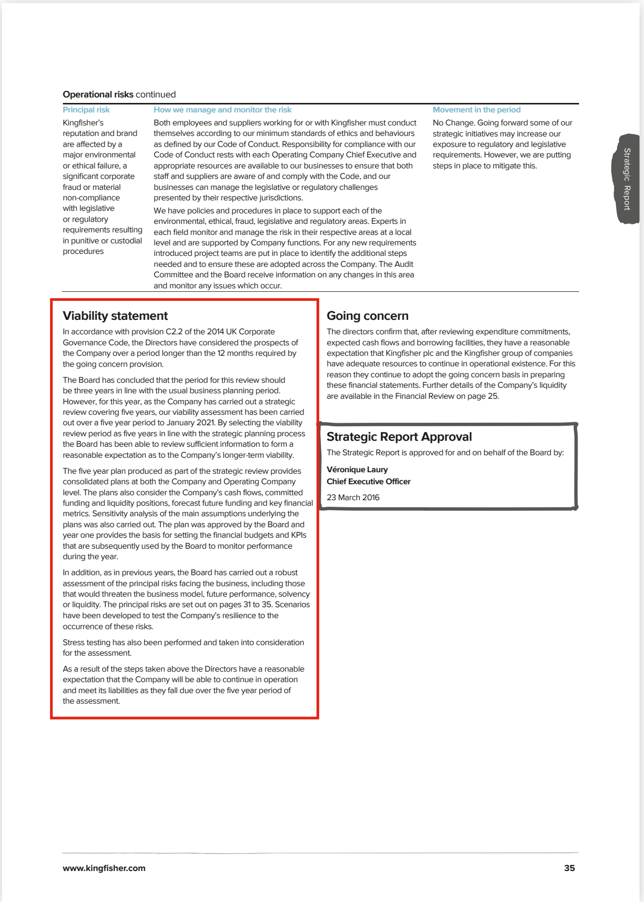
Going concern and viability statements – good practice examples

In this section we highlight a number of going concern and longer term viability statement disclosures which we believe illustrate aspects of good practice. For each example, the aspects of good practice that it illustrates are listed next to it.

Example 9.1

[Kingfisher plc Annual Report 2015/16 (p35)]

Shows rationale for five years in the current year with plans to reduce to three years.



Operational risks continued

Principal risk	How we manage and monitor the risk	Movement in the period
Kingfisher's reputation and brand are affected by a major environmental or ethical failure, a significant corporate fraud or material non-compliance with legislative or regulatory requirements resulting in punitive or custodial procedures	Both employees and suppliers working for or with Kingfisher must conduct themselves according to our minimum standards of ethics and behaviours as defined by our Code of Conduct. Responsibility for compliance with our Code of Conduct rests with each Operating Company Chief Executive and appropriate resources are available to our businesses to ensure that both staff and suppliers are aware of and comply with the Code, and our businesses can manage the legislative or regulatory challenges presented by their respective jurisdictions. We have policies and procedures in place to support each of the environmental, ethical, fraud, legislative and regulatory areas. Experts in each field monitor and manage the risk in their respective areas at a local level and are supported by Company functions. For any new requirements introduced project teams are put in place to identify the additional steps needed and to ensure these are adopted across the Company. The Audit Committee and the Board receive information on any changes in this area and monitor any issues which occur.	No Change. Going forward some of our strategic initiatives may increase our exposure to regulatory and legislative requirements. However, we are putting steps in place to mitigate this.

Viability statement

In accordance with provision C2.2 of the 2014 UK Corporate Governance Code, the Directors have considered the prospects of the Company over a period longer than the 12 months required by the going concern provision.

The Board has concluded that the period for this review should be three years in line with the usual business planning period. However, for this year, as the Company has carried out a strategic review covering five years, our viability assessment has been carried out over a five year period to January 2021. By selecting the viability review period as five years in line with the strategic planning process the Board has been able to review sufficient information to form a reasonable expectation as to the Company's longer-term viability.

The five year plan produced as part of the strategic review provides consolidated plans at both the Company and Operating Company level. The plans also consider the Company's cash flows, committed funding and liquidity positions, forecast future funding and key financial metrics. Sensitivity analysis of the main assumptions underlying the plans was also carried out. The plan was approved by the Board and year one provides the basis for setting the financial budgets and KPIs that are subsequently used by the Board to monitor performance during the year.

In addition, as in previous years, the Board has carried out a robust assessment of the principal risks facing the business, including those that would threaten the business model, future performance, solvency or liquidity. The principal risks are set out on pages 31 to 35. Scenarios have been developed to test the Company's resilience to the occurrence of these risks.

Stress testing has also been performed and taken into consideration for the assessment.

As a result of the steps taken above the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the five year period of the assessment.

Going concern

The directors confirm that, after reviewing expenditure commitments, expected cash flows and borrowing facilities, they have a reasonable expectation that Kingfisher plc and the Kingfisher group of companies have adequate resources to continue in operational existence. For this reason they continue to adopt the going concern basis in preparing these financial statements. Further details of the Company's liquidity are available in the Financial Review on page 25.

Strategic Report Approval

The Strategic Report is approved for and on behalf of the Board by:

Véronique Laury
Chief Executive Officer

23 March 2016

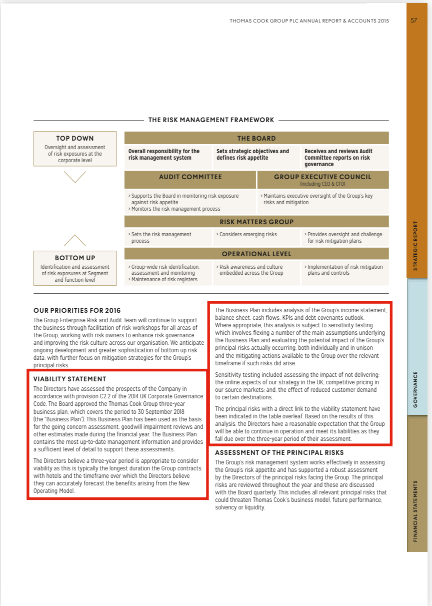
Strategic Report

www.kingfisher.com 35

Example 9.2

[Thomas Cook Group plc Annual Report & Accounts 2015 (p57-59)]

- Refers to principal risks table to indicate which risks are considered to have a direct link to the viability statement – they are clearly indicated there through a star.
- Clear reasons for a three year lookout period.
- Refers to consideration of risks occurring "both individually and in unison."
- Specific detail regarding sensitivities.



Example 9.3

[Shaftesbury PLC Annual Report 2015 (p66)]

- Clear reasons for a five year lookout period.
- Detailed descriptions of key assumptions.
- Analysis of impact of principal risks on viability, setting out scenarios considered.

Example 9.4

[Dairy Crest Group plc Annual Report 2016 (p61)]

- Shows positioning of going concern statement next to viability statement.
- Clear reasons for a three year lookout period.
- Detail about financing assumptions and focus on covenant compliance.

Example 9.3

066 SHAFTESBURY ANNUAL REPORT 2015 **STRATEGIC REPORT**

Viability Statement

In accordance with provision C.2.2 of the 2014 revision of the Code, the Board has assessed the prospects of the Company over a longer period than the twelve months that has in practice been the focus of the 'Going Concern' provision.

The Board conducted the review for a five-year period, corresponding with the period covered by its current forecasts. These forecasts are updated quarterly and reflect the Group's established strategy of investing in London's West End, its existing investment commitments, available financial resources and long-term financing arrangements. They consider profits, cash flows, funding requirements and other key financial ratios over the period, as well as the headroom in the financial covenants contained in our various loan agreements. Important assumptions underlying the forecasts include:

Assumption	Comment
Crystallisation of the portfolio reversionary potential over the period	We have a long record of crystallising the independently-assessed ERV of our portfolio over a three-to-five year period. 63% of the total portfolio reversion comes from shops, restaurants, cafés and pubs, the demand for which, in our locations, is not cyclical and has demonstrated sustained growth over many years. SEE DETAILS ON THE REVERSION ON PAGE 40
The Group had undrawn committed loan facilities at 30 September 2015 totalling £150.3 million, which comfortably exceeds the Group's commitments over the assessment period. This assumes an ability to re-finance revolving credit facilities totalling £150.0 million and £125.0 million which mature in 2018 and 2020 respectively.	The Group maintains a prudent approach to gearing, with debt facilities which are largely fixed and long-term in nature. At 30 September, our loan-to-value ratio was 22.5%. The facilities which mature during the period of assessment represent 18.8% and 15.7%, respectively, of our total committed debt facilities. The Board has reasonable confidence that we shall be able to refinance these facilities and intends to do so in advance of their contractual maturities. SEE THE FINANCE REVIEW ON PAGE 56

The principal risks are set out on pages 61 to 63 and the most relevant potential impact of these risks on viability was considered to be:

- A substantial and sustained decrease in visitor numbers to the West End and our villages which could result in reduced occupier demand, rental income and/or capital values, higher vacancy and declining profitability
- Regulatory changes which reduce profitability and capital values
- Changing economic conditions which reduce capital values, and put pressure on loan covenants

The Board overlaid the potential impact of the principal risks which could affect solvency or liquidity in "severe but plausible" scenarios onto the five-year forecasts and concluded that the business would remain viable. As part of this, they performed sensitivity analyses that flexed inputs to the forecasts including reduced income, profitability and capital values, both individually and in unison, to reflect these severe but plausible scenarios.

Based on the results of the procedures outlined above, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the five-year period of their assessment.

Example 9.4

DIRECTORS' REPORT

The Companies Act 2006 ('CA 2006') together with the UK Listing Authority's Disclosure and Transparency Rules ('DTRs') and Listing Rules ('LRs') require companies to make certain disclosures in their Directors' report. To make the information being presented more accessible and to present it in a more logical and readable sequence, a number of the disclosures required to be made in the Directors' report have been made elsewhere in other sections of this Annual Report. The Strategic report and the Corporate Governance report can be found at pages 2 to 27 and pages 31 to 40 respectively. Details of the Directors in office at the date of this Annual Report can be found at pages 28 to 29. The above-mentioned sections are expressly incorporated by reference into this, the Directors' Report.

Going concern: The Group and Company's business activities, together with factors likely to affect future development, performance and position are set out in the Strategic report from pages 2 to 21. The financial position, cash flows, liquidity position and borrowing facilities are described in the Financial review on pages 12 to 15 (which also form part of the Strategic report). In addition, Notes 30 and 31 to the Accounts include the Group and Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk. As highlighted in Note 30, the Company and Group meet day-to-day working capital requirements through syndicated revolving credit facilities and cash to ensure that forecast net borrowings plus reasonable operating headroom are covered by committed facilities which mature at least 12 months after the year end. At 31 March 2016, effective headroom was £235.3 million. There were no breaches of bank covenants in the year ended 31 March 2016 and projections do not indicate any breaches in the foreseeable future. Having reviewed and taken into account Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009, published by the Financial Reporting Council in October 2009, the Directors are satisfied that the Company and the Group have adequate resources to continue operating for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Viability statement: In accordance with provision C.2.2 of the UK Corporate Governance Code 2014, the directors have assessed the viability of the Group over a three year period. The directors have determined that a three year period to 31 March 2019 is an appropriate period over which to provide its viability statement. This is the period reviewed by the Board in the strategic planning process where assumptions are made around future growth for the existing business, new market opportunities, investment needs and funding requirements of the Group. A robust financial model of the Group is built by product and the metrics for the Group's KPIs and bank covenants are reviewed.

Taking into account the Group's current position and potential impact of the principal risks documented on pages 16 and 17 of the Annual Report, the directors confirm that they have a reasonable expectation that the Company will be able to continue to operate and meet its liabilities as they fall due over the period to 31 March 2019.

In making this statement the Board carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. The Board considers all of the principal risks, the likelihood of crystallisation, the potential net profit impact and the mitigating controls. In assessing the impact of a risk on the viability of the Group, the Board has considered the potential impact that the crystallisation of a severe but plausible risk may have on the Group meeting its bank covenants.

The assumption has been made that the Group will be able to source an appropriate level of funding following the cessation of the £80 million bank facility in October 2018.

Future developments: Future developments are described in the Strategic report at pages 2 to 21.

Group results: The Group's consolidated income statement set out on page 69 shows a loss for the financial year of £113.0 million compared with £20.5 million profit in 2014/15.

Dividends: the Directors are recommending a final dividend of 16.0p (2014/15: 15.7p) per ordinary share, which if approved, will be paid to members whose name appears on the register at the close of business on 8 July 2016. Together, the final dividend and interim dividend (6.1p per ordinary share paid on 28 January 2016) make total dividends for the year of 22.1p per ordinary share (2014/2015: 21.7p).

Directors: Details of the Directors of the Company at the date of this Report are set out at pages 28 to 29.

Directors' interests: Details of the interests in the shares of the Company of the Directors holding office at the date of this Report, along with those of the Directors who held office during the year but retired or resigned from office, and their immediate families appear in the Remuneration Report on page 54. Details of the Directors' service contracts and letters of appointment appear in the Remuneration Report on page 46. No Director had a material interest in any significant contract with the Company or any of its subsidiaries during the year. Procedures for dealing with Directors' conflicts of interest are in place and are operating effectively. The Company maintains liability insurance for its Directors and Officers and those of its subsidiaries. The Directors, Company Secretary and other Officers of the Company and those of its subsidiaries are indemnified by the Company to the extent permitted by company law. That indemnity provision has been in place during the year and remains in force.

Disclosure of information to the Auditor: So far as each Director in office at the date of approval of this Report is aware, there is no relevant audit information of which the Company's External Auditor, Ernst & Young is unaware. Each of the Directors has taken all steps that they might reasonably be expected to have taken in order to (i) make themselves aware of any relevant audit information and (ii) establish that the External Auditor is aware of such information. For the purposes of this statement on disclosure of information to the External Auditor, 'relevant audit information' is the information needed by the Company's External Auditor in connection with the preparation of its report at pages 65 to 68.

Political Donations: No political donations or expenditures were made or incurred during the year.

Financial instruments: Details of the use by the Company and its subsidiaries of financial instruments and any related risk management objectives and policies (including hedging policy) and exposure, including to price risk, credit risk, liquidity risk and cash flow risk (of the Company in connection with such financial instruments) can be found at Note 30 to the financial statements.

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Example 9.5

[HSBC Holdings plc Annual Report and Accounts 2015 (p277-278)]

- Shows combined going concern and viability statement.
- Clear reasons for a three year lookout period.
- Clearly states that all of the principal risks have been considered and why.
- Details about nature of testing, including reverse stress testing.
- Helpful cross-references to other information.

- external audit reports;
- prudential reviews; and
- regulatory reports.

The GRC and GAC have separately established governance frameworks for their respective oversight and interaction with the audit and risk committees of key entities within the Group. These provide for regular reporting, issues escalation and processes for the nomination and endorsement of subsidiary committee appointments. These principles and processes have in turn been cascaded by these key entities to their respective subsidiaries to provide clear vertical channels of governance.

The internal control responsibilities of the GAC and GRC are complemented by the activities of the Conduct & Values Committee ('CVC') and the Financial System Vulnerabilities Committee ('FSVC') which, respectively, oversee internal controls over conduct-related matters and financial crime compliance. The GRC receives regular reports at each of its meetings on the activities of both the CVC and the FSVC. The GRC monitors the status of top and emerging risks and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to Group policies, the GRC and the GAC review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

Effectiveness of internal controls

The Directors, through the GRC and the GAC, have conducted an annual review of the effectiveness of our system of risk management and internal control covering all material controls, including financial, operational and compliance controls, risk management systems, the adequacy of resources, qualifications and experience of staff of the accounting and financial reporting teams and the Global Risk function, and their training programmes and budget. The annual review of effectiveness of our system of risk management and internal control over financial reporting was conducted with reference to the COSO framework. The annual review of other controls was undertaken using the risk management framework on pages 102 to 103.

The GRC and the GAC have received confirmation that executive management has taken or is taking the necessary actions to remedy any failings or weaknesses identified through the operation of our framework of controls. In particular, during the year it was determined that the control environment associated with IT privileged access required significant improvement. Deficiencies were noted in the design and operation of controls for the granting, release and monitoring of privileged access in a number of systems. For the identified deficiencies management responded by implementing a programme to determine the scale and nature of the deficiencies, remediate identified control deficiencies and determine if privileged access had been misused during 2015. Management also identified and assessed the effectiveness of relevant IT, business, monitoring and period-end mitigating controls.

Going concern and viability

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Group and Parent Company have the resources to continue in business for the foreseeable future.

In addition to the requirement to consider whether the going concern basis is appropriate, the Directors now have an obligation under the UK Corporate Governance Code to state in a Viability Statement whether they believe the Group and parent company will be able to continue in operation and meet their liabilities, taking account of their current position and principal risks, our top and emerging risks, and specify the period covered by and the appropriateness of this statement.

It is expected that the period assessed under the Viability Statement will be significantly longer than 12 months, which is the period over which going concern is assessed. For HSBC, the Directors have a reasonable expectation that the Group and parent company will be able to continue in operation and meet liabilities as they fall due over the next three years.

In making the going concern and viability assessments, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows, capital requirements and capital resources.

The assessment has been made over a period of three years as this is within the period covered by the Group's future projections of profitability, the period over which regulatory and internal stress testing is carried out, and the period over which key capital and leverage ratios are forecast. Therefore detailed management information exists for three years, enabling Directors to assess the viability of the Group.

The Directors are satisfied that the period is sufficient to enable a reasonable assessment of viability to be made. In doing so, the Directors have assessed the principal risks (which for the Group are set out in our top and emerging risks on page 43), including the status of the DPA, as more fully described on page 116, that could threaten the Group's future prospects and business model. They considered the effect that those risks could have on the Group's risk profile relative to the risk appetite approved by the Board (see pages 101 and 102). The Directors view all of the identified top and emerging risks as relevant to the assessment of viability. In doing so, the Directors considered the range of information concerning each principal risk, including but not limited to the Annual Operating Plan, the programme of regulatory and internal stress tests, risk appetite and legal reports. The Directors also considered the information from the two reverse stress tests which the Group runs, one based on extreme macroeconomic dislocation in Europe and Asia, the other linked to the DPA. The Directors considered the principal risks in forming the strategic actions set out on page 18, ensuring that the forward-looking risk profile of the Group remained within our risk appetite.

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Corporate Governance
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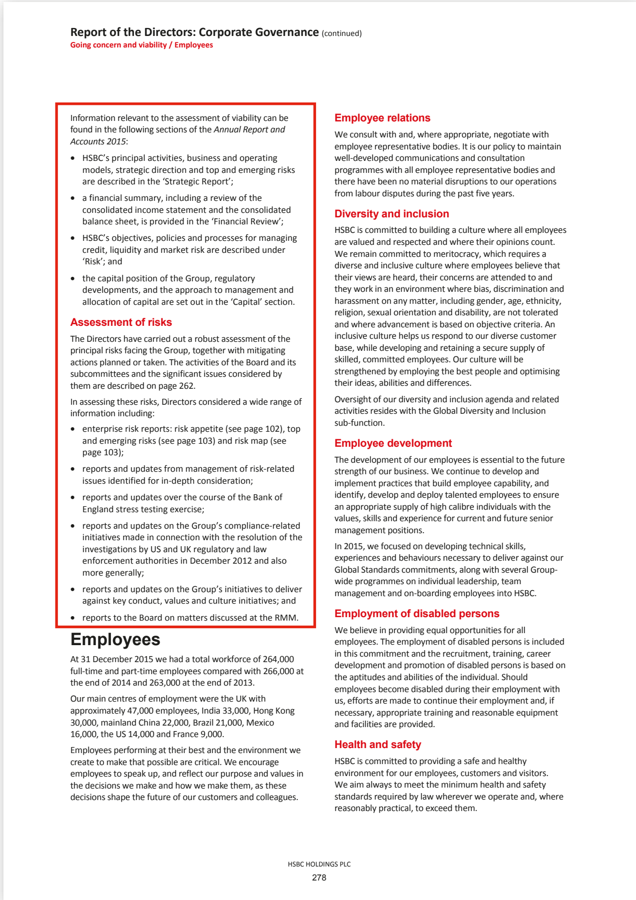

Report of the Directors: Corporate Governance (continued)
Going concern and viability / Employees

Information relevant to the assessment of viability can be found in the following sections of the *Annual Report and Accounts 2015*:

- HSBC's principal activities, business and operating models, strategic direction and top and emerging risks are described in the 'Strategic Report';
- a financial summary, including a review of the consolidated income statement and the consolidated balance sheet, is provided in the 'Financial Review';
- HSBC's objectives, policies and processes for managing credit, liquidity and market risk are described under 'Risk'; and
- the capital position of the Group, regulatory developments, and the approach to management and allocation of capital are set out in the 'Capital' section.

Assessment of risks

The Directors have carried out a robust assessment of the principal risks facing the Group, together with mitigating actions planned or taken. The activities of the Board and its subcommittees and the significant issues considered by them are described on page 262.

In assessing these risks, Directors considered a wide range of information including:

- enterprise risk reports: risk appetite (see page 102), top and emerging risks (see page 103) and risk map (see page 103);
- reports and updates from management of risk-related issues identified for in-depth consideration;
- reports and updates over the course of the Bank of England stress testing exercise;
- reports and updates on the Group's compliance-related initiatives made in connection with the resolution of the investigations by US and UK regulatory and law enforcement authorities in December 2012 and also more generally;
- reports and updates on the Group's initiatives to deliver against key conduct, values and culture initiatives; and
- reports to the Board on matters discussed at the RMM.

Employees

At 31 December 2015 we had a total workforce of 264,000 full-time and part-time employees compared with 266,000 at the end of 2014 and 263,000 at the end of 2013.

Our main centres of employment were the UK with approximately 47,000 employees, India 33,000, Hong Kong 30,000, mainland China 22,000, Brazil 21,000, Mexico 16,000, the US 14,000 and France 9,000.

Employees performing at their best and the environment we create to make that possible are critical. We encourage employees to speak up, and reflect our purpose and values in the decisions we make and how we make them, as these decisions shape the future of our customers and colleagues.

Employee relations

We consult with and, where appropriate, negotiate with employee representative bodies. It is our policy to maintain well-developed communications and consultation programmes with all employee representative bodies and there have been no material disruptions to our operations from labour disputes during the past five years.

Diversity and inclusion

HSBC is committed to building a culture where all employees are valued and respected and where their opinions count. We remain committed to meritocracy, which requires a diverse and inclusive culture where employees believe that their views are heard, their concerns are attended to and they work in an environment where bias, discrimination and harassment on any matter, including gender, age, ethnicity, religion, sexual orientation and disability, are not tolerated and where advancement is based on objective criteria. An inclusive culture helps us respond to our diverse customer base, while developing and retaining a secure supply of skilled, committed employees. Our culture will be strengthened by employing the best people and optimising their ideas, abilities and differences.

Oversight of our diversity and inclusion agenda and related activities resides with the Global Diversity and Inclusion sub-function.

Employee development

The development of our employees is essential to the future strength of our business. We continue to develop and implement practices that build employee capability, and identify, develop and deploy talented employees to ensure an appropriate supply of high calibre individuals with the values, skills and experience for current and future senior management positions.

In 2015, we focused on developing technical skills, experiences and behaviours necessary to deliver against our Global Standards commitments, along with several Group-wide programmes on individual leadership, team management and on-boarding employees into HSBC.

Employment of disabled persons

We believe in providing equal opportunities for all employees. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes and abilities of the individual. Should employees become disabled during their employment with us, efforts are made to continue their employment and, if necessary, appropriate training and reasonable equipment and facilities are provided.

Health and safety

HSBC is committed to providing a safe and healthy environment for our employees, customers and visitors. We aim always to meet the minimum health and safety standards required by law wherever we operate and, where reasonably practical, to exceed them.

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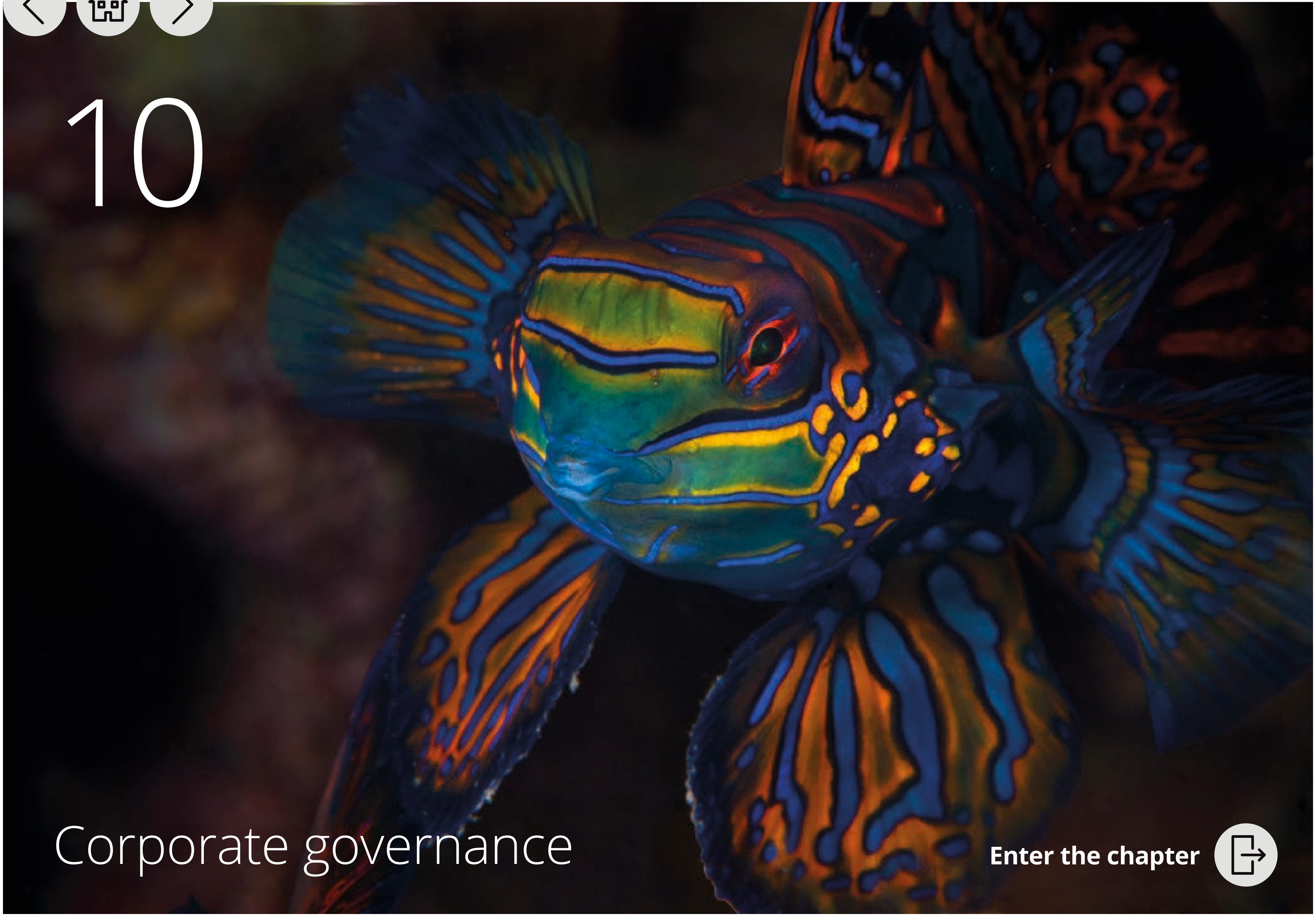

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Corporate governance

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Corporate governance

Top tips

- Comply or explain – a meaningful explanation should be provided for all departures from a Code provision during the year, regardless of when the non-compliance first took place. The explanation should include company-specific context and any mitigating actions. This year we considered that 68% of companies surveyed provided an adequate explanation of the reasons for any non-compliance.

- Good explanations of departures from the Code are an opportunity to describe to users of the annual report the approach the company takes to corporate governance and to make its journey real.

- Additional information on directors is particularly helpful for FTSE 350 companies, where there is a requirement for annual re-election, but all companies should consider adding detail on the contribution each director makes to the board – this was done by 38% of companies surveyed this year.

- Make sure to maintain a focus on current key topics: culture and succession planning. Is there a good story to tell?

- Consider including information on how the board monitors and shows ownership of the corporate culture, with cross-references as necessary to the strategic report. How does the board hold management to account? This year 35% of companies surveyed included a good discussion of corporate culture, either in the strategic report or the governance section.

Keep an eye on

- Whether it is clear in the annual report that the board is monitoring risk management and internal control systems on an ongoing basis. 85% of companies surveyed had disclosures that made it clear that the board monitors risk management and internal control systems on an ongoing basis.

- Whether a significant failing or weakness has been identified as part of the annual review of effectiveness of internal control. If so, remember to make it clear what actions have been or are being taken to remedy the failing or weakness identified – this was a change in the FRC's 2014 Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

- Vulnerability to cyber risk, a current area of focus. It is worth reporting on the governance activities undertaken at board level to understand and set a strategy around cyber risk and to hold the executive to account in this area. Overall, 43% of companies surveyed included disclosure about board activity on cyber risk.

Introduction

Listed companies are required by the Listing Rules to make certain disclosures about corporate governance in their annual reports. Companies with a premium listing are required to state how they have applied the main principles set out in the UK Corporate Governance Code (the Code), in a manner that would enable shareholders to evaluate how the principles have been applied, and a statement of compliance with all relevant Code provisions, identifying provisions that have not been complied with and providing reasons for this non-compliance. During the period covered by this year's survey companies had to report on their compliance with the 2014 Code, which is supported by the associated FRC documents Guidance on Risk Management, Internal Control and Related Financial and Business Reporting and the 2012 version of the Guidance on Audit Committees, both of which recommend various disclosures for inclusion in the annual report.

The Disclosure Guidance and Transparency Rules (the DTR) also requires companies listed on the main market, amongst others, to include certain corporate governance disclosures, such as a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process (DTR 7). There is a degree of overlap between the requirements of the Code and of the DTR.

The 2014 Code introduced changes to the requirements in three principal areas: going concern and longer term viability; risk management and internal control; and remuneration and shareholder engagement.

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Going concern and statement of longer term viability: The annual report should include two distinct statements – the board's confirmation of the appropriateness of the going concern basis of accounting and a broader, longer term assessment by the Board of the company's ongoing viability. (See chapter 9 'Going concern and viability statements').

Risk management and internal control: Boards have to monitor risk management and internal control systems on an ongoing basis, rather than reviewing effectiveness once a year. They should also undertake a robust assessment of the principal risks that might threaten the company's business model, future performance, solvency or liquidity and explain actions taken to remedy any failings or weaknesses identified. (See chapter 8 'Principal risks and uncertainties').

Remuneration and shareholder engagement: Boards should focus on the long-term success of the company when setting remuneration policy and include clawback and malus provisions. There is also a provision requiring companies to explain what action they intend to take in response to situations where a significant proportion of votes have been cast against a resolution at any general meeting. This is likely to be relevant where there is a significant vote against accepting the directors' remuneration report. The way in which companies structure their remuneration reports is discussed in chapter 4.

Where we consider it informative, we have analysed the results between FTSE 100, FTSE 250 and other listed companies separately, to allow trends within those categories to be identified.

<IR> Governance

The <IR> Framework requires an integrated report to provide insight about how the governance arrangements contribute to a company's ability to create value. What a company chooses to disclose can be substantially affected by a company's understanding of the focus its stakeholder groups have on its governance arrangements.

Areas of focus could include the following.

- The corporate governance statement, for example:
  - the way that regulatory requirements influence the design of the governance structure and whether the structure put in place meets or exceeds regulatory requirements;
  - processes used by the company to make strategic decisions and to establish and monitor the company's culture, especially with regard to risk management;
  - actions those charged with governance have taken to influence the strategic direction of the company; or
  - how the board promotes and enables innovation.
- The nomination committee report – the skills and diversity of those charged with governance
- The remuneration committee report – how remuneration and incentives are linked to value creation and the effects on the capitals.

In the UK environment, many of the goals set out in the <IR> Framework coincide with the goals of the FRC to provide sufficient insight to stakeholders in the company. As such, a genuine focus on applying both the spirit and the letter of the UK Corporate Governance Code and its guidance, together with some additional cross-referencing, will lead to a company's report meeting the requirements of the <IR> Framework.

Compliance with the Code

The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that will contribute to the long-term success of the company.

All companies in our sample included a statement of compliance or partial compliance with the Code. The number of companies reporting full compliance with the 2014 Code increased to 56%, from 51% reporting full compliance with the 2012 Code last year.

We continue to see full compliance diminishing with the size of the company, despite the Code having some relaxations for smaller companies. This year 79% (2015: 78%) of the FTSE 100 companies surveyed reported full compliance with the Code, compared with 56% (2015: 51%) of FTSE 250 companies surveyed and only 45% (2015: 40%) of the companies outside the FTSE 350.

Comply or explain

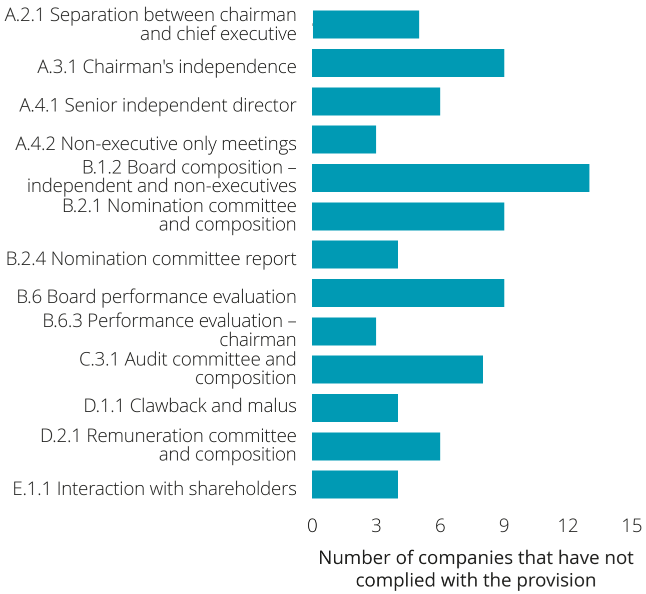
The Listing Rules require companies to set out the provisions they have not complied with along with the reasons they have not complied. In general, the quality of explanations has been improving over the last few years and this is supported by our survey (68% of companies provided an adequate explanation of the reasons for their non-compliance) and has been highlighted by the FRC in their annual Developments in Corporate Governance and Stewardship reports[74]. A high quality explanation can provide useful information to investors enabling them to come to a view of the company's departure from a Code provision and, in many cases, to understand the company's position.

Despite this improving picture on explanations for non-compliance, we did note that some companies had failed to provide an adequate explanation where a non-compliance had taken place (and may have been explained) in a previous year, but no explanation was given this year of the continuing non-compliance. Several of these had not complied with Code provisions A.2.1 and / or A.3.1, which are the provisions that require that the role of chairman and chief executive are not exercised by the same person, and that a chief executive should not go on to become chairman of the same company. We consider that it is helpful to investors – and compliant with the Listing Rules – to provide reasons even where the original non-compliance took place in a prior year.

Although **Johnson Matthey Plc's** departure from the Code first took place in a previous year, the quality of the explanation is high and actions to mitigate the effect of the departure are explained **(Example 10.1)**. Other examples of good explanations include AO World Plc and Bodycote plc.

Figure 10.1 shows the most common areas of non-compliance with the code.

Figure 10.1 What are the most common areas of non-compliance with the Code across all companies surveyed?



The most common areas of non-compliance relate to board and committee composition, the independence of the chairman and board performance evaluation. This is broadly consistent with the nature and proportion of non-compliance that we saw in 2015.

One company reported temporary and partial non-compliance with a new element of a provision in the 2014 Code, provision C.2.3, reporting that ongoing monitoring by the board started part-way through the year. This was a good example of a company explaining its journey towards compliance with the new requirements and acknowledging the work it has been performing towards full compliance with the Code.

Ownership of corporate governance

The preface to the Code encourages chairmen to report personally on how the principles relating to the role and effectiveness of the Board have been applied. The most common approach from chairmen continues to be the provision of an introductory letter to shareholders at the start of the corporate governance section and cross-reference to other parts of the corporate governance statement or Strategic Report (for risk management and the viability statement) as appropriate. This year, 77% of chairmen (2015: 81%) clearly took ownership of the corporate governance section of the annual report. Of the 92% of companies that included a chairman's statement in the strategic report, 33% included reference to governance arrangements which address how the principles have been applied in that statement.

74 https://frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-governance/UK-Corporate-Governance-Code.aspx

NMC Health plc provided a good example of reporting personally in the chairman's statement in their strategic report (**Example 10.2**), whilst good examples of chairman's introductions to the corporate governance section include **The Unite Group plc (Example 10.3)** and **Barclays PLC (Example 10.4)**.

We discuss board performance evaluation in chapter 11 on nomination committee reporting.

The board of directors

Two areas where we are seeing developments in reporting are:

- a move to explain more clearly the contribution each board member makes; and
- companies providing more detail around the rigorous review applied to a non-executive director term beyond six years (Code provision B.2.3).

Both of these are very helpful to investors, particularly investors in FTSE 350 companies who are asked to vote every year on the re-election of directors. A greater understanding of what each board member brings to the table and what relevant expertise they have derived from their past C.V. can be used alongside the summary of experience when drawing conclusions on the value the board member offers. 38% of our full survey sample provided such disclosure this year and 48% of the FTSE 350 survey sample. Good, yet very different examples, include **Centrica plc (Example 10.5)** and **Jardine Lloyd Thompson Group plc (Example 10.6)**.

Similarly, where the board is putting forward a long-serving non-executive director for re-election, it is helpful for investors to understand the reason the board believes retaining the director is in the best interests of the company and whether and how the director continues to be deemed to be independent. This disclosure was provided by 30% of our full survey sample in the current year and 33% of the FTSE 350 survey sample, in both cases this percentage based on those companies that had non-executive directors who had served for over six years. Good examples include **Fidessa group plc (Example 10.7)** and **Savills plc (Example 10.13)**.

We explore the diversity and succession of the board in chapter 11 Nomination committee reporting.

Culture

The FRC has now issued a report of observations emerging from its culture project: Corporate Culture and the Role of Boards[75]. This gives a clear message that companies need to have a strong purpose, culture and ethical values to succeed and be sustainable in the longer term. The public, the media and government are asking more questions about corporate purpose, including contribution to society, taxation and the behaviour of directors.

The FRC believes that more can be done to improve corporate reporting in this area, with investors believing there is not enough visibility on culture and values in annual reports. There are opportunities to provide meaningful insight into culture through the annual report, including:

- providing a sufficiently good explanation of the business model and the principal risks to the business to enable the reader to understand actions the company takes around culture;
- focusing on actions the company has taken around culture, ethics and human capital initiatives;
- practical illustrations of how the company expects its business to be conducted in given circumstances; and
- non-financial metrics, including on human capital.

75 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Repor-(1).pdf

Non-financial metrics and indicators need to be relevant to investors and appropriate to the company and its industry, with the goal of reliable and consistent data allowing measurement year on year and against peers – also see chapter 7 Key performance indicators.

The FRC's figures are that only 14% of annual reports discuss corporate culture – the following table shows our findings based on our survey sample. It is disappointing to note that the results of our survey show that good disclosure of how the board owns and drives corporate culture has actually reduced somewhat since 2015. Perhaps that is a result of companies waiting for the results of the FRC's project; we hope to see a significant increase in our 2017 survey sample.

Table 10.1 – How has corporate culture been discussed in the annual report?

How has corporate culture been discussed in the annual report?	2016	2015
There is specific discussion of how the board owns and drives corporate culture	11%	15%
There is a good discussion in the strategic report	26%	19%
There is discussion but it is not sufficiently specific	12%	20%

76 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf

Good examples of discussion of corporate culture in the corporate governance section include **Marks and Spencer Group plc (Example 10.14)** and **Pearson plc (Example 10.15)**, where culture is the responsibility of the Reputation and Responsibility Committee.

Good examples of discussion of corporate culture in the strategic report include **Rotork Plc (Example 10.16)** and **Premier Oil plc (Example 10.17)**.

Only two companies in our sample referred to any assurance being undertaken around culture within the organisation. An example of a case study around embedding culture throughout the business is given by **Unilever (Example 10.18).** This echoes one of the FRC's recommendations to illustrate the work performed.

Internal control and risk management

Code provision C.2.3 requires that the board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[76] clarifies that monitoring needs to take place on an ongoing basis. This year, 100% of our sample (2015: 100%) provided an internal control statement in line with the Code and 85% had disclosures that made it clear that the board monitors risk management and internal control systems on an ongoing basis.

Good examples are **Findel plc (Example 10.8)** and **G4S plc (Example 10.9).**

Table 10.2 – Internal control statement – what does it include?

Internal control statement – what does it include?	2016	2015
A summary of the process which the board has applied in reviewing the effectiveness of the systems of risk management and internal control		
Overall	98%	89%
The increase is likely attributable to the increased focus on risk management arising from the implementation of the 2014 Code.		
A definition of 'material controls' is provided		
Overall	2%	Not surveyed
There is no requirement to do this but the FRC Guidance refers to monitoring of 'material controls'.		
Have any internal control breakdowns been identified?		
Yes	8%	Not surveyed
Confirmation that no breakdowns have occurred	44%	Not surveyed
No comment	48%	Not surveyed
We would expect a higher proportion of companies to report clearly on the outcome of the board's review.		
There is an explanation of what actions have been or are being taken to remedy any significant failing or weakness identified from the review		
Overall	4%	Not surveyed
This represents only half of companies that reported a breakdown in internal control.		

Cyber security and governance

Organisations have never been more at risk from cyber-attacks. Recent high-profile attacks on companies in the retail, media and industrial sectors have highlighted the type of damage that can be done by hackers and cyber terrorists. This growing threat comes at a time when there is also increasing focus on how organisations manage risk. Regulators, investors and senior executives are putting companies under pressure to explain how they identify risks to their business and how they ensure these are being managed within an agreed risk appetite. The increasing incidence of cyber risk or IT security risk in annual report principal risks is highlighted in chapter 8.

The UK Government runs an annual survey of cyber governance[77] covering the FTSE 350. The most recent results showed that board awareness of the nature and impact of cyber risk continues to improve, demonstrated by a notable increase in the number of companies who include cyber as a primary group risk, to 49% from 29%. 71% of the respondents to the Government's survey expected net cyber risk to increase over the next year. Our survey findings in chapter 8 indicate that, of our FTSE 350 sample, 66% identified cyber risk as a principal risk.

77 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/521484/Cyber_Governance_Health_Check_report_2015.pdf

We would expect this increase in attention and in cyber risk being identified as a principal risk to lead to an increase in board activity around cyber risk and IT security. Given the external focus on this risk and the publicity around data breaches, we wanted to see how many boards reported on the activity they undertook to understand cyber risk, to set a strategy and to challenge the executive around the work they had done to manage the risk.

Table 10.3 – Board activity around cyber risk/IT security

Board activity around cyber risk / IT security	2016	2015
Overall	43%	32%
FTSE 100	79%	56%
FTSE 250	59%	41%
Others	12%	14%

Most FTSE 350 boards undertook activity themselves around cyber risk, compared to smaller companies who rarely reported such activity.

The table shows that, for FTSE 350 companies, there is a significant increase in the board referring to activity around cyber risk and IT security compared to last year.

Similar to last year, there was a wide variety of approaches taken to disclosure around board activity on cyber risk and IT security. Disclosures included:

- mention of the risk as an area of board focus in the chairman's introduction to the corporate governance section;
- receipt and review of reports or presentations on the topic by the audit committee, the risk committee or the full board;
- review of the results of the Government's Cyber Governance Health Check Tracker Report;
- part of a deep dive risk review;
- an area of focus for internal audit;
- an area on which the board has received independent assurance;
- the establishing of a committee, such as a technology committee or cyber security committee, as a committee of the board or a sub-committee of the executive committee;
- part of training for directors; or
- an area of focus for the year arising from previous board performance evaluation.

Only 3% of our survey sample indicated that they had a director on the board with cyber security or IT expertise.

Given the variety of approaches, disclosures are of varying length and quality, however good examples include **National Grid plc (Example 10.10)** and **IP Group plc (Example 10.11)**.

Corporate governance – good practice examples

In this section we highlight a number of disclosures of governance arrangements which we believe represent good practice. For each example, the aspects of good practice that it illustrates are listed next to it.

Example 10.1

Johnson Matthey Plc Annual Report and Accounts 2016 (p97)

- Description of the Code provision not complied with.
- Clear reasons for non-compliance with the provision.
- Approach to mitigating non-compliance.

Example 10.2

NMC Health plc Annual Report and Accounts 2015 (p4)

- Chairman's statement in the Strategic Report addresses the board's approach to more than one Principle of the Code.
- Recognises new developments in governance landscape.
- Highlights new developments in the board's approach.

Example 10.1

Example 10.2

Overview

Chairman's 2015 report to shareholders continued

GROUP FINANCING AND VIABILITY
Any period of substantial growth and capital development needs to be progressed against a background of a strong financial base. As I reported last year, in February 2015 the Company announced a new US$825m financing facility which was made up of two elements, namely a US$350m facility to repay existing debt and for general corporate purposes, and a US$475m facility to facilitate strategic acquisitions.

This strong financial base enabled the Company to restructure existing loans, reduce its cost of funds and create additional headroom to ensure that the Group is conservatively financed.

RISK
Our Group businesses deal with risk every day in operating and in planning within their particular business or facility. The Board has always considered strategic risks in operating our businesses, executing our growth strategy and reviewing potential acquisitions. In Q4, 2014 the management team, supported by PwC, implemented a full risk identification process with the risks facing the business developed through a bottom-up/top-down review process which has been, and will be, reviewed during each financial year. There have been a few changes to the Group's risk profile in the last 12 months including specific focus on those risks which are inherent as part of an acquisitive strategy for growth. A list of the risks facing the Group, how these are mitigated and what effect the principal risks could have on the Group are set out on pages 37 to 39.

The Board has taken a proactive stance in considering risk, and the board sees this as an essential element in the successful development of the Group and in creating long term value for our shareholders.

GOVERNANCE/VIABILITY
Your Board has been evolving in size, skill sets and cultural diversity since the Company's IPO in 2012. You will have noted in previous Annual Reports that the Board considered that an appraisal of its own performance was not appropriate in previous years given its changing nature and the continuing development of Board processes which were considered appropriate as the Group grew in size and complexity.

However, in December 2015 the Board did undertake an appraisal process by way of a questionnaire completed by Board members. This appraisal concluded that, in the Board's view, its structure, composition, processes and discussions are appropriate for NMC at the current time. Of course we will now appraise ourselves each year and continue to develop as a Board team.

The other governance related focus for the Board and the Company this year has been the inclusion of a Viability Statement as recommended under the 2014 UK Corporate Governance Code. The new requirement to make a statement in relation to our longer term viability is different in nature to the traditional consideration of whether we can continue to prepare our accounts on a Going Concern basis on a forward 12 month time frame. The Board has reviewed the Company's viability over a three year timeframe and our Viability Statement is included on page 89.

DIVIDEND
As a result of the continued good performance and financial stability of the Company, your Board plans to submit a resolution to shareholders at the 2016 Annual General Meeting authorising payment of a cash dividend of 6.2 pence per share, an increase of 14.8% compared to the 2014 dividend payment as shareholders continue to benefit from the improved performance of the Group. For the fourth year running this is approximately 20% of profit after tax, within the range which the Board indicated at the time of the Company's IPO would be their dividend target.

BOARD
2014 saw significant changes in the size and structure of the Board. During the 2015 financial year, however, there were no board changes, with the board structured with:

- A wider cultural and ethnic mix benefitting Board discussions given the Company's listing in the UK and operations in the UAE;
- Significant female representation (33%) on the Board;
- More than half of its number resident in the UAE, the Company's home market; and
- A wide range of skills and experience, including more than half of the Board having significant operational or regulatory experience of healthcare services from different parts of the world.

Heather Lawrence has since year end decided to step down from the Board with her resignation effective on 12 January 2016. Heather joined the Board in March 2012 prior to the Company's IPO and as well as serving on the Audit Committee, was instrumental in the Board setting up the Clinical Governance Committee to provide Board oversight of quality and safety in the Group's healthcare division. The Board are very grateful for her contribution over the last three years and wish her well for the future.

MANAGEMENT AND STAFF
The management team was restructured with effect from 1 January 2015 when Prasanth Manghat was appointed Deputy Chief Executive Officer and Suresh Krishnamoorthy was appointed Chief Financial Officer. Prasanth Manghat has been assisting Dr Shetty in both managing the Group businesses and in executing the next phase of our strategic growth plan. Mr Krishnamoorthy has ensured that the Group is in a good financial position to be able to progress this strategy. The Board is delighted with the excellent progress that the Executive Directors and Senior Management Team have made in growing the Group in 2015.

Across the Group, we continue to consider the Company's human capital as vital to the success of your Company, particularly during this period of significant change and growth. We have welcomed new businesses and employees to the NMC family and both the Board and I would like to thank them all, whether new or long time employees, for their continued commitment, contribution, energy and goodwill during this period of change.

OUTLOOK
Despite some challenging economic conditions within some of the markets where we operate due largely to the fall in the price of oil, the anticipated growth in private healthcare, in the UAE and the wider GCC continues to be generally favourable and your Board continues to view the outlook for your Group with confidence.

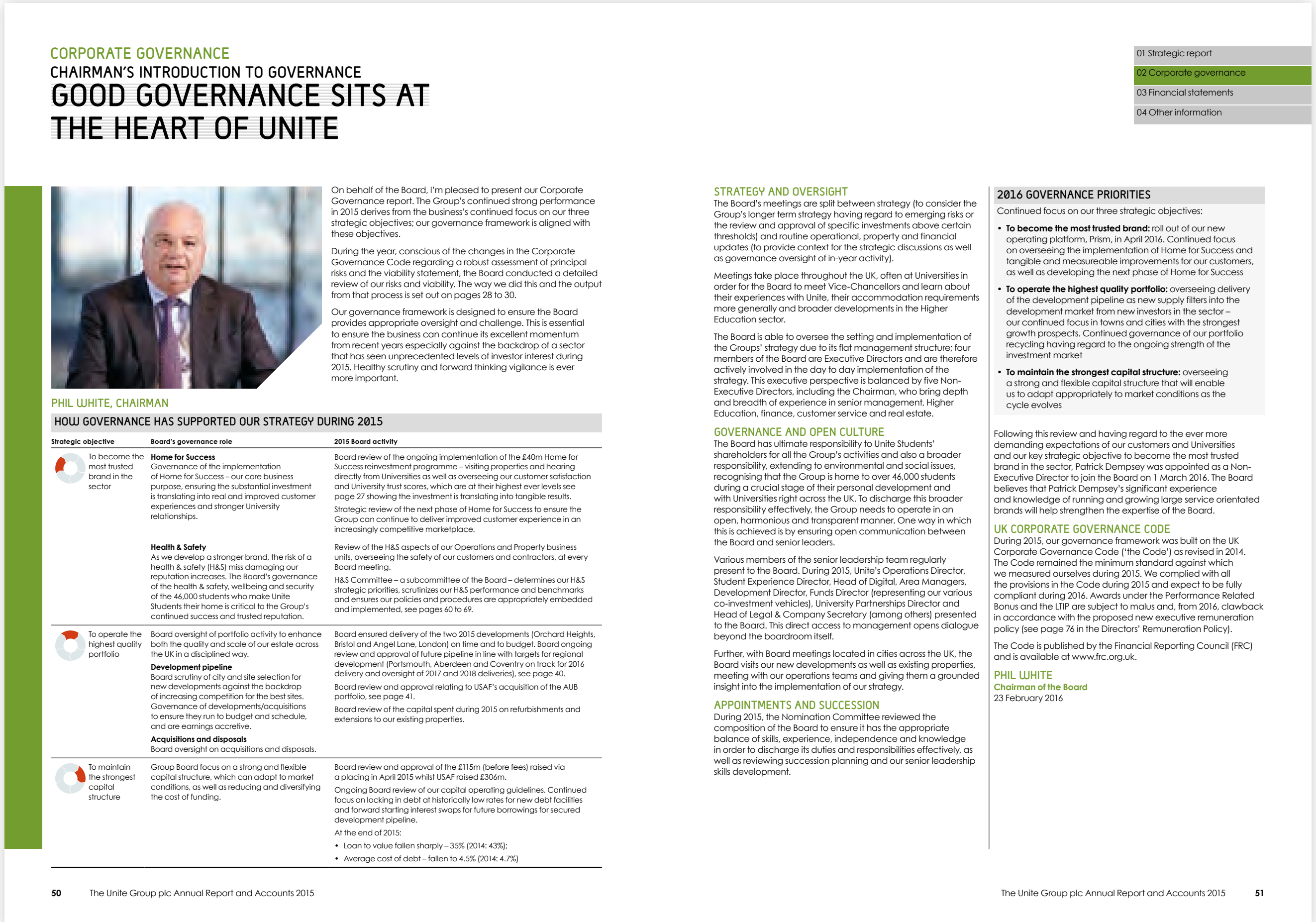
H.J. MARK TOMPKINS
Non-Executive Chairman

4 NMC Health plc Annual Report and Accounts 2015

Example 10.3

The Unite Group plc Annual Report and Accounts 2015 (p50-51)

- Chairman's introduction to the corporate governance statement.
- Demonstrates how good governance contributes to company success.



CORPORATE GOVERNANCE

CHAIRMAN'S INTRODUCTION TO GOVERNANCE

GOOD GOVERNANCE SITS AT THE HEART OF UNITE

PHIL WHITE, CHAIRMAN

On behalf of the Board, I'm pleased to present our Corporate Governance report. The Group's continued strong performance in 2015 derives from the business's continued focus on our three strategic objectives; our governance framework is aligned with these objectives.

During the year, conscious of the changes in the Corporate Governance Code regarding a robust assessment of principal risks and the viability statement, the Board conducted a detailed review of our risks and viability. The way we did this and the output from that process is set out on pages 28 to 30.

Our governance framework is designed to ensure the Board provides appropriate oversight and challenge. This is essential to ensure the business can continue its excellent momentum from recent years especially against the backdrop of a sector that has seen unprecedented levels of investor interest during 2015. Healthy scrutiny and forward thinking vigilance is ever more important.

HOW GOVERNANCE HAS SUPPORTED OUR STRATEGY DURING 2015

Strategic objective	Board's governance role	2015 Board activity
To become the most trusted brand in the sector	**Home for Success** Governance of the implementation of Home for Success – our core business purpose, ensuring the substantial investment is translating into real and improved customer experiences and stronger University relationships.	Board review of the ongoing implementation of the £40m Home for Success reinvestment programme – visiting properties and hearing directly from Universities as well as overseeing our customer satisfaction and University trust scores, which are at their highest ever levels see page 27 showing the investment is translating into tangible results. Strategic review of the next phase of Home for Success to ensure the Group can continue to deliver improved customer experience in an increasingly competitive marketplace.
	Health & Safety As we develop a stronger brand, the risk of a health & safety (H&S) miss damaging our reputation increases. The Board's governance of the health & safety, wellbeing and security of the 46,000 students who make Unite Students their home is critical to the Group's continued success and trusted reputation.	Review of the H&S aspects of our Operations and Property business units, overseeing the safety of our customers and contractors, at every Board meeting. H&S Committee – a subcommittee of the Board – determines our H&S strategic priorities, scrutinizes our H&S performance and benchmarks and ensures our policies and procedures are appropriately embedded and implemented, see pages 60 to 69.
To operate the highest quality portfolio	Board oversight of portfolio activity to enhance both the quality and scale of our estate across the UK in a disciplined way. **Development pipeline** Board scrutiny of city and site selection for new developments against the backdrop of increasing competition for the best sites. Governance of developments/acquisitions to ensure they run to budget and schedule, and are earnings accretive. **Acquisitions and disposals** Board oversight on acquisitions and disposals.	Board ensured delivery of the two 2015 developments (Orchard Heights, Bristol and Angel Lane, London) on time and to budget. Board ongoing review and approval of future pipeline in line with targets for regional development (Portsmouth, Aberdeen and Coventry on track for 2016 delivery and oversight of 2017 and 2018 deliveries), see page 40. Board review and approval relating to USAF's acquisition of the AUB portfolio, see page 41. Board review of the capital spent during 2015 on refurbishments and extensions to our existing properties.
To maintain the strongest capital structure	Group Board focus on a strong and flexible capital structure, which can adapt to market conditions, as well as reducing and diversifying the cost of funding.	Board review and approval of the £115m (before fees) raised via a placing in April 2015 whilst USAF raised £306m. Ongoing Board review of our capital operating guidelines. Continued focus on locking in debt at historically low rates for new debt facilities and forward starting interest swaps for future borrowings for secured development pipeline. At the end of 2015: • Loan to value fallen sharply – 35% (2014: 43%); • Average cost of debt – fallen to 4.5% (2014: 4.7%)

STRATEGY AND OVERSIGHT

The Board's meetings are split between strategy (to consider the Group's longer term strategy having regard to emerging risks or the review and approval of specific investments above certain thresholds) and routine operational, property and financial updates (to provide context for the strategic discussions as well as governance oversight of in-year activity).

Meetings take place throughout the UK, often at Universities in order for the Board to meet Vice-Chancellors and learn about their experiences with Unite, their accommodation requirements more generally and broader developments in the Higher Education sector.

The Board is able to oversee the setting and implementation of the Groups' strategy due to its flat management structure; four members of the Board are Executive Directors and are therefore actively involved in the day to day implementation of the strategy. This executive perspective is balanced by five Non-Executive Directors, including the Chairman, who bring depth and breadth of experience in senior management, Higher Education, finance, customer service and real estate.

GOVERNANCE AND OPEN CULTURE

The Board has ultimate responsibility to Unite Students' shareholders for all the Group's activities and also a broader responsibility, extending to environmental and social issues, recognising that the Group is home to over 46,000 students during a crucial stage of their personal development and with Universities right across the UK. To discharge this broader responsibility effectively, the Group needs to operate in an open, harmonious and transparent manner. One way in which this is achieved is by ensuring open communication between the Board and senior leaders.

Various members of the senior leadership team regularly present to the Board. During 2015, Unite's Operations Director, Student Experience Director, Head of Digital, Area Managers, Development Director, Funds Director (representing our various co-investment vehicles), University Partnerships Director and Head of Legal & Company Secretary (among others) presented to the Board. This direct access to management opens dialogue beyond the boardroom itself.

Further, with Board meetings located in cities across the UK, the Board visits our new developments as well as existing properties, meeting with our operations teams and giving them a grounded insight into the implementation of our strategy.

APPOINTMENTS AND SUCCESSION

During 2015, the Nomination Committee reviewed the composition of the Board to ensure it has the appropriate balance of skills, experience, independence and knowledge in order to discharge its duties and responsibilities effectively, as well as reviewing succession planning and our senior leadership skills development.

2016 GOVERNANCE PRIORITIES

Continued focus on our three strategic objectives:

- **To become the most trusted brand:** roll out of our new operating platform, Prism, in April 2016. Continued focus on overseeing the implementation of Home for Success and tangible and measureable improvements for our customers, as well as developing the next phase of Home for Success
- **To operate the highest quality portfolio:** overseeing delivery of the development pipeline as new supply filters into the development market from new investors in the sector – our continued focus in towns and cities with the strongest growth prospects. Continued governance of our portfolio recycling having regard to the ongoing strength of the investment market
- **To maintain the strongest capital structure:** overseeing a strong and flexible capital structure that will enable us to adapt appropriately to market conditions as the cycle evolves

Following this review and having regard to the ever more demanding expectations of our customers and Universities and our key strategic objective to become the most trusted brand in the sector, Patrick Dempsey was appointed as a Non-Executive Director to join the Board on 1 March 2016. The Board believes that Patrick Dempsey's significant experience and knowledge of running and growing large service orientated brands will help strengthen the expertise of the Board.

UK CORPORATE GOVERNANCE CODE

During 2015, our governance framework was built on the UK Corporate Governance Code ('the Code') as revised in 2014. The Code remained the minimum standard against which we measured ourselves during 2015. We complied with all the provisions in the Code during 2015 and expect to be fully compliant during 2016. Awards under the Performance Related Bonus and the LTIP are subject to malus and, from 2016, clawback in accordance with the proposed new executive remuneration policy (see page 76 in the Directors' Remuneration Policy).

The Code is published by the Financial Reporting Council (FRC) and is available at www.frc.org.uk.

PHIL WHITE
Chairman of the Board
23 February 2016

Example 10.4
Barclays PLC Annual Report 2015 (p40)

- Part of the Chairman's introduction to the corporate governance statement.
- Company-specific and year-specific – entitled "What we did in 2015."
- Calls out focus on key areas – succession planning, culture.

Governance: Directors' report
What we did in 2015
Chairman's introduction

I am also delighted to report that we have met the Board diversity target we set back in 2012, which was that 25% of the Board by the end of 2015 should be women. We have now agreed a new diversity target, which is that 33% of the Board by the end of 2020 should be women, although our overriding principle is that all appointments to the Board are made on merit, taking into account the skills and experience that the Board needs now and may need in the future to support delivery of our strategy.

I am on record as saying that Barclays needs to reduce its internal bureaucracy by becoming leaner and more agile and consequently more effective and the Board and its processes are no exception to this. One of the steps I took on becoming Chairman was to review the Board's governance structure, with assistance from the Company Secretary, in order to simplify and streamline the principal Board Committees, in particular those Board Committees with responsibility for oversight of risk. As a result, the Board decided to disband the Board Enterprise Wide Risk Committee, with its responsibilities for oversight of enterprise-wide risk being assumed by the Board as a whole. We also concluded that the Board Financial Risk Committee should assume responsibility for oversight of the capital and financial aspects of operational risk, in addition to financial risk, leaving the Board Conduct, Operational and Reputational Risk Committee to focus on conduct and culture, reputational risk and citizenship. The Board Audit Committee continued to focus on the control aspects of operational risk. The Board Committees have subsequently been renamed to more accurately reflect their responsibilities.

As part of our discussions on Board and Board Committee succession planning, membership of each Committee was also reviewed to ensure that it had the right balance of skills, experience and perspectives and also to ensure that individual Directors were not being over-burdened by Committee responsibilities. Board Committees play a vital role in supporting the Board in its oversight of internal control and financial reporting, risk and risk management and reward and remuneration. Each of the Board Committee Chairmen report below on how their committees discharged their responsibilities during 2015 and the material matters each considered. The Board Nominations Committee has continued to play a role in succession planning for Group Executive Committee and senior leadership roles and, having had the opportunity during 2015, as Executive Chairman, to work even more closely with Group Executive Committee members, I was able to bring some fresh perspectives on the talent pipeline and talent management processes. More detail on the Board Nominations Committee's work on succession planning can be found on page 61.

It is important to periodically obtain an independent perspective on the effectiveness of the Board and particularly so in a year when our conventional Board governance processes were temporarily revised. We have conducted an externally facilitated review of the effectiveness of the Board each year since 2004 and for 2015 we asked Independent Board Evaluation to facilitate that review. I am pleased to advise that the overall outcome of the review was that the Board is operating effectively, although there are some areas that could be enhanced. A report on the evaluation process and the outcomes may be found on pages 64, 66 and 67.

Culture and values
People matter more than anything else in any business: it is a company's people that make it great, help it stand out from its competitors, and make it an attractive proposition for customers and investors. As a Board, we are responsible for ensuring that Barclays' people do things – the right things – in the right way by setting the tone from the top, by living Barclays' culture and values in everything that we do and in the decisions we make, by holding the Group Executive Committee to account for the integrity of our Purpose and Values and by creating a culture in which doing the right thing is integral to the way we operate, globally. In an organisation as large and as complex as Barclays, that can be, and is, a challenge, but we are only too alive to the consequence of getting this wrong. I have personally endorsed our Code of Conduct, *The Barclays Way*, and the Board Reputation Committee has been monitoring, on behalf of the Board, the progress we are making to embed cultural change.

Shareholder and regulatory engagement
Meaningful engagement with our shareholders and regulators is a key pillar of our approach to corporate governance. We welcome open and constructive discussion with our stakeholders, particularly with regard to governance and succession planning, strategy and remuneration. You can read more about how we have engaged with key stakeholders during 2015 in this report. I also hope to meet with many of our private shareholders at our AGM, which will be held on 28 April 2016. A significant activity during 2015 was our external audit tender, on which we engaged with a number of our major shareholders, and you can read a report from Tim Breedon, who chaired our Audit Tender Oversight Sub-Committee, on page 51.

Looking ahead
2015 has not been without its challenges, but I believe that we now have the leadership in place to take forward execution of our strategy at pace, to deliver on our priorities and generate the long-term sustainable value that will benefit not only Barclays' shareholders, but society at large.

John McFarlane
Chairman
29 February 2016

40 I Barclays PLC Annual Report 2015 home.barclays/annualreport

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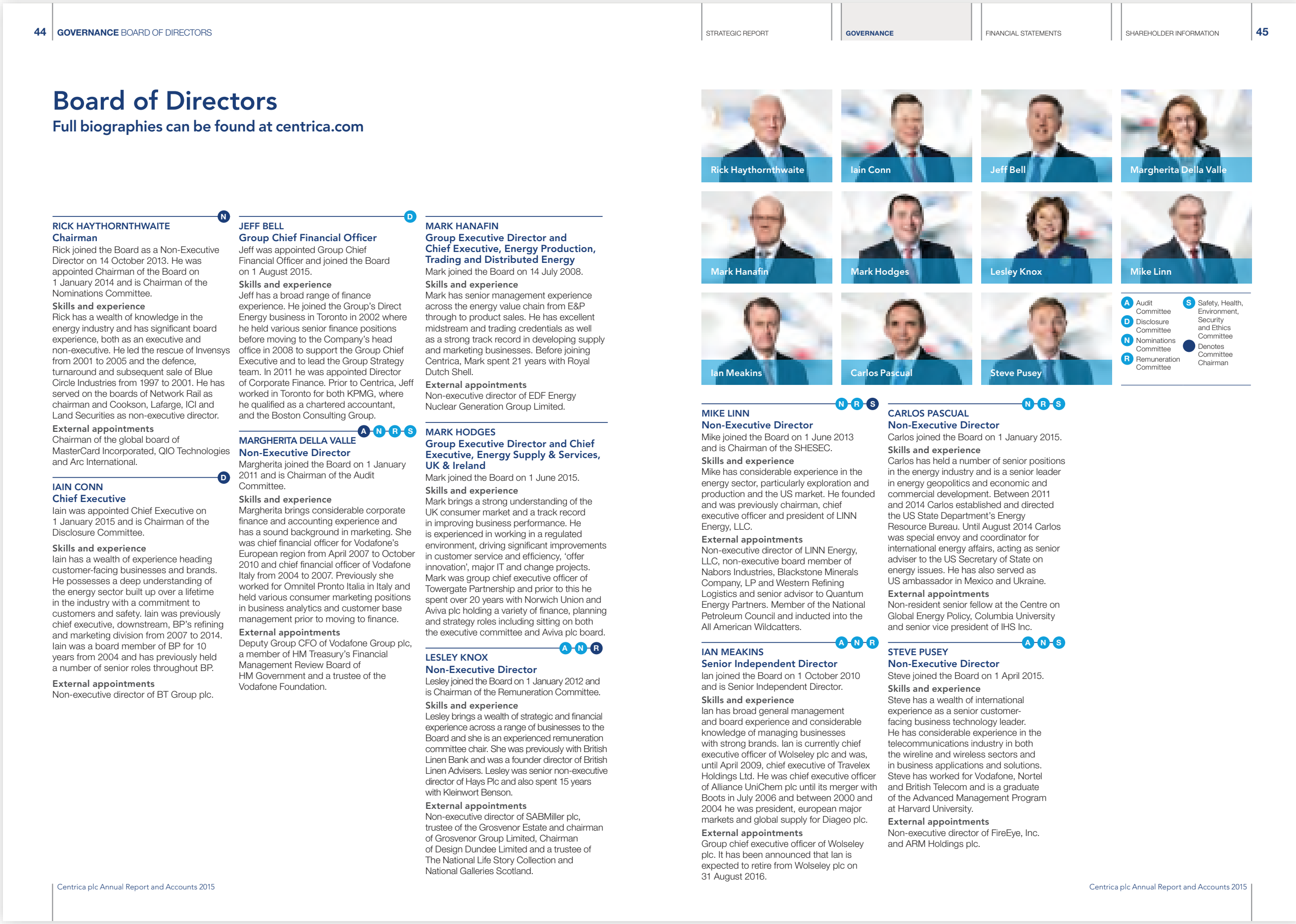
Example 10.5

[Centrica plc Annual Report and Accounts 2015 (p44-45)](#)

- Board of directors biographies disclosure.
- Focuses on skills and experience, including sector and specialism.
- Includes cross-references to where full biographies can be found.



44 GOVERNANCE BOARD OF DIRECTORS

STRATEGIC REPORT | GOVERNANCE | FINANCIAL STATEMENTS | SHAREHOLDER INFORMATION 45

Board of Directors

Full biographies can be found at centrica.com

RICK HAYTHORNTHWAITE
Chairman
N
Rick joined the Board as a Non-Executive Director on 14 October 2013. He was appointed Chairman of the Board on 1 January 2014 and is Chairman of the Nominations Committee.

Skills and experience
Rick has a wealth of knowledge in the energy industry and has significant board experience, both as an executive and non-executive. He led the rescue of Invensys from 2001 to 2005 and the defence, turnaround and subsequent sale of Blue Circle Industries from 1997 to 2001. He has served on the boards of Network Rail as chairman and Cookson, Lafarge, ICI and Land Securities as non-executive director.

External appointments
Chairman of the global board of MasterCard Incorporated, QIO Technologies and Arc International.

IAIN CONN
Chief Executive
D
Iain was appointed Chief Executive on 1 January 2015 and is Chairman of the Disclosure Committee.

Skills and experience
Iain has a wealth of experience heading customer-facing businesses and brands. He possesses a deep understanding of the energy sector built up over a lifetime in the industry with a commitment to customers and safety. Iain was previously chief executive, downstream, BP's refining and marketing division from 2007 to 2014. Iain was a board member of BP for 10 years from 2004 and has previously held a number of senior roles throughout BP.

External appointments
Non-executive director of BT Group plc.

JEFF BELL
Group Chief Financial Officer
D
Jeff was appointed Group Chief Financial Officer and joined the Board on 1 August 2015.

Skills and experience
Jeff has a broad range of finance experience. He joined the Group's Direct Energy business in Toronto in 2002 where he held various senior finance positions before moving to the Company's head office in 2008 to support the Group Chief Executive and to lead the Group Strategy team. In 2011 he was appointed Director of Corporate Finance. Prior to Centrica, Jeff worked in Toronto for both KPMG, where he qualified as a chartered accountant, and the Boston Consulting Group.

MARGHERITA DELLA VALLE
Non-Executive Director
A N R S
Margherita joined the Board on 1 January 2011 and is Chairman of the Audit Committee.

Skills and experience
Margherita brings considerable corporate finance and accounting experience and has a sound background in marketing. She was chief financial officer for Vodafone's European region from April 2007 to October 2010 and chief financial officer of Vodafone Italy from 2004 to 2007. Previously she worked for Omnitel Pronto Italia in Italy and held various consumer marketing positions in business analytics and customer base management prior to moving to finance.

External appointments
Deputy Group CFO of Vodafone Group plc, a member of HM Treasury's Financial Management Review Board of HM Government and a trustee of the Vodafone Foundation.

MARK HANAFIN
Group Executive Director and Chief Executive, Energy Production, Trading and Distributed Energy
Mark joined the Board on 14 July 2008.

Skills and experience
Mark has senior management experience across the energy value chain from E&P through to product sales. He has excellent midstream and trading credentials as well as a strong track record in developing supply and marketing businesses. Before joining Centrica, Mark spent 21 years with Royal Dutch Shell.

External appointments
Non-executive director of EDF Energy Nuclear Generation Group Limited.

MARK HODGES
Group Executive Director and Chief Executive, Energy Supply & Services, UK & Ireland
Mark joined the Board on 1 June 2015.

Skills and experience
Mark brings a strong understanding of the UK consumer market and a track record in improving business performance. He is experienced in working in a regulated environment, driving significant improvements in customer service and efficiency, 'offer innovation', major IT and change projects. Mark was group chief executive officer of Towergate Partnership and prior to this he spent over 20 years with Norwich Union and Aviva plc holding a variety of finance, planning and strategy roles including sitting on both the executive committee and Aviva plc board.

LESLEY KNOX
Non-Executive Director
A N R
Lesley joined the Board on 1 January 2012 and is Chairman of the Remuneration Committee.

Skills and experience
Lesley brings a wealth of strategic and financial experience across a range of businesses to the Board and she is an experienced remuneration committee chair. She was previously with British Linen Bank and was a founder director of British Linen Advisers. Lesley was senior non-executive director of Hays Plc and also spent 15 years with Kleinwort Benson.

External appointments
Non-executive director of SABMiller plc, trustee of the Grosvenor Estate and chairman of Grosvenor Group Limited, Chairman of Design Dundee Limited and a trustee of The National Life Story Collection and National Galleries Scotland.

A Audit Committee
D Disclosure Committee
N Nominations Committee
R Remuneration Committee
S Safety, Health, Environment, Security and Ethics Committee
Denotes Committee Chairman

MIKE LINN
Non-Executive Director
N R S
Mike joined the Board on 1 June 2013 and is Chairman of the SHESEC.

Skills and experience
Mike has considerable experience in the energy sector, particularly exploration and production and the US market. He founded and was previously chairman, chief executive officer and president of LINN Energy, LLC.

External appointments
Non-executive director of LINN Energy, LLC, non-executive board member of Nabors Industries, Blackstone Minerals Company, LP and Western Refining Logistics and senior advisor to Quantum Energy Partners. Member of the National Petroleum Council and inducted into the All American Wildcatters.

IAN MEAKINS
Senior Independent Director
A N R
Ian joined the Board on 1 October 2010 and is Senior Independent Director.

Skills and experience
Ian has broad general management and board experience and considerable knowledge of managing businesses with strong brands. Ian is currently chief executive officer of Wolseley plc and was, until April 2009, chief executive of Travelex Holdings Ltd. He was chief executive officer of Alliance UniChem plc until its merger with Boots in July 2006 and between 2000 and 2004 he was president, european major markets and global supply for Diageo plc.

External appointments
Group chief executive officer of Wolseley plc. It has been announced that Ian is expected to retire from Wolseley plc on 31 August 2016.

CARLOS PASCUAL
Non-Executive Director
N R S
Carlos joined the Board on 1 January 2015.

Skills and experience
Carlos has held a number of senior positions in the energy industry and is a senior leader in energy geopolitics and economic and commercial development. Between 2011 and 2014 Carlos established and directed the US State Department's Energy Resource Bureau. Until August 2014 Carlos was special envoy and coordinator for international energy affairs, acting as senior adviser to the US Secretary of State on energy issues. He has also served as US ambassador in Mexico and Ukraine.

External appointments
Non-resident senior fellow at the Centre on Global Energy Policy, Columbia University and senior vice president of IHS Inc.

STEVE PUSEY
Non-Executive Director
A N S
Steve joined the Board on 1 April 2015.

Skills and experience
Steve has a wealth of international experience as a senior customer-facing business technology leader. He has considerable experience in the telecommunications industry in both the wireline and wireless sectors and in business applications and solutions. Steve has worked for Vodafone, Nortel and British Telecom and is a graduate of the Advanced Management Program at Harvard University.

External appointments
Non-executive director of FireEye, Inc. and ARM Holdings plc.

Centrica plc Annual Report and Accounts 2015

Centrica plc Annual Report and Accounts 2015

Example 10.6

[Jardine Lloyd Thomson Group plc Annual Report 2015 (p56)](#)

- A visual approach to highlighting the experience each director contributes.
- Helps the reader understand whether there are gaps and how important those are.
- Allows for list of former roles to be provided in the board of directors section.

Example 10.7

[Fidessa group plc Annual Report and Accounts 2015 (p17)](#)

- Disclosure of why long serving director remains independent.
- Explains tenure and experience of director.
- Explains director's positive contribution to board discussions.
- Details the rigorous review of independence and contribution and its conclusion.

Example 10.6

CORPORATE GOVERNANCE

CORPORATE GOVERNANCE REPORT CONTINUED

The Board confirms that, since the date of entry into the Agreement, the Group has complied with its provisions and that, so far as the Company is aware, Jardine Matheson Holdings and its associates have also complied with the independence and procurement obligations set out in the Agreement. During the year the Company reviewed the processes it has in place to control the provision of information to Jardine Matheson and concluded that these processes should be formalised. In March 2016 an updated version of the Agreement was signed with Jardine Matheson, clarifying when and how information may be requested by Jardine Matheson from JLT.

BOARD EXPERIENCE AND BALANCE

Following review, the Board remains satisfied that it continues to have the appropriate balance of expertise, experience, independence and knowledge to run the business effectively and deliver long-term shareholder value. The chart below provides an overview of experience of each of the Directors:

Name	Position/Committee membership as at 31 Dec 2015	Length of service as Board member as at 31 Dec 2015	Independent	Other public board experience	Operational experience	Insurance industry experience	International experience	Legal/M&A experience	Finance experience	Government experience
Geoffrey Howe	Non-Executive Chairman Member of NC	14 years	No	✓	✓	✓	✓	✓	-	-
Annette Court	Non-Executive Director Member of ARC, RC, NC	3 years, 5 months	✓	✓	✓	✓	✓	✓	-	-
Jonathan Dawson	Non-Executive Director Chairman ARC Member of RC, NC	3 years, 5 months	✓	✓	✓	-	✓	✓	✓	-
Richard Harvey	Non-Executive Director Chairman RC Member of ARC, NC	6 years	✓	✓	✓	✓	✓	✓	✓	-
Lord Leach	Non-Executive Director Chairman NC Member of RC	18 years, 11 months	No	✓	✓	✓	✓	✓	-	-
Nicholas Walsh	Non-Executive Director Member of ARC, RC, NC	1 year, 3 months	✓	-	✓	✓	✓	✓	-	-
Lord Sassoon	Non-Executive Director Member of ARC, RC, NC	2 years, 8 months	No	✓	✓	-	✓	✓	✓	✓
Dominic Burke	Group Chief Executive	11 years	N/A	✓	✓	✓	✓	✓	✓	-
Mark Drummond Brady	Deputy Group CEO	4 years, 10 months	N/A	-	✓	✓	✓	✓	-	-
Charles Rozes	Group Finance Director	4 months	N/A	-	✓	-	✓	✓	✓	-
James Twining	Group Commercial Director	3 years, 5 months	N/A	-	✓	✓	✓	✓	✓	-

Key: ARC – Audit & Risk Committee RC – Remuneration Committee NC – Nominations Committee

BOARD MEETINGS

The Board held six scheduled meetings during the year and the attendance of the Directors is set out in the following table:

	Eligible to Attend	Attended
Geoffrey Howe	6	6/6
Dominic Burke	6	6/6
Annette Court	6	6/6
Jonathan Dawson	6	6/6
Mark Drummond Brady[1]	6	4/6
Richard Harvey	6	6/6
Lord Leach of Fairford	6	6/6
Mike Reynolds	4	4/4
Charles Rozes	2	2/2
Lord Sassoon	6	6/6
James Twining	6	6/6
Nicholas Walsh[2]	6	5/6

1 Mark Drummond Brady was unable to attend the Board meeting on 30 January 2015 due to a clash of prior commitments and the meeting on 1 May 2015 due to travelling on business in Asia.
2 Nicholas Walsh was unable to attend the Board meeting held on 30 January 2015 due to a prior commitment advised before his appointment.

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Example 10.7

17 Fidessa group plc
Annual Report and Accounts 2015

Ken Archer (age 64), Independent Non-Executive Director
Ken Archer joined the Board as a non-executive director in November 2014. He is Chairman of Gresham Computing plc, where he has been a non-executive director since 2010. Ken was Chief Executive Officer of SmartStream Technologies until 2009 and prior to that, the President, European Business Development of Computer Sciences Corporation where he managed the sales team responsible for large scale outsourcing projects across Europe. Ken has also worked at J.P. Morgan, where he served as VP, Information Services and subsequently at Mercantile Information Services and The Savings Corporation.

In accordance with provision B.7.1 of the UK Corporate Governance Code (Code), and with the exception of Andy Malpass, all the directors offer themselves for re-election at the forthcoming Annual General Meeting.

As announced in August 2015, Andy Malpass, will retire as an executive director in February 2016. Andy Malpass remained on the Board following Andy Skelton's appointment as Chief Financial Officer to facilitate a well-managed handover of responsibilities.

In 2013 Ron Mackintosh completed nine years of service as non-executive director of Fidessa. Following consultation in October 2013 with the largest 13 shareholders (holding over 60% of Fidessa's shares at that time) the Board reappointed Ron and he was re-elected by shareholders at the 2015 Annual General Meeting. During 2015, the Board undertook a rigorous review of Ron's independence and contribution to the Board and continues to conclude that he remains independent in character and judgement. The Board believes that Ron's considerable experience within the technology sector in UK listed companies is both rare and very valuable and given recent changes in other parts of the Board it is beneficial to the Company to retain Ron's services both as an independent non-executive director and as the Senior Independent Director. The Board further considers his valuable contribution to, and in-depth understanding of, Fidessa's business together with his fair and transparent participation in Board discussions as beneficial and valuable to the Board and Fidessa as a whole. Accordingly, the Board recommends that Ron be re-elected as an independent non-executive director at the 2016 Annual General Meeting.

As announced by the Company on 11th January 2016, Ron Mackintosh stepped down as Chairman of the Remuneration Committee with Ken Archer assuming that role and also becoming a member of the Nominations Committee, both with effect from 8th January 2016.

After a formal review, the Board confirmed that John Worby, Elizabeth Lake and Ken Archer are independent in character and judgement. When reaching its decision on independence, the Board considered the independence criteria set out in paragraph B.1.1 of the Code.

The Chairman confirms that the performance of each of the directors continues to be effective and that they continue to demonstrate commitment to their roles, bringing their considerable commercial experience to Fidessa; accordingly their re-election is recommended. The Senior Independent Director, Ron Mackintosh, confirms, on behalf of the non-executive directors, that the performance of the Chairman continues to be effective and his re-election is accordingly recommended.

Directors' interests in shares and share incentives in Fidessa group plc are detailed in the Directors' Remuneration Report.

At the date of this Directors' and Corporate Governance Report, indemnities are in force under which Fidessa has agreed to indemnify the directors and the Company Secretary to the extent permitted by law and by Fidessa group plc's Articles of Association in respect of losses arising in their capacity as officer of any member of the Fidessa group. In addition, Fidessa has purchased and maintained throughout the year, directors' and officers' liability insurance in respect of itself and its directors and officers.

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Example 10.8
Findel plc Annual Report & Accounts 2016 (p58)

- Disclosure in corporate governance statement on outcome of annual assessment of internal controls.
- Provides context for the annual review.
- Clearly identifies and explains areas of exception.
- Provides some detail of actions to respond to exceptions and timing of those actions.

Governance

Audit & Risk Committee Report

Management uses a "three lines of defence" approach, where the first line of defence is in the management of the business units, who are responsible for ensuring that a robust risk and control environment is established as part of their daily operations. The second line of defence is provided by the oversight functions within the business and at Group level, setting policies, procedures, and compliance and governance frameworks. The third line of defence is the internal and external auditors who offer independent challenge to the levels of assurance provided by the business operations and oversight functions.

During the previous year, the structure of internal control within the Group's largest business, Express Gifts, was further strengthened by the establishment of its own Audit and Risk Committees. During the year the output from those committees has provided valuable insights to complement that of the Group's own assessments of the key risks within the business. Senior members of the Express Gifts management team have also undergone extensive training during the year on the ongoing requirements of the FCA in respect of risk management and conduct.

In the year since the last annual report, the Committee has also monitored and challenged:

(a) how the Group's businesses were dealing with the challenges of the digitalisation of aspects of their interfaces with suppliers and customers, the changes in customer buying behaviour and the adequacy of the businesses' defences against cyber-attack;

(b) the preparations by Express Gifts for their application for a full FCA licence in late 2015;

(c) the continuing compliance journey at Express Gifts as new systems are brought on stream and change programmes are developed to further improve processes and behaviours, including performance measurement and staff appraisal systems, all to underpin appropriate customer outcomes;

(d) the risk of customer fraud at both our businesses and the tools required to identify and mitigate against this;

(e) a review of systems access in relation to data protection requirements and the actions required to mitigate the risks in this area;

(f) a review of authorisation levels across the Group to update the existing approved authority listings for changing business circumstances; and

(g) a review of project management to give assurance to the Board on project delivery, timescales and budgets.

The Committee used the experience and expertise of its members to meet with management outside of Committee meetings to ensure that their experience was available to management. In relation to matters listed at (a), (b) and (c) above the Committee also received presentations from the Express Gifts management team, at which plans were reviewed and challenged, noting that a significant amount of work was still required to achieve the level of behavioural change, understanding of the interaction between product and financial services policies and efficiency desired by the Board. The Committee reviewed the significant changes in organisation and personnel within Express Gifts as key elements of the plan to achieve greater regulatory resilience. The Committee noted that Express Gifts had continuously improved its IT security over the last year to further mitigate the risk of cyber-attacks and were extending training to its staff on recognising cyber threats as they develop.

Internal Audit reports were also received and discussed relating to each of the matters set out at (d) to (g) above.

The Committee oversees the adequacy of Findel's whistleblowing arrangements, ensuring that they are proportionate for the Group and enable staff and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Committee considered a report on the whistleblowing arrangements within the Group and an overview of instances of whistleblowing. The chairman of the Committee also reviewed the service provided by the external provider of the whistleblowing service with the head of that company. The report concluded that there is awareness of whistleblowing processes and procedures within the Group and that there were no matters that would suggest these are not operating effectively.

The Committee has conducted its annual review of the effectiveness of the Group's system of internal control. The Committee is satisfied with the progress made during the year, save for three areas of exception. First, until it was sold, Kitbag, as reported last year, was reliant upon interim compensating manual controls to compensate for shortcomings in its not fully automated IT systems. Secondly, in respect of the customer receivables impairment provision at Express Gifts, two key assumptions have been revised in response to changes in business practices during the year (principally relating to debt sales and arrangements with customers on forbearance) which has necessitated changes to the model's output at the year-end, in part due to challenges raised by the auditors, in order to maintain an appropriate level of provision and resulted in an exceptional charge to the profit and loss account. An improved suite of KPIs in this area is being introduced in the first quarter of the current financial year and an upgraded model is being developed and is planned to be in place during the second half of the current financial year. Finally, the KPIs relating to the monitoring and control of conduct risk and fair customer outcomes with Express Gifts and related financial services income streams continue to be developed.

During the period, it was recognised that with the level of change in the regulatory environment which the business is currently experiencing and with the addition of Greg Ball as a Non-Executive Director, it was an appropriate opportunity to increase the Board level focus on risk management even further. To that end, proposals to separate the Audit and Risk Committee into two separate Committees of the Board were put to and accepted by the Board and will be implemented in the near future. The newly constituted Audit Committee will continue to monitor, challenge and guide the traditional areas involving assurance through internal and external audit of the financial activities. The separate Risk Committee will allow greater scrutiny of the risk management framework being

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Example 10.9

G4S plc Integrated Report and Accounts 2015 (p72-73)

- Disclosure in audit committee report on outcome of annual assessment of internal controls.
- Context of breakdown in financial reporting controls.
- Detailed explanation of actions put in place.

SPECIFIC ITEMS

Description
The Audit Committee reviewed the treatment of items considered as specific items that are separately disclosed by virtue of their size, nature or incidence. Management prepared documentation to support these items and the disclosure proposed in the financial statements.

Action taken
The Audit Committee reviewed and challenged, in light of the guidance issued by the Financial Reporting Council in December 2013, the disclosures prepared by management in relation to specific items, considered that the nature of these items was within the group's accounting policies that were being applied consistently from year to year and that these items included both debits and credits in a balanced manner.

The Audit Committee also considered the recognition in the current year of future unavoidable losses related to onerous contracts as specific items and determined that onerous contract provisions would only be classified as specific items if they were deemed to be material to the group's underlying performance. The Audit Committee set a threshold amount below which onerous contracts would not be classified as specific items.

The committee also requested information from management to satisfy itself that changes in estimates related to items that were classified as specific items were consistently treated for both increases and decreases provisions.

Conclusion
The committee was satisfied that the group's accounting policies have been applied consistently and that the designation of specific items was subject to objective and balanced criteria and was appropriate to give an improved understanding of the continuing operations of the group.

Internal control

In the last three years, under the leadership of the chief financial officer, the group has had a heightened focus on improving systems of internal control and risk management for financial reporting. The main features of these control systems include clearly defined reporting lines and authorisation procedures, a comprehensive budgeting and monthly reporting system, written policies and procedures and the use of a single global consolidation system for both internal management reporting, budgeting and planning as well as external reporting. The group budget is approved by the board. A regular update is provided by the group CFO on the outlook. Actual results at business unit, region and group level are reported monthly and variances reviewed. A programme of business internal financial reviews (IFRs) is performed by the finance team from either region or group to check the accuracy of financial reporting and compliance with the group finance manual.

The system is designed to ensure the integrity of financial reporting and the committee's responsibility is to perform an annual review to consider whether these internal controls remain effective. The committee does this primarily through receiving reports from management, the internal audit function and the external auditor.

During the year, significant progress was made in continuing to strengthen the capabilities in finance, internal audit and risk management and to improve insight into the financial performance of business units at a country level. These insights identified significant failings in controls related to material accounting errors in three areas that have led to the restatement of the 2014 financial statements:

- The revenue recognition policy previously applied in respect of the supply and installation of alarm systems in Europe, together with the underlying assumptions used in 2007 at inception of certain related sale and leaseback transactions entered into until 2013, were incorrect. These led to the incorrect timing of recognition of profit on installation of those alarm systems with upfront gains being recognised instead of being deferred over the life of the lease and to certain leases being classified as operating rather than as finance leases;
- A number of legacy control weaknesses identified in the Africa region led management to perform a full review of the balance sheet in all countries of the region from which prior year errors were identified, mainly relating to cash reconciliations, under-accrual of employee and customer-related liabilities, incorrect classification of finance leases as operating leases and expenses incorrectly capitalised; and
- A number of errors in respect of the calculation of goodwill on certain acquisitions, gains and losses on certain disposals and related tax balances in North America between 2007 and 2014 mainly resulting in goodwill being overstated as at 1 January 2014 and at 31 December 2014 and profit on disposals in 2014 being understated.

The committee reviewed in detail papers prepared by management explaining the issues identified as well as the corrective action put in place to prevent re-occurrence of such errors which included sharing the findings with the group finance leadership team and cascading it down to business level, confirming that these issues were not repeated in other locations, putting in tighter controls and group review when entering into material new leases, providing 'master classes' and updates on the group finance manual as well as integrating further the operations of the group tax department with the local tax departments. In relation to the broader failure of financial controls and reconciliations in the Africa region, the Audit Committee observed that this had been identified through the strengthening of the financial controls and organisation through specific actions such as the appointment of a new regional finance director, a new regional financial controller, and 12 new finance directors during 2015, as well as from a fresh review from the new external auditors.

The committee acknowledged the strengthening of the controls and the 2016 plans which include a targeted group internal audit plan for the areas where significant failures have taken place, a review of the group's financial control framework with a view to simplifying it to key essential controls to ensure these operate effectively, training programmes and up-skilling capabilities. The committee also considered the plans that are being implemented by management to reduce reliance on manual controls, mainly in respect to implementation and integration of new financial systems over the longer term.

Further details on internal controls are set out on page 47. The Audit Committee confirmed to the board that it is satisfied that the group's risk management and internal control processes and procedures are appropriate.

Internal audit

During 2015 the group internal audit team focused on taking a more risk based approach to auditing, with the goal of focusing local management on the most material control issues given their specific local environment. In 2016 the internal audit team will spend a minimum of 20% of their time providing coaching and consulting to business units with control issues in order to seek to prevent recurrence of control failures.

External auditor

In the summer of 2014, the company put the external audit engagement for the 2015 financial year out to tender. The process resulted in the appointment of PricewaterhouseCoopers LLP (PwC) as the group's external auditor for the 2015 financial year at the company's AGM on 4 June 2015. A tri-partite transition plan setting out the agreed principles, framework and timeline to ensure the efficient and effective transfer of the external audit arrangement from the previous group auditor KPMG Audit plc to PwC was put into place.

Non-audit services

To ensure that the independence of the audit is not compromised, the committee has put a policy in place for the non-audit services that can be provided by the external auditor, the relevant approval process for certain services and those services the auditor is prohibited from providing. In essence, the external auditor is prohibited from providing services that could create a conflict of interest, result in the audit firm auditing its own work or result in the performance of management functions. The committee has pre-approved certain services which can be provided by the auditor subject to specified fee limits above which further approval is required. All other services would require prior approval by the committee. Every year the Audit Committee reviews its policy on the provision of non-audit services by the external auditor.

Non-audit services include tax compliance and tax services. The Audit Committee has reconsidered the company's policy in this area in the context of the new EU guidance on non-audit services. Whilst PwC do provide such services the vast majority of tax compliance and tax advisory services undertaken by PwC are deemed insignificant both individually and in aggregate and were either terminated or transitioned to other providers by 30 June 2015. A specific exception was made for certain insignificant pre-existing services where transition presented significant business risks or difficulties and a final termination date of 30 June 2016 was established for these services.

The provision of any non-audit services by the audit firm must, in any event, comply with the requirements in that regard of the Auditing Practices Board.

Details of the fees paid for audit services, audit-related services and non-audit services can be found in note 10 to the financial statements.

Effectiveness of the external auditor

A combination of formal and informal processes are used in the assessment of the effectiveness of the external audit process. A formal questionnaire is completed at the end of the audit by members of the Audit Committee, group finance department and the finance directors of significant operations across the group and the output is reviewed by the Audit Committee. The assessment of the external audit concluded that it remained effective and the external auditor is independent.

Committee performance

The assessment of the committee's performance conducted as part of the board review process with Lintstock's assistance showed that the committee remains effective at discharging its responsibilities and in particular in reviewing the quality of the group's financial reporting.

CMA Order Compliance

The committee confirms that the company has complied with the Audit Services for Large Companies (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2004.

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Example 10.10

National Grid plc Annual Report and Accounts 2015/16 (p46)

- The Chairman discussing the board's approach to cyber security in his introductory letter highlights the board's focus on this matter.
- Includes information about training and future strategy on cyber security.

Example 10.11

IP Group plc Annual Report and Accounts 2015 (p89)

- The audit committee report includes detail on the committee's approach to cyber security, which highlights the committee's focus on this matter.
- Details external assurance over cyber security.
- Uses external framework to assess progress.
- Clear and specific about actions taken.

Example 10.10

Example 10.11

Example 10.12
Rotork Plc Annual Report 2015 (p65)

- This UK Corporate Governance Code Compliance Statement, in the corporate governance report, provides clear reasons for temporary and partial non-compliance with Code provision C.2.3.

- Demonstrates the company's journey towards improved governance.

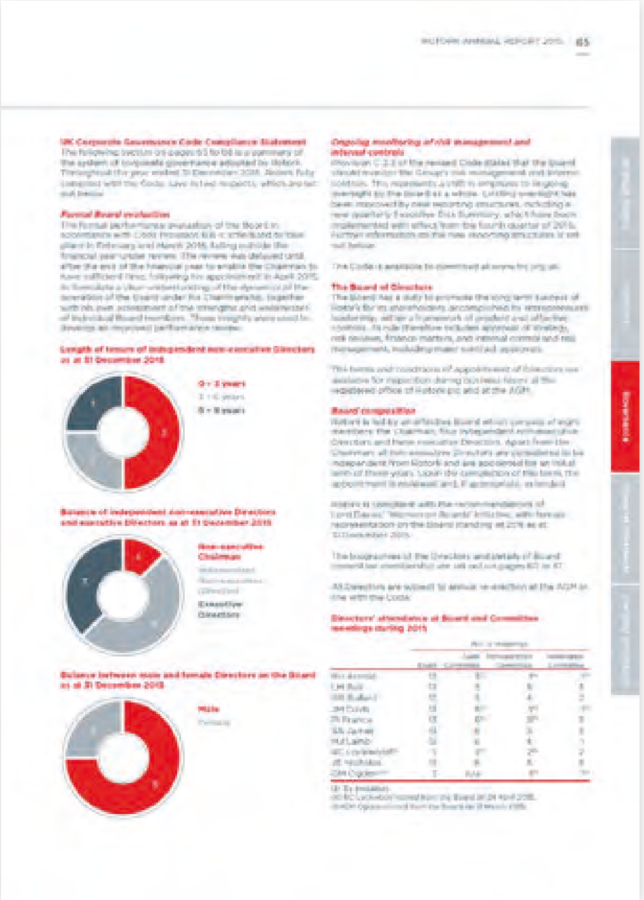
- Keeps the explanation brief and refers to further detail about the new reporting structures.

Example 10.13
Savills plc Report and Accounts 2015 (p46)

- Providing a view about the independence of the non-executive directors in the section of the corporate governance statement dealing with board effectiveness.

- Highlights the considerations around a long-serving non-executive director, including the value he brings to the board and the board's view of his ongoing independence of character and judgement.

Example 10.12



Example 10.13

Corporate Governance Statement
continued

Effectiveness

Board composition and balance

Balance of Non-Executive Directors and Executive Directors

Length of Tenure of Non-Executive Directors

At all times during the year at least half of the Board members, excluding the Chairman, were Independent Non-Executive Directors.

Chairman and Chief Executive
The posts of Chairman and Group Chief Executive are distinct and separate and their roles and responsibilities are clearly established. The Chairman leads the Board and ensures the effective engagement and contribution of all Executive and Non-Executive Directors. The Group Chief Executive has responsibility for all Group businesses and acts in accordance with the authority delegated by the Board. There are a number of areas where the Board has delegated specific responsibility to management, including responsibility for the operational management of the Group's businesses as well as reviewing strategic issues and risk matters in advance of these being considered by the Board and/or its Committees. The Board considers that throughout the year the Company was in full compliance with the Code.

Independence of the Non-Executive Directors
The Non-Executive Directors are responsible for bringing independent and objective judgement and scrutiny to matters before the Board and its Committees. The Board monitors the independence of its Non-Executive Directors, particularly those who have given long service. It is the view of the Board that each of the Non-Executive Directors brings considerable management expertise and is an Independent Non-Executive Director, being independent of management and having no business or other relationship which could interfere materially with the exercise of their judgement.
In particular, notwithstanding his long service on the Board, the Board continues to consider that Charles McVeigh remains entirely independent in character and judgement. His experience provides valuable insight, knowledge and continuity.

Senior Independent Director
Martin Angle is the Senior Independent Director and is available to shareholders if they have concerns which have not been addressed by contact with the Chairman and/or Group Chief Executive.

Time commitments and conflicts
The Board is satisfied that the Chairman and each of the Non-Executive Directors committed sufficient time during the year to enable them to fulfil their duties as Directors of the Company. None of the Non-Executive Directors has any conflict of interest which has not been disclosed to the Board in accordance with the Company's Articles of Association ('Articles').

Board evaluation
In accordance with the provisions of the Code it is our intention to conduct an external independent evaluation of Board effectiveness and performance and that of its principal Committees at least every three years.

This year the annual Board evaluation was led by the Chairman and supported by the Group Legal Director & Company Secretary. Next year the Board will engage an independent external facilitator to undertake the evaluation. The 2015 internal evaluation covered the performance of the Board as a whole as well as that of its Committees and involved each Board member completing a questionnaire and then using this as the background for a confidential interview. The evaluation covered six core themes: Board effectiveness, Board structure, working practices, succession planning, relationships with shareholders and future priorities in relation to Board performance. The feedback obtained was collated into a report which was presented to the Board.

The evaluation showed that the Board and its Committees continued to operate effectively without any significant areas of concern. In an effort to continue to improve, however, recommendations arising from the evaluation included: the need to further enhance succession plans in place covering both the executive and Non-Executive Directors, the need to maintain the culture of the Board and maintain continuity through a period of significant change in the membership of the Board, the need to have both updated and tested crisis management plans in place to allow the Board to respond to serious unexpected events and the need to keep the Group's strategy and development plans under constant review to ensure that these remain appropriate in the light of the current market uncertainty.

Overall, the Board considers the performance of each Director to be effective and concluded that both the Board and its Committees continue to provide effective leadership and exert the required levels of governance and control. The shareholders should therefore support their re-election or re-appointment (as applicable) to the Board at the AGM in May. The Board will continue to review its procedures, effectiveness and development.

The skills and experience of the Directors are set out on page 44.

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Corporate culture – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 10.14

Marks and Spencer Group plc Annual Report and Accounts 2016 (p30)

- Provides details about succession planning approach for executive, non-executive and senior leadership.
- Cross-reference to detailed discussion in the strategic report.
- Focuses on board culture and highlights that some of the focus comes from board evaluation.

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MARKS AND SPENCER GROUP PLC
DIRECTORS' REPORT

GOVERNANCE

CHAIRMAN'S GOVERNANCE OVERVIEW

Our approach to succession has **enhanced our ability to replace and develop responsibilities** quickly and seamlessly, and improved our ability to react to both planned and unplanned changes.

ROBERT SWANNELL CHAIRMAN

During the year the Board has placed much focus on **operational delivery, succession planning and risk management**. The following pages provide insight into these activities alongside the Board's discussions and governance processes.

An open and balanced review of our business performance has been covered earlier on pages 02 to 29. As highlighted, although we made headway against a number of the priorities we set ourselves at the start of the year, our performance in Clothing & Home and International remains unsatisfactory, despite the significant effort from the teams in these areas of the business. The last two years have seen a significant improvement in our clothing gross margin, delivered through improved design capabilities, smarter buying, a more flexible supply base and growth in our international reach. However, we recognise that we have more work to do to deliver sustained performance in Clothing & Home and International. These will both be key areas of focus for the year ahead.

A key area of Board discussion and challenge this year centered on improving the performance and risk management of our website and the Castle Donington distribution centre. The Board was pleased with the significant improvement in the operations of these over the critical Christmas period. Better process management and controls, and extensive testing by the team leading up to the intensive peak trading period, was a critical factor in this success. This focus on delivering an improved customer experience has underpinned a strong performance from M&S.com and delivered growth in market share.

Our balance sheet remains strong and we are delivering well against our free cashflow targets, even after returning £451.7m to shareholders, via dividend payments and the share buyback.

During the year the Board also discussed its strategic priorities, operational delivery and the associated key business risks and their management. We have sought to provide insight into the scope of the Board's activities, discussions and resulting actions on pages 36 and 37 of this report.

Much thought has been given to our **risk appetite** resulting in the agreement of a formal set of Group level statements, as discussed on page 48. We have also spent time considering management of our **cyber and business continuity risks,** these will remain key items on the Board agenda.

SUCCESSION PLANNING AND CULTURE

This year has been particularly intensive for both the Board and the Nomination Committee relating to **succession planning and culture**, assessing the executive, non-executive and senior succession pipeline, and identifying what skills are needed to support our strategy and business for the long-term.

Board and senior management succession has been a regular feature of our Board and Committee discussion over the last five years, with development and continued assessment forming a key agenda item. So, when Marc Bolland raised his potential retirement with the Board, the Nomination Committee was well prepared to ensure a careful and systematic transition. This process along with further detail on the activities of the Nomination and Remuneration Committees are provided on pages 40 to 41 and 50 to 71 respectively.

In reaching its conclusion to appoint Steve Rowe as Chief Executive (CEO), the Committee followed a rigorous assessment, development and selection process, including external benchmarking.

The Board was unanimous in supporting Steve's appointment in the light of his considerable knowledge of the business and its people, his appetite to continue the process of change, his perceptive and effective problem solving, his values and his observed leadership. The Board is grateful to Marc for his planning, enabling the Nominations Committee to work carefully and systematically on his succession.

Leadership, culture and good governance are essential considerations for our Board as it seeks to build a business that can deliver sustainable performance and an organisation fit for the longer term. Steve has outlined on page 06 to 08 the importance of customer focus, clarity, simplicity, and better ways of working to deliver on improved operational performance.

As the business looks at how it can work more effectively, the Board recognises the role it can play in demonstrating leadership and tone from the top.

Following our Board evaluation last year, we set out to articulate our Board culture with an internal framework to identify how we wanted to work as a Board and how we wished to operate and behave as a team. This has helped us to reflect not just on what we do but the way we do it. Furthermore, it aligns the Board with M&S's internal performance management to ensure that values and behaviours are integral to our corporate DNA.

THIS REPORT'S KEY FEATURES

Over the next few pages we look at our Board members, the role of the Board, its performance and its oversight. We provide an overview of the process undertaken to ensure CEO succession and provide insight into differing induction programmes.

Following feedback on our 2015 report, we again provide detail on the activities and discussions undertaken during the year by sharing some of the actions arising from those discussions and the progress against them. Given the timing of the change in leadership, certain discussions pertaining to future strategy and Board evaluation were undertaken subsequent to year-end. In the interest of transparency, to align with previous years and provide clarity to the reader, these have also been included in the table on pages 36 and 37.

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Example 10.15

Pearson plc Annual report and accounts 2015 (p90-91)

- Reputation and responsibility committee responsibilities include a specific focus on culture.
- Discusses alignment of culture and business strategy.
- Recognises that employee engagement is critical.

90 **Pearson plc** Annual report and accounts 2015 | **Section 4** Governance/Engagement 91

Reputation & responsibility committee report

Chairman
Vivienne Cox

Members Vivienne Cox, Josh Lewis, Linda Lorimer, Harish Manwani

"Throughout the year, the committee provided oversight and input as Pearson continued to develop its sustainability practices, including the launch of Project Literacy and progress towards efficacy reporting. Our priority is to ensure Pearson's activities and policies align with our business strategy and stakeholder priorities."

Reputation & responsibility committee role

Having been formalised in 2014, the remit of the reputation & responsibility committee expanded during 2015, reflecting Pearson's continuing commitment and ambition around its corporate reputation, our belief in the importance of fulfilling our obligations to the communities in which we work, and maximising Pearson's positive impact on society.

The committee's work is closely aligned with the company's sustainable business initiatives and our meetings are now preceded by meetings of Pearson's responsible business leadership council – an internal governance group – ensuring that we are able to provide the necessary scrutiny and challenge to the council as our sustainability strategy is developed and integrated into the business. Read more about Social impact on p55-67.

Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website at www.pearson.com/governance

Progress against 2015 targets

At the start of 2015, we set out to achieve a number of ambitious goals during our first full year as a formal board committee. You can read more about our progress below.

Areas of focus	Progress
Oversee delivery of our strategy for managing our reputation and maximising our contribution to society within the organisation	This was a regular feature of our meetings throughout the year as Pearson builds its reputation management capabilities through an increasingly proactive approach. In particular we have explored in depth the work being done in our US market to proactively manage Pearson's reputation. We also developed and adopted a new process for managing global reputation risk, which takes into account our expanded activity and exposure in growth markets, as well as our presence in certain high-risk countries.
Monitor integration of social impact into Pearson's business following the closure of the Pearson Charitable Foundation	The committee provided input into a number of social impact projects established and accelerated in 2015, particularly high-profile initiatives such as Project Literacy and our Every Child Learning partnership with Save the Children.
Review progress towards 2018 efficacy commitments	Through focused sessions at two committee meetings, we reviewed progress toward meeting our efficacy commitment, and made recommendations for improving the efficacy measurement, reporting and auditing processes. Learn more about Efficacy on p46-53

Key activities in 2015

Key areas of focus for the committee were the launch of Project Literacy, our progress towards external efficacy reporting, plans to link the UN's sustainable development goals to our business model, and the ongoing work around Pearson's brand and culture. In all of these areas, our priority is to ensure Pearson's activities and policies align with our business strategy and stakeholder priorities, while reflecting best practice.

In addition, Pearson has formalised a process for its reputational risk management, involving business leaders and corporate affairs representatives, and the committee now receives a reputational risk report at every meeting. The committee also conducts deep dives into areas of particular reputational impact, such as through a focused session in 2015 on Pearson's US reputational strategy.

More detail about the committee's responsibilities, and the activities it undertook in each area of its remit, is given below. For reputation & responsibility committee meeting attendance see overview table on p78

Committee aims for 2016

In 2016 the committee will continue to maintain a clear focus on reputational management in the US – our largest, and most reputationally high-profile market. We will oversee Pearson's continuous progress in embedding social impact into our strategy and business model, continue to monitor our corporate culture, ensuring employee engagement and values remain strong to help ensure Pearson is in good shape for the future, and we will undertake a review of the ethical business priorities identified in 2015.

Vivienne Cox
Chairman of reputation & responsibility committee

Committee responsibilities

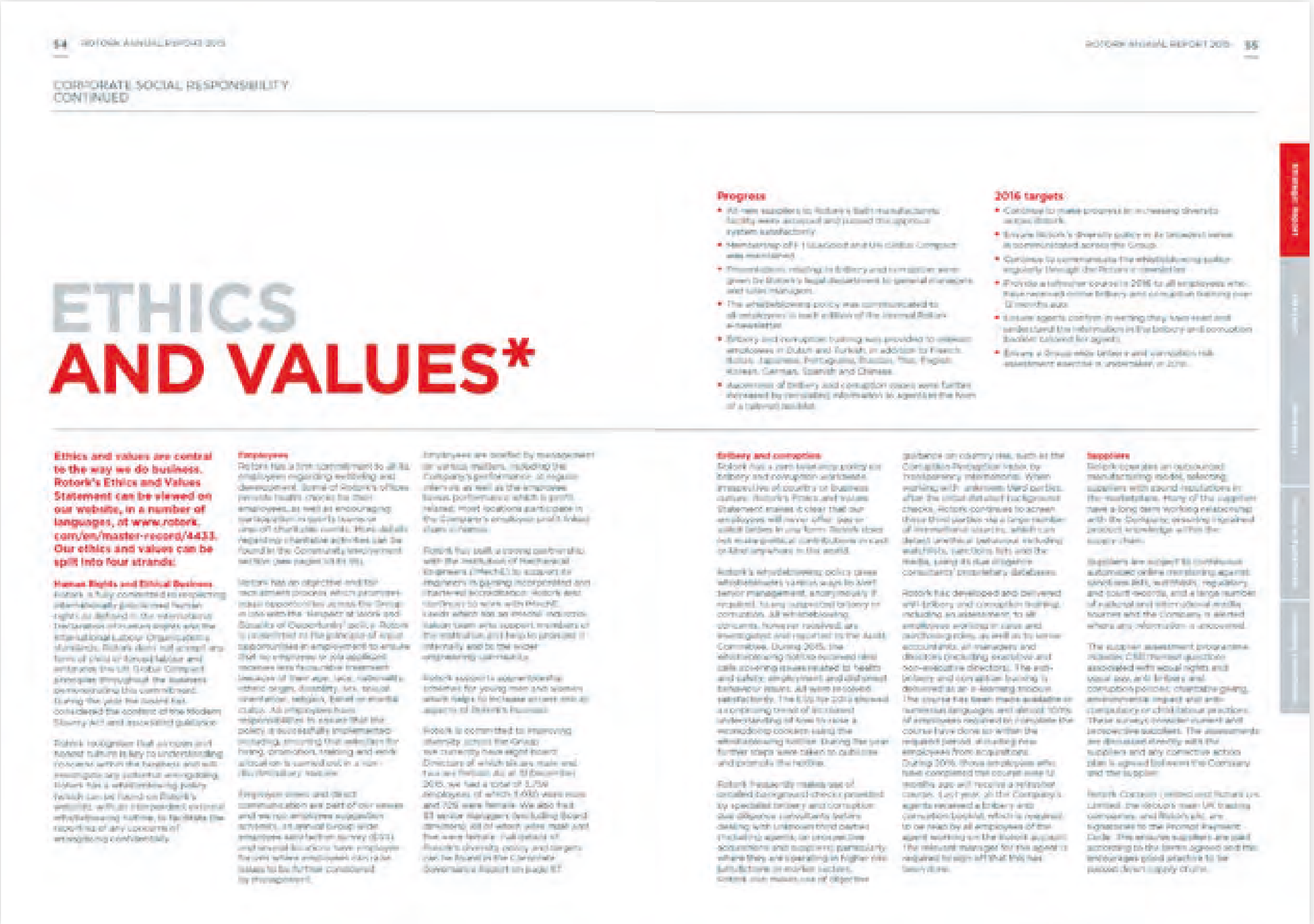
Topic	Responsibility	Activity	Strategy
Reputation	Pearson's reputation among major stakeholders, including governments, investors, employees, customers, learners and the education community	Updates on reputational 'hot topics' at each meeting Review of US reputational strategy Working with the audit committee to ensure that health & safety issues are properly considered from a reputation and responsibility perspective	Communications strategies, policies and plans related to reputational issues and the people, processes and policies that are in place to manage them
Risk	Oversight of Pearson's approach to reputational risk, including ensuring that clear roles have been assigned for management	Overview of reputational risk approach in growth and US markets, through in-country personnel and central corporate affairs team Regular consideration of reputational risk dashboards	
Social	Social impact initiatives, including Pearson's non-financial public commitments and progress towards them	Progress on efficacy, including launch of 'On the Road' publication and draft reporting framework Introduction to new reach and impact strategy Commitment to UN sustainable development goals and integration into business model Launch of Save the Children partnership	
Brand and culture	Management of the Pearson brand to ensure that its value and reputation are maintained and enhanced. Pearson's approach to monitoring and supporting the values and desired behaviours that form our corporate culture	Brand tracker update Review of progress on employee values and engagement Employee participation in social impact activities	
Ethics	Ethical business standards, including Pearson's approach to issues relevant to its reputation as a responsible corporate citizen	Consideration of ethical issues in the wider context of reputational risk identification	

Our business | Our performance | Our Social impact | Governance | Financial statements

Example 10.16

[Rotork Plc Annual report and accounts 2015 (p54-55)](#)

- Disclosure regarding corporate culture in the strategic report.
- Covers whistleblowing policy, employee views and direct communication and briefings.
- Includes a pervasive focus on ethical business dealings.


CORPORATE SOCIAL RESPONSIBILITY CONTINUED

ETHICS AND VALUES*

Progress

2016 targets

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Example 10.17

[Premier Oil plc 2015 Annual Report and Financial Statements (p60)]

- Information about governance and business ethics given in the strategic report.
- Includes specific metrics used.
- Highlights code of conduct, other policies, whistleblowing.
- Embedded in business through champions.

Example 10.18

[Unilever Annual Report and Accounts 2015 (p29)]

- Example of actions taken to embed appropriate culture throughout the business.
- Discussion of challenges faced and actions taken.

Example 10.17

60 CORPORATE RESPONSIBILITY REVIEW continued

C. High-level material issues

The following section provides an overview of our material corporate responsibility issues and explains why they are material to us, how we manage them and some of the key performance indicators we use to measure our performance.

Further details can be found in our 2015 Corporate Responsibility Report.

Governance and business ethics

Why this issue is material
Good governance underpins the entire scope of our business and our ability to act in a way that is not only legally compliant but which is also responsible. Doing business in this manner allows us to build and maintain the trust of our key stakeholders, including actual and potential investors, host governments and societies, business partners (including suppliers) and customers, whilst also ensuring our compliance with applicable laws and regulations. Furthermore, it is our responsibility to enhance rather than undermine our business environments, both for our own benefit and that of our stakeholders.

How we manage this issue
Our Corporate Responsibility Policy is owned and promulgated by our Board, whilst its supporting policies are owned and implemented by our Executive Committee. Premier's corporate responsibility activities are managed on a day-to-day basis by:

- The Group Development and Operations Manager, who oversees the management of HSES issues
- The Group Head of Corporate Services, who oversees human rights, government relations and risk management
- The Group Human Resources Director, who oversees human resources
- The Group General Counsel, who overseas legal and regulatory compliance, as well as ethical behaviour

Premier's Business Ethics Policy supports its overall Corporate Responsibility Policy, and our activities in this respect are governed by our Global Code of Conduct (the 'Code'). Implementation of the Code is supported by a Company-wide leadership group, made up of business ethics champions from each business unit. The group meets twice a year and addresses any opportunities for improving performance.

The Code is compliant with the UK Bribery Act and covers:

- Legal compliance
- Anti-bribery
- Facilitation payments
- Gifts and hospitality
- The appointment of intermediaries
- Charitable and political donations
- Whistleblowing
- The proper recording of transactions and the application of relevant accounting and reporting standards

All employees and those associated with Premier, such as consultants, are required to adhere to the Code. We require our business partners, including joint venture partners, contractors, customers and suppliers, to apply the principles of the Code or equivalent standards. The main means by which we do so is the integration of business ethics provisions (such as anti-corruption requirements) into our contracts.

Any breach of the Code by our employees will result in disciplinary action, and, in extreme cases, in instant dismissal and referral to the relevant law enforcement authorities.

Whistleblowing hotline
Premier encourages employees, contractors and agency workers to voice their concerns to line managers if they think the Company or anyone working on behalf of the Company has not acted in accordance with the Global Code of Conduct. Premier provides a confidential and well publicised independent third party reporting hotline for employees who feel unable to raise concerns via other procedures. This hotline is available 24 hours a day, seven days a week. No material incidents of corruption or non-compliance with the Code were identified in 2015.

Key indicators – Governance and business ethics

Material issue	Premier Oil metric	2013	2014	2015
Governance and ethics	Disciplinary actions or dismissals for breaches of the Code	0	0	0
	New employees receiving induction training on the Code	100%	100%	100%
	Existing employees receiving training on the Code	100%	96%	N/A[2]

2 As our training cycle works on a triennial basis, no existing employees required refresher training in 2015.

Premier Oil plc // 2015 Annual Report and Financial Statements

Example 10.18

LEARNING
Unilever operates in highly competitive markets so recruiting, retaining and developing skilled people are critical. Our skills need to align to our strategy so revenues grow and productivity improves while our people grow professionally.

To achieve this we improved and sharpened our learning strategy in 2015. A priority was to deliver the right learning at the right time in a form easy to use wherever and whenever needed.

Our learning material also needs to keep pace with the changing nature of working life where office-based work is a constantly changing environment while many of our people are on the move, working through mobile devices. At the same time, skills need updating ever more rapidly so our learning strategy must deliver professional education that is mobile, engaging, easy to consume and on-demand.

To achieve this we launched the Learning Hub in late 2015 which hosts all Unilever's learning content. We want to bring together all business, leadership and functional skills in a single framework with all skills clearly aligned to our business strategy. Extensive internal and external research has identified six business skills that are crucial to Unilever in the 21st century and will enable everyone to fulfil their potential and create important competitive advantages for the Group. The content has been refreshed, rationalised and made more relevant with user reviews supporting a renewed focus on quality.

New mobile-enabled content will be developed further during 2016. The Hub uses digital technology and collaborative tools to meet the demands of modern, multilingual working.

But we are not restricted to our own internal approach. Our leadership development includes a consortium programme where we partner with the world's leading establishments.

The consortium programme is one way that we bring the learning outside-in, to invite our suppliers, customers and like-minded companies to learn together. We selected topics and programmes which, when learnt together with external parties, enrich the learning process. These included Women Leadership, Learning Professionals Program (IMD), Sustainability (Cambridge in 2014 and INSEAD in 2015), Asian Leaders (IMD in 2016) and developing Asian Finance Talents (TMS Academy and Wharton in 2016). We have already included some programmes in the Four Acres curriculum.

Within Unilever, our supply chain is where the bulk of Unilever's people work and so is a big focus for our training activity. This number of people requires us to focus on self-directed learning via the use of effective systems and core skills curricula. This year we have updated the Learning Management System and all the core curricula, which cover over 1,300 individual online courses.

Our face-to-face training still plays a key role. Here we drive skills that develop deep functional understanding, with more than 15 new programmes being developed across the whole of our supply chain, including Procurement, Planning and Logistics. We use WebEx extensively and specifically on more general supply chain training, having reached more than 30% of our supply chain management team.

We also use face-to-face programmes to drive professional supply chain leadership development and have run programmes that cover the senior leadership teams in more than 60 of our factories globally.

We have further strengthened our Manufacturing Training programme with the implementation of a new system specifically to manage the driving of manufacturing skills of blue collar staff as part of our World Class Manufacturing programme.

OUR SAFETY RECORD

Based on our Vision Zero strategy we updated our mission in 2015 to build an interdependent safety culture that protects the well-being of our employees, visitors, contractors and assets to help deliver responsible growth. We also rolled out our Motor On Mobile Off campaign which bans the use of mobile devices – hands-free and hand-held – while driving on company business.

In our supply chain in 2015, we began integrating our behavioural-based BeSafE safety programme and World Class Manufacturing (WCM) methodology. This provided the opportunity for the safety and manufacturing teams to work more closely in delivering continuous safety improvement in full alignment with WCM. It also allowed us to combine the best elements from both BeSafE and WCM to create a stronger safety programme overall and ensure the highest level of safety and accountability for our manufacturing teams. We also appointed a dedicated process and construction safety director to focus on large-scale risks.

Unilever reports safety data from October to September. Our Total Recordable Frequency Rate (TRFR) from 1 October 2014 to 30 September 2015 increased to 1.12 accidents per 1 million hours worked, up from 1.05 in 2014. There are three main reasons for this increase. Firstly, safe travel incidents, which is an area of focus for the Group following the introduction of the global Safe Travel standard. Safe travel incidents are recordable events that occur on the roads when our employees drive designated vehicles on company time or business and have a collision with other road users, animals or stationary objects. Secondly, the acquisition of new companies with different safety cultures. Thirdly, a major transformation project that involved the closing down of sites in the US.

VISION ZERO
ZERO FATALITIES
ZERO INJURIES
ZERO MOTOR VEHICLE ACCIDENTS
ZERO PROCESS INCIDENTS
ZERO TOLERANCE OF UNSAFE BEHAVIOUR & PRACTICES

Unilever Annual Report and Accounts 2015 **Strategic Report** 29

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Nomination committee reporting

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Nomination committee reporting

Top tips

- Improve disclosure around human capital metrics and any assurance gained by the board over human capital, including ethics, or culture audits.
- Make it clear whether succession planning focuses on executive, non-executive or other senior leadership, the time period it covers and provide solid examples of activity during the year. This year only 11 FTSE 100 companies, 10 FTSE 250 companies and 2 smaller companies included clear disclosure around succession planning.

Keep an eye on

- Whether the nomination committee is meeting frequently enough to adequately consider succession planning and keep skills and experience matrices up to date. On average this year, nomination committees met three times.
- Developments around the FRC's update to the Guidance on Board Effectiveness. Review the nomination committee terms of reference promptly when changes occur.
- Diversity, including gender diversity but also broader diversity. This is not simply a regulatory challenge but about ensuring each board has the strength and depth to address threats and take advantage of opportunities – and there is a lot of work still to do to ensure the executive pipeline is sufficiently diverse.

Introduction

The UK Corporate Governance Code requires companies to describe the work of their nomination committee, including a description of the board's policy on diversity, including gender, any measurable objectives it has set for implementing the policy, and progress on achieving the objectives.

Nomination committee reporting is an area of increased regulatory focus at the moment, with the FRC currently undertaking a project focussed on the importance of succession planning. In response to the FRC's initial discussion paper on this subject there was some support for further guidance, particularly in relation to the role of the nomination committee and on reporting on succession planning. This is likely to take the form of changes to the FRC's Guidance on Board Effectiveness, which will be reviewed in 2017 and will also incorporate any changes thought necessary as a result of the Culture project. The FRC's recent paper arising from the project, Corporate Culture and the Role of Boards[78] recommends a series of measures to improve communication around culture in annual reports – we provide more detail in chapter 10.

Presentation of the nomination committee report

The Code requires there to be a separate section of the report which describes the work of the nomination committee in discharging its responsibilities. Although the Code specifies that information on the work of the nomination committee should be included in a 'separate section of the annual report', this could be a subsection within the overall corporate governance report.

86% of our survey sample presented a separate nomination committee report, including 100% of FTSE 100 companies and 92% of FTSE 250 companies. The smaller companies were less likely to have a nomination committee and often included some commentary on the role of the nomination committee within the broader corporate governance statement.

On average, nomination committees had met three times in the year, although FTSE 350 companies had on average met more often at around four times in the year. 23% of nomination committees had met once or less during the year – 6% in the FTSE 250 and 17% from the smaller companies.

Code provision B.2.4 encourages the nomination committee to disclose "the process it has used in relation to board appointments". Overall, we found that 60% of companies that had made board appointments during the year provided a disclosure around the process they had used for those appointments. Moreover, 28% described the process they had used for board appointments in general – 61% of those companies had also provided a disclosure around specific board appointments during the year. Booker Group plc, instead of providing a disclosure in the annual report, referred to "Board approved procedures" around board appointments being available on their website.

78 https://www.frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-governance/Corporate-Culture-and-the-Role-of-Boards.aspx

Board diversity

Diversity continues to be a hot topic, in the context of Board composition as well as the wider staff population (as discussed in chapter 6). The Women on Boards Davies review issued its five year summary in October 2015[79] which has revived the discussion on gender diversity. Lord Davies extended his recommendations from the FTSE 100 to the FTSE 350, increased the target of representation on boards to 33% and has strongly encouraged more executive positions and development of the leadership pipeline for women in business.

The preface to the Code extends diversity beyond gender diversity, bringing in "differences of approach and experience". We continue to see improvements in the nature of the discussion around broader aspects of diversity.

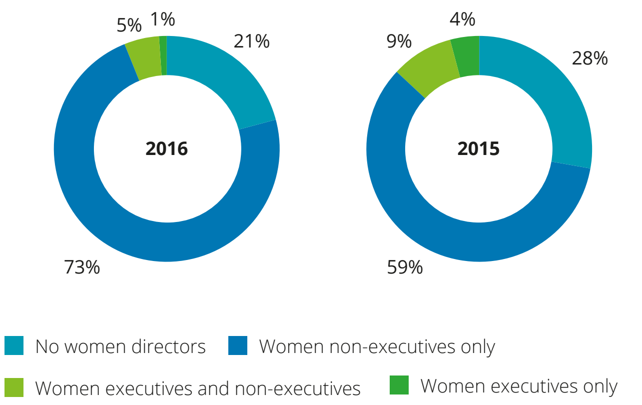
In 2015, we commented that we expected to see the target 25% of women on the boards of FTSE 100 companies reached in our 2016 survey – it was 24% last year. We're pleased to say that the proportion of women directors in the FTSE 100 companies in our survey was 27%. This compares, however, to 21% for FTSE 250 companies and only 10% below the FTSE 350 population. There were no women executive directors at all in our survey sample below the FTSE 350. Although there has been substantial achievement, there is therefore still a long way to go.

79 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482059/BIS-15-585-women-on-boards-davies-review-5-year-summary-october-2015.pdf

Only 9 companies from our sample indicated that they had a future target to achieve for gender diversity on the board. There is a concern that, with the initial target set by Lord Davies having been achieved, companies consider their job is done.

Figure 11.1 shows the distribution of companies which have female directors. The overall percentage of companies with women directors has increased from 72% last year to 79% this year.

Figure 11.1 How many companies have women directors?



It is important to remember that when the Code talks of board diversity, it is diversity in its broadest sense. It was encouraging to see that 64% (2015: 63%) of companies surveyed made reference to wider aspects of diversity in their disclosures, taking advantage of different ideas and perspectives to gain the benefits of a highly functional board, adaptable to market circumstances, with a good level of challenge and debate.

The most common areas of diversity mentioned were experience (39%), race or ethnicity (36%), skills (32%), nationality or geographical origin (25%), background (23%), knowledge (15%), age (16%) and disability (12%).

Good discussions of diversity were provided by **Marks and Spencer Group plc (Example 11.1)** and by **National Grid plc (Example 11.2)**.

Board performance evaluation

In accordance with Code principle B.6, the board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The Code recommends that companies in the FTSE 350 have board performance evaluations externally facilitated at least once every three years.

External facilitation once every three years has an important role, as a good external facilitator can add much external perspective which a board would otherwise not be able to access.

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There is discussion of internal performance evaluation in the current year	2016	2015
Overall	70%	78%
FTSE 350	64%	71%
Others	79%	88%

Discussion of internal performance evaluation has decreased both for FTSE 350 companies and smaller companies. This is not fully offset by a small increase in the number of companies that conducted external evaluations compared to 2015.

An external evaluation has been conducted this year or is planned to be conducted within a three year period	2016	2015
Overall	56%	58%
FTSE 350	84%	83%
Others	17%	23%

There is a good description of prior year findings and actions	2016	2015
Overall	20%	Not surveyed
FTSE 350	29%	Not surveyed
Others	7%	Not surveyed

A further 6% of companies included some description of prior year findings, but no action points or no real detail.

There is a good description of current year findings and actions	2016	2015
Overall	27%	Not surveyed
FTSE 350	36%	Not surveyed
Others	14%	Not surveyed

A further 25% of companies included some description of current year findings, but no action points or no real detail.

In terms of descriptions of both prior year and current year findings and actions, there is a substantial difference in the proportion of companies including high quality disclosure in the FTSE 350 compared to smaller companies. However, there is considerable room for improvement.

Premier Oil plc provided a good example of disclosure around an internal performance evaluation **(Example 11.3)**.

Other examples of disclosure focused on the findings and actions taken regarding board evaluation and include **Tate & Lyle PLC (Example 11.4)** and **Rexam PLC (Example 11.5)**.

Succession planning

In October 2015, the FRC issued a discussion paper UK Board Succession Planning[80] which sought views on various issues surrounding succession for both executives and non-executives. The FRC's interest stemmed primarily from the fact that the quality of succession planning was one of the most frequent issues highlighted as a consequence of board evaluation. The FRC believes that unless Boards are planning over the medium to long-term, for both executive and non-executive positions, they will struggle to ensure that there is the right mix of skills and experience needed as the company evolves.

The feedback to the FRC's paper[81] highlighted that an active nomination committee is key to promoting effective board succession and the importance of succession planning being aligned to company strategy. It encourages regular nomination committee meetings and the regular and detailed review of matrices set up to manage the skills, experience and competencies on the board.

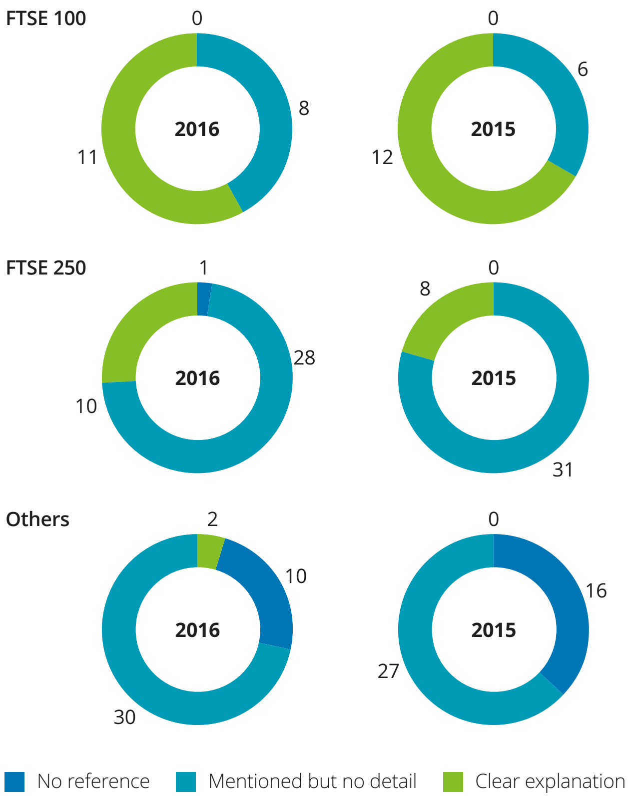
The FRC is considering providing nomination committee guidance as part of its review of the Guidance on Board Effectiveness, planned for 2017.

80 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Discussion-Paper-UK-Board-Succession-Planning-(1)-File.pdf

81 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Feedback-Statement-Succession-Planning-Discussion.pdf

Our survey examined whether there had been a reference to succession planning and whether, if so, it constituted a clear explanation of the board's activities in this area.

Figure 11.2 How did boards disclose activity around succession planning?



It is encouraging to see an increase in companies providing a relatively clear explanation of some of the board's activities relating to succession planning, with this year, smaller companies in our sample including more detail. One of these offered a tailored response to board evaluation findings, including describing focus on the pipeline of executive talent in subsidiaries. The other was in the FTSE 250 until recently and has maintained the quality of disclosure in this area.

78% of companies describe a focus on executive directors for succession planning purposes, 76% on non-executive directors and 56% on other senior leadership roles. Several of the companies that mentioned senior leadership roles and the pipeline of internal talent outlined clear programmes introduced to develop senior talent and also explained that this focus was in response to board evaluation findings – showing that performance evaluation has a genuine and pervasive impact.

We examined some of the main suggestions included in the FRC's feedback statement on its succession planning discussion paper and how far companies incorporate them into annual reports.

This demonstrates that there is a lot of opportunity for companies to substantially improve their disclosures around succession planning; we will look at these disclosures with interest next year.

Chesnara plc (Example 11.6) and **Thomas Cook Group plc (Example 11.7)** included elements of good disclosures around succession planning activities, some of which were proactive in nature.

The company sets out clearly the system the board uses to maintain good succession planning practices	2016
Overall	21%

A link to strategy is described or implied	2016
Overall	11%

The description sets out:	2016
How far ahead the board looks	
Overall	1%
How they search, select and appoint new candidates	
Overall	13%
What sort of skills, experience and expertise are needed	
Overall	5%
Information on the quality of the internal pipeline	
Overall	9%

Targets, metrics or KPIs are included in the nomination committee report*	
Overall	5%

*The most common are diversity metrics.

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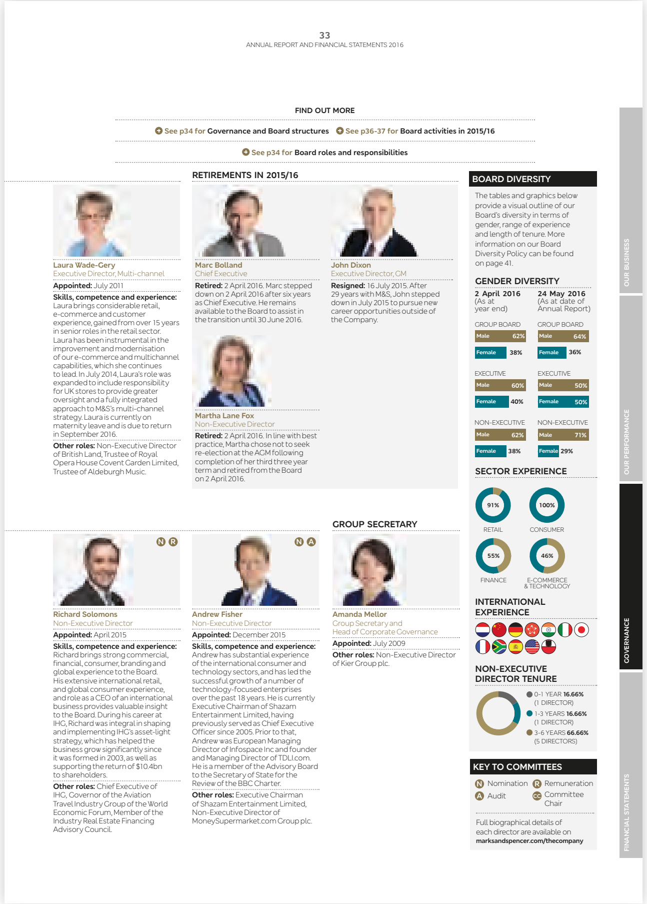
Diversity – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 11.1

[Marks and Spencer Group plc Annual Report and Financial Statements 2016 (p33/41)](#)

- Diagrams from board of directors disclosure and text from nomination committee report.
- Visually engaging diagrams covering more aspects of board diversity than gender alone, here international experience and length of non-executive director tenure.
- Split between executive and non-executive gender representation is in line with the new focus of the Women on Boards initiative.
- Disclosure answers questions regarding the board's approach to diversity and provides practical, specific examples of activity.



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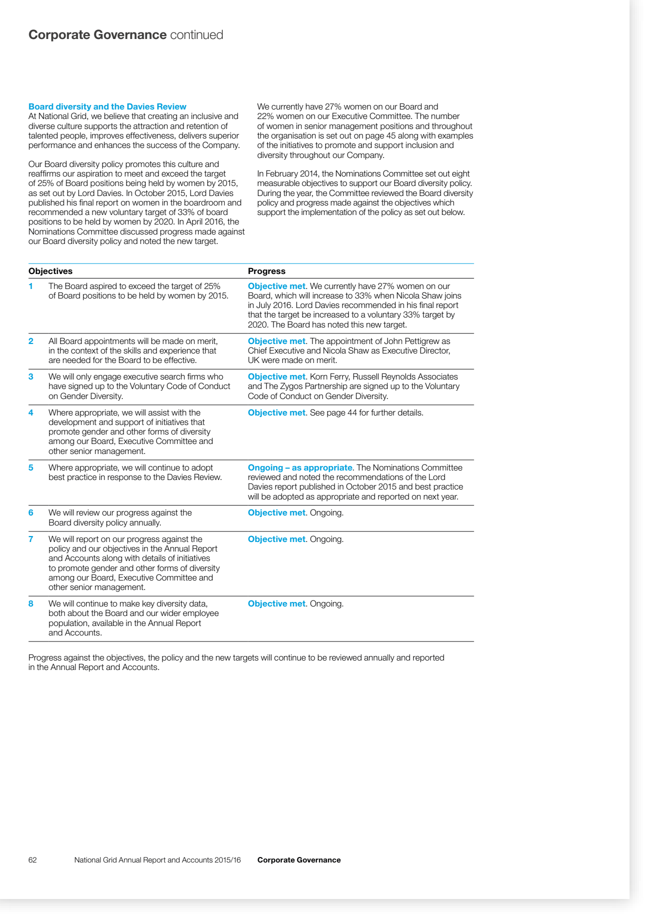
Example 11.2

National Grid plc Annual Report and Accounts 2015/16 (p62)

- The Nominations Committee provides detailed reporting on board gender diversity.
- Clearly laid out, presents objectives on diversity and the board's progress against its objectives.
- Notes more recent recommendations of the Davies Review and commits to reviewing in the coming year.



Corporate Governance continued

Board diversity and the Davies Review
At National Grid, we believe that creating an inclusive and diverse culture supports the attraction and retention of talented people, improves effectiveness, delivers superior performance and enhances the success of the Company.

Our Board diversity policy promotes this culture and reaffirms our aspiration to meet and exceed the target of 25% of Board positions being held by women by 2015, as set out by Lord Davies. In October 2015, Lord Davies published his final report on women in the boardroom and recommended a new voluntary target of 33% of board positions to be held by women by 2020. In April 2016, the Nominations Committee discussed progress made against our Board diversity policy and noted the new target.

We currently have 27% women on our Board and 22% women on our Executive Committee. The number of women in senior management positions and throughout the organisation is set out on page 45 along with examples of the initiatives to promote and support inclusion and diversity throughout our Company.

In February 2014, the Nominations Committee set out eight measurable objectives to support our Board diversity policy. During the year, the Committee reviewed the Board diversity policy and progress made against the objectives which support the implementation of the policy as set out below.

	Objectives	Progress
1	The Board aspired to exceed the target of 25% of Board positions to be held by women by 2015.	**Objective met**. We currently have 27% women on our Board, which will increase to 33% when Nicola Shaw joins in July 2016. Lord Davies recommended in his final report that the target be increased to a voluntary 33% target by 2020. The Board has noted this new target.
2	All Board appointments will be made on merit, in the context of the skills and experience that are needed for the Board to be effective.	**Objective met**. The appointment of John Pettigrew as Chief Executive and Nicola Shaw as Executive Director, UK were made on merit.
3	We will only engage executive search firms who have signed up to the Voluntary Code of Conduct on Gender Diversity.	**Objective met**. Korn Ferry, Russell Reynolds Associates and The Zygos Partnership are signed up to the Voluntary Code of Conduct on Gender Diversity.
4	Where appropriate, we will assist with the development and support of initiatives that promote gender and other forms of diversity among our Board, Executive Committee and other senior management.	**Objective met**. See page 44 for further details.
5	Where appropriate, we will continue to adopt best practice in response to the Davies Review.	**Ongoing – as appropriate**. The Nominations Committee reviewed and noted the recommendations of the Lord Davies report published in October 2015 and best practice will be adopted as appropriate and reported on next year.
6	We will review our progress against the Board diversity policy annually.	**Objective met**. Ongoing.
7	We will report on our progress against the policy and our objectives in the Annual Report and Accounts along with details of initiatives to promote gender and other forms of diversity among our Board, Executive Committee and other senior management.	**Objective met**. Ongoing.
8	We will continue to make key diversity data, both about the Board and our wider employee population, available in the Annual Report and Accounts.	**Objective met**. Ongoing.

Progress against the objectives, the policy and the new targets will continue to be reviewed annually and reported in the Annual Report and Accounts.

62 National Grid Annual Report and Accounts 2015/16 **Corporate Governance**

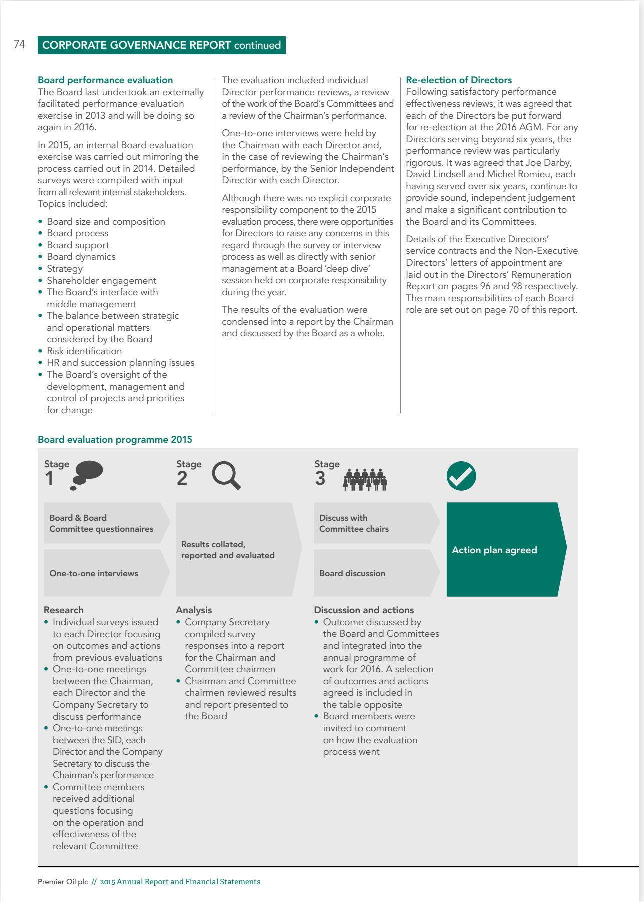
Board evaluation – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 11.3

[Premier Oil plc 2015 Annual Report and Financial Statements (p74)]

- Visually engaging description of how internal board evaluation is conducted.
- Separates into clear stages with defined responsibilities.
- Focus on outcomes.



74 CORPORATE GOVERNANCE REPORT continued

Board performance evaluation

The Board last undertook an externally facilitated performance evaluation exercise in 2013 and will be doing so again in 2016.

In 2015, an internal Board evaluation exercise was carried out mirroring the process carried out in 2014. Detailed surveys were compiled with input from all relevant internal stakeholders. Topics included:

- Board size and composition
- Board process
- Board support
- Board dynamics
- Strategy
- Shareholder engagement
- The Board's interface with middle management
- The balance between strategic and operational matters considered by the Board
- Risk identification
- HR and succession planning issues
- The Board's oversight of the development, management and control of projects and priorities for change

The evaluation included individual Director performance reviews, a review of the work of the Board's Committees and a review of the Chairman's performance.

One-to-one interviews were held by the Chairman with each Director and, in the case of reviewing the Chairman's performance, by the Senior Independent Director with each Director.

Although there was no explicit corporate responsibility component to the 2015 evaluation process, there were opportunities for Directors to raise any concerns in this regard through the survey or interview process as well as directly with senior management at a Board 'deep dive' session held on corporate responsibility during the year.

The results of the evaluation were condensed into a report by the Chairman and discussed by the Board as a whole.

Re-election of Directors

Following satisfactory performance effectiveness reviews, it was agreed that each of the Directors be put forward for re-election at the 2016 AGM. For any Directors serving beyond six years, the performance review was particularly rigorous. It was agreed that Joe Darby, David Lindsell and Michel Romieu, each having served over six years, continue to provide sound, independent judgement and make a significant contribution to the Board and its Committees.

Details of the Executive Directors' service contracts and the Non-Executive Directors' letters of appointment are laid out in the Directors' Remuneration Report on pages 96 and 98 respectively. The main responsibilities of each Board role are set out on page 70 of this report.

Board evaluation programme 2015

Research
- Individual surveys issued to each Director focusing on outcomes and actions from previous evaluations
- One-to-one meetings between the Chairman, each Director and the Company Secretary to discuss performance
- One-to-one meetings between the SID, each Director and the Company Secretary to discuss the Chairman's performance
- Committee members received additional questions focusing on the operation and effectiveness of the relevant Committee

Analysis
- Company Secretary compiled survey responses into a report for the Chairman and Committee chairmen
- Chairman and Committee chairmen reviewed results and report presented to the Board

Discussion and actions
- Outcome discussed by the Board and Committees and integrated into the annual programme of work for 2016. A selection of outcomes and actions agreed is included in the table opposite
- Board members were invited to comment on how the evaluation process went

Premier Oil plc // 2015 Annual Report and Financial Statements

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Example 11.4

Tate & Lyle PLC Annual Report 2016 (p50-51)

- Provides detail of findings and actions.
- Specific detail provided on review conducted in response to other factors.
- Clear on whether actions have been taken, will be taken or are in progress.

Corporate Governance continued

Board and committee evaluation
The Code provides that the review of Board effectiveness should be facilitated by an independent party at least once every three years. The diagram below sets out the Board's approach to this process:

2015 Board effectiveness review
This review was led by Liz Airey, the Senior Independent Director, and identified a number of individual and collective actions which are set out below:

- **Improving the robustness of our investor communications and processes**
  The Board approved an enhanced disclosure framework that is now in place for investor communications.
- **Improving the way information is presented to the Board and ensuring issues are fully surfaced in Board presentations**
  Work continues to be undertaken to enhance papers submitted to the Board. All major papers are sponsored by a Director who is responsible for obtaining input into the scope of the paper to ensure issues are identified and addressed in the paper.
- **Applying additional disciplines to operational or strategic proposals that are submitted to the Board**
  Proposals that are submitted to the Board are subject to a detailed review process, which includes input from independent experts where appropriate.
- **Driving forward succession planning and talent development**
  The Nominations Committee undertook a review of the succession planning and talent development processes and continues to keep this as a key area of focus.

Independent review following 2015 Annual General Meeting
Following the July 2015 AGM where the Directors' Remuneration Report was passed with 58.77% votes cast in favour, we commissioned an independent review to better understand the reasons for this outcome. This was led by Jon Edis-Bates who runs an independent corporate governance consultancy. He reviewed a range of key documents, met with a number of investors, advisers and a number of Tate & Lyle directors and senior executives and produced a detailed report for the full Board.

The Directors discussed Mr Edis-Bates's findings and recommendations, which principally focused on the Company's shareholder engagement practices and then set up a working party to develop a plan to address his recommendations.

The major priority areas that are being actioned are as follows:

Key action	Progress
Enhancing the Board's knowledge and understanding of the engagement practices of the Company's major shareholders	As part of this, the Board participated in a dedicated information session, led by the Company's advisers, on the operations and engagement practices of the Company's major investors and the role of proxy advisers
Extending the Group's communication policy document on shareholder engagement	Our internal Investor Relations guidelines were extended to include remuneration consultations
Increased involvement of the Company's external advisers	The remit of the Remuneration Committee's external advisers has been reinforced and formally extended; with greater involvement by our brokers and Investor Relations advisers
Committee composition and governance	Lars Frederiksen, who has extensive remuneration and investor experience, joined the Remuneration Committee, and Sybella Stanley, who has extensive investor relations experience, joined the Audit Committee on their appointment to the Board

2016 Board effectiveness review
This year, the Chairman worked with the Company Secretary to develop a questionnaire which was designed to build on actions that had already been identified to improve Board effectiveness, including those actions agreed following Mr Edis-Bates's review. The output from this questionnaire was then summarised in a report that was discussed by the Board. The Directors concluded that they are satisfied that the Board and its Committees continued to operate effectively and a number of action points were agreed, including the following:

- **Carve out more opportunities for Directors to discuss broad strategic/industry issues**
  We have changed the focus for Board dinners held when the Board is in London; these will generally be private sessions for Directors to explore broader longer-term issues.
- **Diversity of thinking styles**
  Following the 2015 session on leveraging the diverse nature of Directors' thinking styles, we will set up an additional session to ensure continued focus on this area.
- **Innovation pipeline**
  Additional detail will be provided to the Directors for each scheduled meeting setting out the progress of projects within the innovation pipeline.

Review of the committees
In addition to the Board effectiveness review, the chairman of each of the Committees facilitated a review of his or her own committee's effectiveness. These reviews confirmed that all committees continue to provide effective support to the Board. Areas for further focus are noted in the individual committee reports.

Review of individual directors
Liz Airey led the review of the Chairman's performance again this year. As part of this process, she sought the individual views of each of the executive and non-executive directors, led a meeting of the non-executive directors to discuss the feedback and then provided feedback to the Chairman.

The Chairman led performance reviews of the non-executive directors and the performance of the Chief Executive and Chief Financial Officer was considered by the Nominations Committee, in line with its terms of reference. These reviews confirmed that each director continues to make an effective contribution to the Board's work and is well-prepared and informed about issues they needed to consider. In each case, their commitment remains strong.

Professional development and independent site visit programme
Directors receive ongoing training and updates on relevant issues as appropriate, taking into account their individual qualifications and experience. The Company Secretary helps directors undertake any other professional development they consider necessary to assist them in carrying out their duties. In November 2015, Directors participated in an education session on cyber risk, facilitated by an independent adviser. This provided Directors with insights into market and leading-edge practices. Visits to external events are also arranged to help non-executive directors in particular to gain a deeper insight into the Group's operating environment. During the year, in addition to the Board's visits to the Commercial and Food Innovation Centre in Chicago, USA, and the manufacturing facility in Loudon, Tennessee, the Chairman and the non-executive directors visited three of the Group's sites in Europe and the US as part of their independent site visit programme. These visits provide directors with the opportunity to interact with local management and gain in-depth knowledge about the challenges being faced by the Group's operations across the world. Over the past three years, the Chairman and non-executive directors have visited 20 of the Group's principal locations as part of this programme.

Advice and support
All directors have access to the advice and services of the Company Secretary, Lucie Gilbert, who is responsible for ensuring that Board processes are followed and that applicable rules and regulations are complied with.

There is also a formal procedure whereby directors can obtain independent professional advice, if necessary, at the Company's expense.

Directors' conflicts of interest
Directors have a statutory duty to avoid situations in which they may have interests that conflict with those of the Company, unless that conflict is first authorised by the Board. As permitted under the Companies Act 2006, the Company's Articles of Association allow directors to authorise conflicts of interest and the Board has an established policy and set of procedures for managing and, where appropriate, authorising, actual or potential conflicts of interest.

The key elements of those procedures are as follows:

- Directors are required to disclose proposed new appointments to the Chairman before taking them on, to ensure that any potential conflicts of interest can be identified and addressed appropriately, for instance through the agreement and implementation of guidelines and protective measures regarding the ongoing management of any situational conflict
- Directors are required to declare other situations which could result in a potential conflict of interest
- Any potential conflicts of interest in relation to proposed directors are considered by the Board prior to their appointment
- The Board reviews directors' actual or potential conflicts of interest at least annually.

During the year, potential conflicts were considered and assessed by the Board and approved, together with guidelines and protective measures as appropriate.

Directors' indemnities and insurance cover
As at the date of this Annual Report, indemnities are in force under which the Company has agreed to indemnify the directors, to the extent permitted by the Companies Act 2006, against claims from third parties in respect of certain liabilities arising out of, or in connection with, the execution of their powers, duties and responsibilities as directors of the Company or any of its subsidiaries. The directors are also indemnified against the cost of defending a criminal prosecution or a claim by the Company, its subsidiaries or a regulator, provided that where the defence is unsuccessful the director must repay those defence costs. These indemnities are qualifying indemnity provisions for the purposes of Sections 232 to 234 of the Companies Act 2006 and copies are available for inspection at the registered office of the Company during business hours on any weekday except UK public holidays. Equivalent indemnities remain in force for Virginia Kamsky who ceased to be a director on 1 July 2015.

The Company also maintains directors' and officers' liability insurance cover, the level of which is reviewed annually.

Example 11.5

Rexam PLC Annual Report 2015 (p43-44)

Provides company-specific detail of findings and actions.

REXAM ANNUAL REPORT 2015 43

EFFECTIVENESS

STRATEGIC REPORT
GOVERNANCE
FINANCIAL STATEMENTS

Our board members bring important skills and experience to our organisation and this complements the skills of our executive team.

My ambitions for the composition of the board are to maintain and, where applicable, broaden the range of expertise, experience and diversity and ensure that effective succession plans are in place. Throughout 2015 the members of the board have continued to challenge each other to ensure the quality of our decisions.

Stuart Chambers
Nomination committee chairman

EFFECTIVENESS OF THE BOARD

The board acts in the best interests of the Company, making well informed and high quality decisions within a framework of prudent risk management. Matters are discussed cohesively by the board as a whole, with challenge and debate encouraged, and no one individual has unrestricted power of decision making.

The composition of the board and its committees facilitates the effective discharge of its duties and responsibilities. Rexam has a board of directors with international business backgrounds and a range of diverse skills, experience and nationalities. Their diversity and knowledge are invaluable in challenging and developing the Group's strategy and enable the board to govern the global business effectively.

Throughout 2015 and up to the date of this annual report the Company had a majority of independent non executive directors on the board.

The board is aware of the other commitments of the directors and considers that these commitments do not conflict with their duties as directors of the Company. A biography of each member of the board, including details of their business experience and other directorships, is given on pages 38 and 39.

BOARD PERFORMANCE EVALUATION

The directors recognise that the evaluation process is an important annual opportunity to review the practices and performance of the board, its committees and its individual directors, and implement actions to improve the board's focus, effectiveness and ability to contribute to the Company's success. An externally facilitated performance evaluation of the board was last conducted in 2013.

In 2015, the chairman and company secretary agreed the scope of the review which took into account, amongst other areas, the principal challenges and opportunities identified in the 2014 performance evaluation. The evaluation explored specific aspects of board and board committee effectiveness: the work of the board in 2015, and board environment, information and meetings. Directors were asked to complete a questionnaire which was reviewed and scored. The chairman met with each director to discuss their views on the effectiveness of the board and obtain open and constructive feedback.

The senior independent director is responsible for the annual performance appraisal of the chairman and presents the feedback from this process and her recommendations to the nomination committee.

Our board performance evaluation process

Completion of questionnaires
Analysis of responses, strengths and challenges
Recommendations and discussion document
Individual meetings with the chairman
Collective board and board committee discussions

Having conducted its performance evaluation, the board believes that it, and each of its committees has been effective in carrying out their objectives in 2015 and that each individual director has been effective and demonstrated commitment to the role. The challenges and opportunities were identified through the performance evaluation and the board agreed to focus on the following areas over the coming year to improve the board's effectiveness in 2016:

Challenges and opportunities	2016 development points following 2015 evaluation
Board environment and information	Learning from the additional requirements and challenges arising from the Ball offer; to heighten the focus in 2016 on emphasising and facilitating the importance of regular and full information flow, individual contribution from each director and open and transparent discussions at the board and board committees.
Board and committee professional development	To increase the professional development of the board and the board committees to extend their understanding of the Group and the issues faced on a business as usual basis, and to effectively contribute to discussions connected with the expected closing of the Ball offer.
Competitors, customers and suppliers	To continue presentations of detailed market intelligence on customers and suppliers to further develop the level of knowledge achieved in 2015. Refocus of discussions relating to competitors' strategies, strengths and weaknesses, and underlying commercial trends that are shaping the future of the beverage packaging industry.
Succession planning and leadership development	To continue informal meetings between the board, senior management and the talent pool so that the board can add value in discussions relating to talent identification, development and succession planning.

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EFFECTIVENESS CONTINUED

The board made progress during 2015 against the areas for development identified in the 2014 evaluation although the announcement of the Ball offer changed the emphasis of the board's priorities. In particular:

Challenges and opportunities	2015 progress on 2014 development points
Competitors, customers and suppliers	Progress was achieved by providing the board with customer and supplier insight through presentations and analysis of the global tender process. In conjunction with the progress made in 2014, the board achieved a further enhanced understanding of the beverage packaging industry. Development of the board's knowledge of the range of competitors to the beverage can industry will continue in 2016.
Talent pipeline and succession planning	Helpful interaction and debate on this topic between the board and senior management at board meetings, and events that were arranged to facilitate meetings with members of the talent pipeline. The Ball offer influenced the board's focus in the area of succession planning and the board was able to add value to discussions relating to senior management succession planning.
Board and committee professional development	Time constraints in 2015 affected plans for general professional development. The Ball offer provided scope for regular external training and development in the structure of takeover transactions, global regulatory clearance processes and associated divestment and integration workstreams.

The board committees each discussed their own effectiveness evaluations and identified areas for focus to improve their effectiveness in 2016. A full performance evaluation of the board, its committees and the individual directors will continue to be conducted annually.

DEVELOPMENT, INFORMATION AND SUPPORT

Formal board meetings are held during the year and the chairman and the company secretary ensure that, prior to each meeting, the directors receive accurate, clear and timely information which helps them to discharge their duties. In the months with no scheduled board meeting, the directors receive the prior month and cumulative financial, operating and risk information relating to the Group and its businesses. The directors receive their board papers through a secure electronic portal and are able to reference and mark the electronic papers in the board meeting.

All newly appointed directors participate in an internal induction programme that introduces the director to the Group and includes visiting Group businesses. This programme is tailored to each director's needs, taking into account individual qualifications and experience. If required, an overview of the role and responsibilities of a director can be facilitated by an external consultant. The company secretary gives guidance on board procedures and corporate governance.

New board directors participate in an induction programme which comprises one to one meetings with functional and operational management for an overview of the corporate and business aspects of the Group. Directors meet with the Group's external auditors, legal advisors, the Company's brokers and capital markets advisors. Governance and board related matters are discussed with the company secretary. Visits to the Group's plants in different jurisdictions are also arranged to provide a clear understanding of the beverage can manufacturing process and the beverage can markets.

The chairman is responsible for, and reviews and agrees with each director their training and development needs. Members of the committees receive specific updates on matters that are relevant to their role. The chairman arranges for the board to visit at least one of the Group's business locations each year to ensure that the directors' knowledge of, and familiarity with, the businesses are updated and maintained.

During 2015, the board visited the beverage can plant in Milton Keynes, UK where directors met with local management and toured the manufacturing facilities. They also toured Rexam's graphics and design centre in Luton. Rexam is the only beverage can maker to currently provide a full suite of design development capability under one roof.

Members of the senior management team with responsibility for the Group's businesses and those with corporate and service centre functional responsibilities make periodic presentations at board meetings about their businesses, functions, performance, suppliers, customers, competitors, markets and strategy.

The company secretary, who is appointed by the board, is responsible for ensuring compliance with board procedures. This includes taking minutes of the board meetings and recording any concerns relating to the running of the Company or proposed actions arising therefrom that are expressed by a director in a board meeting. The company secretary is also secretary to the audit and risk, nomination and remuneration committees.

Under the direction of the chairman, the company secretary is responsible for the communication of relevant information between the board, its committees and the senior management team. He also advises the board, through the chairman, on all governance and regulatory compliance matters.

Should a director reasonably request independent professional advice to carry out their duties, such advice is made available at the Company's expense.

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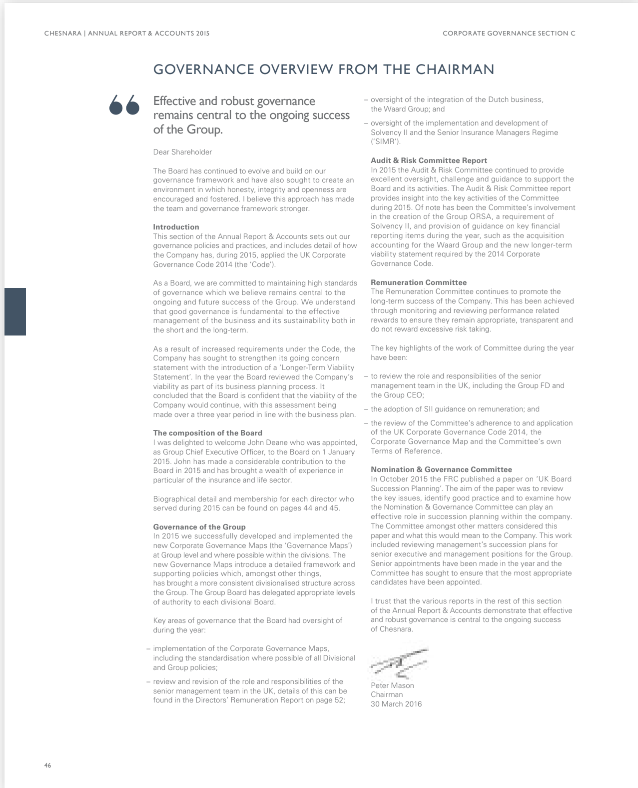
Succession planning – good practice examples

For each example, the aspects of good practice that it illustrates are listed next to it.

Example 11.6

Chesnara plc Annual Report and Accounts 2015 (p46)

- Recognises recent regulatory focus.
- Highlights that this has been considered by the company.
- Explains that work has been conducted to address points raised.



CHESNARA | ANNUAL REPORT & ACCOUNTS 2015

CORPORATE GOVERNANCE SECTION C

GOVERNANCE OVERVIEW FROM THE CHAIRMAN

Effective and robust governance remains central to the ongoing success of the Group.

Dear Shareholder

The Board has continued to evolve and build on our governance framework and have also sought to create an environment in which honesty, integrity and openness are encouraged and fostered. I believe this approach has made the team and governance framework stronger.

Introduction
This section of the Annual Report & Accounts sets out our governance policies and practices, and includes detail of how the Company has, during 2015, applied the UK Corporate Governance Code 2014 (the 'Code').

As a Board, we are committed to maintaining high standards of governance which we believe remains central to the ongoing and future success of the Group. We understand that good governance is fundamental to the effective management of the business and its sustainability both in the short and the long-term.

As a result of increased requirements under the Code, the Company has sought to strengthen its going concern statement with the introduction of a 'Longer-Term Viability Statement'. In the year the Board reviewed the Company's viability as part of its business planning process. It concluded that the Board is confident that the viability of the Company would continue, with this assessment being made over a three year period in line with the business plan.

The composition of the Board
I was delighted to welcome John Deane who was appointed, as Group Chief Executive Officer, to the Board on 1 January 2015. John has made a considerable contribution to the Board in 2015 and has brought a wealth of experience in particular of the insurance and life sector.

Biographical detail and membership for each director who served during 2015 can be found on pages 44 and 45.

Governance of the Group
In 2015 we successfully developed and implemented the new Corporate Governance Maps (the 'Governance Maps') at Group level and where possible within the divisions. The new Governance Maps introduce a detailed framework and supporting policies which, amongst other things, has brought a more consistent divisionalised structure across the Group. The Group Board has delegated appropriate levels of authority to each divisional Board.

Key areas of governance that the Board had oversight of during the year:

– implementation of the Corporate Governance Maps, including the standardisation where possible of all Divisional and Group policies;
– review and revision of the role and responsibilities of the senior management team in the UK, details of this can be found in the Directors' Remuneration Report on page 52;
– oversight of the integration of the Dutch business, the Waard Group; and
– oversight of the implementation and development of Solvency II and the Senior Insurance Managers Regime ('SIMR').

Audit & Risk Committee Report
In 2015 the Audit & Risk Committee continued to provide excellent oversight, challenge and guidance to support the Board and its activities. The Audit & Risk Committee report provides insight into the key activities of the Committee during 2015. Of note has been the Committee's involvement in the creation of the Group ORSA, a requirement of Solvency II, and provision of guidance on key financial reporting items during the year, such as the acquisition accounting for the Waard Group and the new longer-term viability statement required by the 2014 Corporate Governance Code.

Remuneration Committee
The Remuneration Committee continues to promote the long-term success of the Company. This has been achieved through monitoring and reviewing performance related rewards to ensure they remain appropriate, transparent and do not reward excessive risk taking.

The key highlights of the work of Committee during the year have been:

– to review the role and responsibilities of the senior management team in the UK, including the Group FD and the Group CEO;
– the adoption of SII guidance on remuneration; and
– the review of the Committee's adherence to and application of the UK Corporate Governance Code 2014, the Corporate Governance Map and the Committee's own Terms of Reference.

Nomination & Governance Committee
In October 2015 the FRC published a paper on 'UK Board Succession Planning'. The aim of the paper was to review the key issues, identify good practice and to examine how the Nomination & Governance Committee can play an effective role in succession planning within the company. The Committee amongst other matters considered this paper and what this would mean to the Company. This work included reviewing management's succession plans for senior executive and management positions for the Group. Senior appointments have been made in the year and the Committee has sought to ensure that the most appropriate candidates have been appointed.

I trust that the various reports in the rest of this section of the Annual Report & Accounts demonstrate that effective and robust governance is central to the ongoing success of Chesnara.

Peter Mason
Chairman
30 March 2016

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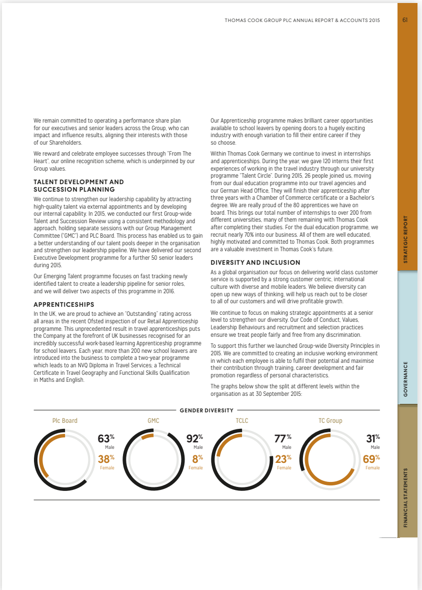
Example 11.7

[Thomas Cook Group plc Annual Report & Accounts 2015 (p61, 69, 77)]

- Focus on talent pipeline and senior leadership.
- Pervasive comment in annual report – both in strategic report and governance section.
- Explains outcome of board evaluation and includes cross-reference to further disclosure.



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Audit committee reporting

Enter the chapter

Audit committee reporting

Top Tips

- Make it clear how the significant issues considered in relation to the financial statements have changed from the previous year and why they remain relevant for the current year. Consider providing suitable cross-references to elsewhere in the annual report rather than repeating disclosure.
- Consider making appropriate disclosures in the audit committee report where you have had interaction with the FRC's Corporate Reporting Review team or Audit Quality Review team. This year, two companies disclosed interacting with the Corporate Reporting Review team and ten companies disclosed that an audit of the company had been reviewed by the Audit Quality Review team.
- Use the FRC's Audit Quality Practice Aid[82] to assist in structuring the disclosure on how the audit committee has assessed the effectiveness of the external audit process – and do remember it is how the effectiveness of the audit process has been assessed, not that it has been assessed. This year we considered 23% of these disclosures were comprehensive, compared to only 9% in 2015.

Keep an eye on

- Developments in reporting on auditor independence. The 2016 Guidance on Audit Committees[83] encourages more clarity in disclosure of non-audit services, fees and safeguards to protect auditor independence.
- The audit committee terms of reference and non-audit services policy. Make sure these have been reviewed in light of the 2016 Code changes and the Guidance on Audit Committees and Ethical Standards.
- Changing requirements regarding auditor rotation. For FTSE 350 companies, don't forget to make a statement of compliance with the CMA Order[84] – only 65% of companies subject to the Order did so this year.

Introduction

The UK Corporate Governance Code[85] requires there to be a separate section of the report which describes the work of the audit committee in discharging its responsibilities. Although the Code specifies that information on the work of the audit committee should be included in a 'separate section of the annual report', this could be a subsection within the overall corporate governance report. Reflecting the increasing profile of the audit committee's activities, nowadays most companies present a clearly separate audit committee report within the governance section of their report. This separation is useful as it provides a clear definition between the work of the audit committee and the work of the board as a whole.

The Code requires that the audit committee report includes not just a description of the audit committee's responsibilities but also detail about what the audit committee has done during the year under review to fulfil those responsibilities. This level of transparency gives shareholders a much clearer picture of what the key issues considered by the committee are and how they are addressed and what the audit committee does to oversee the external audit relationship.

The 2014 version of the Code requires FTSE 350 companies to put the audit out to tender at least every ten years, subject to transitional provisions – although this provision is removed in the 2016 Code as it has been superseded by a tendering requirement under UK legislation.

In September 2014 the Competition & Markets Authority published its Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014[86] (the CMA Order), which applies to FTSE 350 companies with periods commencing on or after 1 January 2015. This introduced a requirement that FTSE 350 companies put their statutory audit engagement out to tender at least every ten years. However, under the Statutory Auditors and Third Country Auditors Regulations 2016[87], going forward all listed companies will be required to tender their audit at least every 10 years, with a change of auditor required at least every 20 years.

In addition to the new rules around tendering, the CMA Order also gave FTSE 350 audit committees increased responsibilities for auditor independence and oversight, plus reporting obligations detailed later, which came into force for periods commencing on or after 1 January 2015.

82 https://frc.org.uk/News-and-Events/FRC-Press/Press/2015/May/FRC-provides-aid-to-Audit-Committees-in-evaluating.aspx
83 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-(2).pdf
84 https://assets.publishing.service.gov.uk/media/54252eae40f0b61342000bb4/The_Order.pdf
85 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf
86 https://assets.publishing.service.gov.uk/media/54252eae40f0b61342000bb4/The_Order.pdf
87 www.legislation.gov.uk/uksi/2016/649/contents/made

Presentation of the audit committee report

99% (2015: 100%) of the companies in our survey presented an audit committee report in accordance with the Code.

The level of responsibility taken on by the audit committee, which increased with the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting in 2014, is set to increase again in the coming years given that June 2016 saw the release of the new 2016 Code and, importantly, new FRC Guidance on Audit Committees including additions to audit committee responsibilities and substantial additions to audit committee reporting recommendations.

As such, it is no real surprise to note that the number of companies presenting a stand-alone audit committee report within the corporate governance section of the annual report has increased again this year, with 89 companies (2015: 83, 2014: 67) presenting such a report. This separation is useful as it provides a clear definition between the work of the audit committee and the work of the board as a whole. There has also been another notable increase in the number of audit committee chairmen showing clear ownership of the audit committee report at 84% (2015: 74%). Most audit committee chairmen do this through an introductory address, although some sign the audit committee report and a couple write the full audit committee report from a first person perspective.

<IR> Ownership

The <IR> Framework has an emphasis on ownership and stewardship which echoes the good practice shown when the audit committee chairman takes clear ownershjp of the audit report (or, indeed, the chairman of the board takes ownership of corporate governance as a whole).

In the UK environment, the 2014 Corporate Governance Code provides that a separate section of the annual report should describe the work of the committee. As explained in the FRC's Guidance on Audit Committees, this "deliberately puts the spotlight on the audit committee and gives it an authority that it might otherwise lack."

How does this affect the production of an integrated report? The main impact is that a consistent narrative and message regarding the capitals of the company needs to carry through in a further separately presented report.

The reader should be able to see the business model and the principal risks and uncertainties carrying through and affecting the risk management and internal control reported on by the audit committee, as well as the significant issues the audit committee considered in relation to the financial statements.

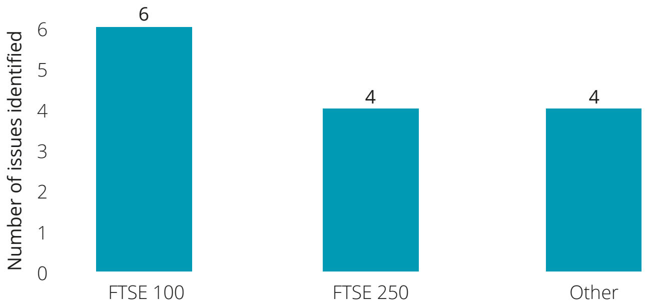
Significant issues considered by the audit committee

The Code requires audit committees to describe the significant issues considered in relation to the financial statements and how those issues were addressed. The interrelationship between the significant issues in the audit committee report, the risks disclosed by the auditors in the enhanced audit report and the critical accounting judgements and key sources of estimation uncertainty in the financial statements is addressed in chapter 4.

Only two of the companies we surveyed (2015: three) had not disclosed the significant issues considered by the audit committee and how they were addressed. One of those had not included an audit committee report at all, the other, a FTSE 100 company, had disclosed significant issues but not how they had been addressed – a critical component of the Code requirements, which are designed to encourage audit committees to inform the reader on how they have exercised their responsibility to pursue the integrity of financial reporting.

For the third year running, the average number of issues disclosed across the three company size categories has been the same. This is set out in Figure 12.1.

Figure 12.1 On average, how many significant financial reporting issues were identified by the audit committee?



Those FTSE 100 and FTSE 250 companies that reported the most significant issues in our sample had one more significant issue than in the prior year. In both cases, these companies included a significant issue relating to the new longer term viability statement, explaining the increase year on year.

Using our own judgement we rated the disclosures on the significant issues as brief, moderate or comprehensive. We considered 14% to be brief, 58% moderate and only 28% comprehensive. This is however an improvement on 2015, where we considered 23% brief, 52% moderate and 22% comprehensive, and indicates that there were more companies providing a more comprehensive disclosure of the significant issues they had considered and how those were addressed.

To achieve a rating of comprehensive we would have seen many of the characteristics referred to below (from the Financial Reporting Lab's report on Reporting of Audit Committees) in the disclosure.

- Reporting should be bespoke, company specific and tailored to the year under review.
- Providing context to the issue helps to communicate the specific story, e.g. quantifying the issue, identifying the related business unit, geography, contract or transaction type, describing the nature of the issue as being related to a specific policy or involving a specific assumption or estimate.
- Providing greater depth on how the audit committee fulfilled its role and the robustness of the steps it undertook to assess each significant issue and reach conclusions.
- Using more descriptive, 'active' language stated in the past tense, as this provides assurance that the audit committee has positively taken specific steps to address the issue.
- Disclosing ranges or scenarios taken into consideration, key assumptions, and whether reported amounts fall within an acceptable range.

Echoing the increase in quality of disclosure on the significant issues overall, more audit committee reports cross-referenced these disclosures to elsewhere in the annual report this year, at 43% (2015: 41%) – a slight, but positive trend.

We considered that good examples of disclosures on significant issues this year included **The Weir Group PLC (Example 12.1)** and **Lonmin Plc (Example 12.2)**. We have also included an example from **Findel plc (Example 12.3)**, which is unusual in its detailed description of the areas of challenge identified by the audit committee on each of the significant issues – this gives increased confidence in the robustness of the audit committee's process.

Effectiveness of the external audit process

Almost all audit committees explained that they had assessed the effectiveness of the external audit process. However, some continue to fail to meet the Code requirement to explain how they have assessed the effectiveness of the external audit process. This year, 95% of FTSE 100 and FTSE 250 companies met the requirement (2015: 100% and 95%), whilst 79% of the smaller listed companies met the requirement – an increase on prior years (2015: 73%; 2014: 61%).

Using our own judgement, we rated the quality of the disclosure on how the audit committee had assessed the effectiveness of the external audit process as brief, moderate or comprehensive. We considered 36% to be brief, 41% moderate and 23% comprehensive. This is a significant improvement from 2015 where only 9% of companies were deemed to have included comprehensive disclosures.

We looked for disclosure that explained the process undertaken; the method of assessment; key parties involved, both internal and external to the company; other information taken into account (if any) and some detail about which aspects of the audit process had been assessed. Examples of good disclosure were given by **Mondi Group (Example 12.4)** and **Croda International Plc (Example 12.5)**.

Following the recommendation of the Competition & Markets Authority that audit committees of FTSE 350 companies whose audit had been reviewed by the FRC's Audit Quality Review Team should disclose this, the FRC has consulted upon this and included a recommendation in the 2016 Guidance on Audit Committees.

This year, 20 audit committees in our sample mentioned the Audit Quality Review team's report on the firm. Of these, 10 referred to a specific AQR inspection of their own company (2015: one company).

The FRC's guidance indicates that audit committees should, where a company's audit has been reviewed by the FRC's Audit Quality Review team:

- discuss the findings with their auditors;
- consider whether any of those findings are significant; and
- if so, make disclosures about the findings and the actions they and the auditors plan to take.

The FRC advises that this discussion should not include disclosure of the audit quality category and indeed, none of the companies in our sample did so (2015: none). Almost all included their disclosure in the discussion on how they had assessed the effectiveness of the external audit process. Chesnara plc mentioned the Audit Quality Review team's overall report on the firm and carried on to make it clear that their auditor had not been subject to a specific AQR inspection in respect of their audit. None of the companies in our sample provided any specific detail on significant findings.

Only two audit committees made any reference to discussions with the FRC's Corporate Reporting Review team. This was lower than expected given the number of letters issued by the CRR team in 2014/15. One audit committee commented on the finalisation of the "routine review" of the 2013 report and accounts; the other stated that "as a result of the correspondence, the group refined the wording of certain of its significant accounting policies and extended certain disclosures." This year we also saw examples of audit committees stating that there had been no correspondence from regulators in respect of financial reporting, including Vodafone Group Plc.

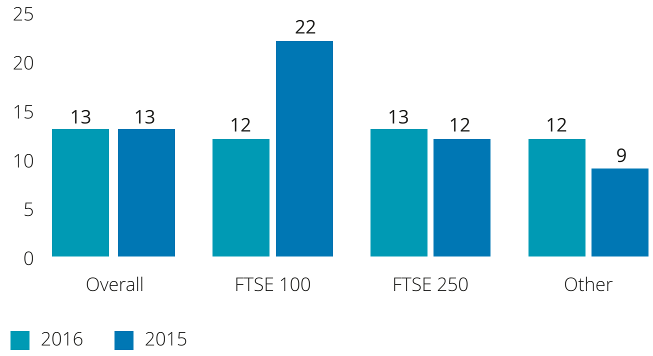
Audit tendering

The CMA Order applies to FTSE 350 companies with periods commencing on or after 1 January 2015. The first mandatory disclosures in our sample related to years ending on 31 December 2015. The two disclosure requirements imposed on FTSE 350 companies by the CMA Order, one a statement of compliance with the provisions of the Order and one a disclosure about the timing of future tendering if there has been no audit tender for five years, must be included in the audit committee report. These are legal requirements, so it was surprising to see just 65% of companies subject to the requirements including a statement of compliance with the Order, and only 58% of those required to include a statement regarding future tendering doing so. Most statements of compliance were very brief. **Rotork Plc's** is helpful in explaining to the reader some of the requirements of the Order over and above the tendering requirement **(Example 12.6)**.

As might be expected, the number of companies providing information on the tenure of the incumbent auditor continues to increase, to 87% this year from 85% in 2015. Of those that did not clearly disclose the tenure of the incumbent auditor, several had information about an imminent tender or other disclosure – for instance, about partner rotation – from which some detail about the length of auditor tenure could be derived.

As Figure 12.2 shows, despite the overall average tenure of the external auditor being comparable to last year, that statistic conceals real change within the population.

Figure 12.2 – How long was the tenure of the incumbent external auditor?



The average auditor tenure for FTSE 100 companies has fallen noticeably, from 22 years to 12 years, showing that companies that have had the same external auditor for a long time have conducted audit tenders recently. This is not as clear-cut for the FTSE 250 population – we are one year on and average auditor tenure has increased by a year – and some of the change in the 'Other' population can be attributed to higher level of disclosure of auditor tenure by those who have had the same auditor for a long time.

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Auditor independence

Of the companies surveyed, 97% had received some non-audit service(s) from their external auditor. Only 54% of these explained why the auditor had been engaged to provide the service and only 68% of companies that received significant other non-audit services included a description of what those services related to. Of the companies that had received significant non-audit services from their external auditor, only 28% described safeguards that had been applied to reduce the risk of impairing auditor independence.

Although 90% of audit committees (2015: 91%) included some detail on their non-audit services policy, fewer than half included description of those services which are prohibited, those which are pre-approved and those for which specific approval is required (we also accepted a cross-reference to a suitable policy on their website). With the 2016 Guidance on Audit Committees expecting audit committees to include more disclosure in this area, it will be interesting to see whether there is a gradual or a step-change in reporting this coming year. With the non-audit services that auditors are permitted to provide also being further restricted by the FRC's Ethical Standard 2016, companies will need to consider whether their non-audit services policy needs to be amended.

Internal audit

We looked in more detail at internal audit disclosures this year, given the increased focus on internal audit in the FRC's 2014 Guidance on Risk Management, Internal Control and Related Financial and Business Reporting [88] and the FRC's 2016 Guidance on Audit Committees[89].

When reviewing disclosures on internal audit, we did not focus solely on the audit committee report, but looked at risk committee reports and at risk management disclosures in the strategic report.

Table 12.1 – Disclosures on internal audit

Disclosures on internal audit	2016	2015
Confirmed that a review of the plans and work of the internal audit function was carried out		
Overall	75%	76%
19 companies did not have an internal audit function (2015: 18); 6 companies with an internal audit function did not include the disclosure (2015: 6).		
Reporting lines for internal audit are clear and involve a direct line to the audit committee		
Overall	41%	Not surveyed
For a further 35% of companies there was insufficient evidence to conclude on this question.		
Internal audit plans are clearly set with reference to the principal risks of the business		
Overall	34%	Not surveyed
This is a recommendation of the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.		
If there is no internal audit function, there is an explanation of why one is not considered necessary		
Overall	89%	Not surveyed

88 https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf

89 https://frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-(2).pdf

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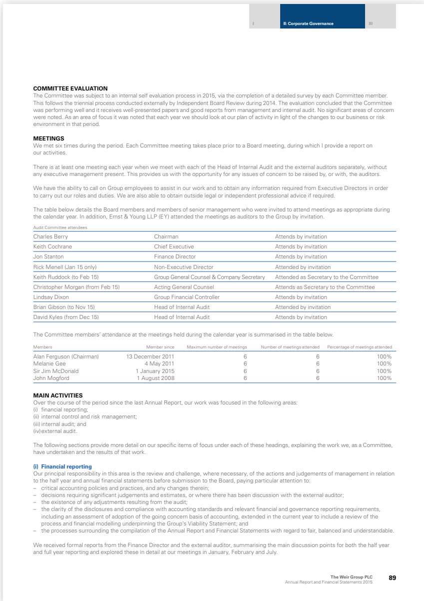
Audit committee reporting – good practice examples

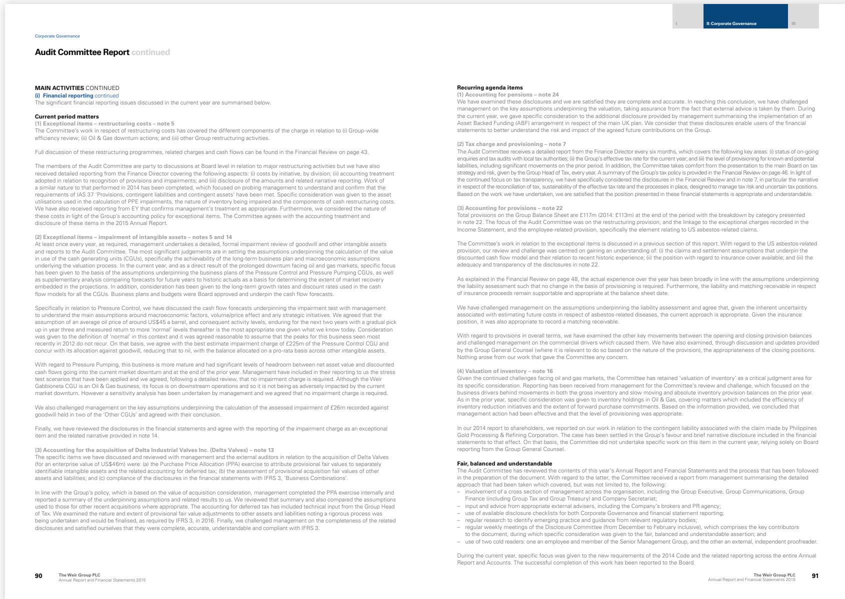
In this section we highlight a number of audit committee disclosures which we believe illustrate aspects of good practice. For each example, the aspects of good practice that it illustrates are listed next to it.

Example 12.1

[The Weir Group PLC Annual Report and Financial Statements 2015 (p89-91)]

- Disclosure of significant issues relating to financial reporting.
- Separation of disclosure between current period matters – with more detail – and recurring agenda items – with brief detail.
- Cross-referencing to notes and accounting policies in the financial statements.

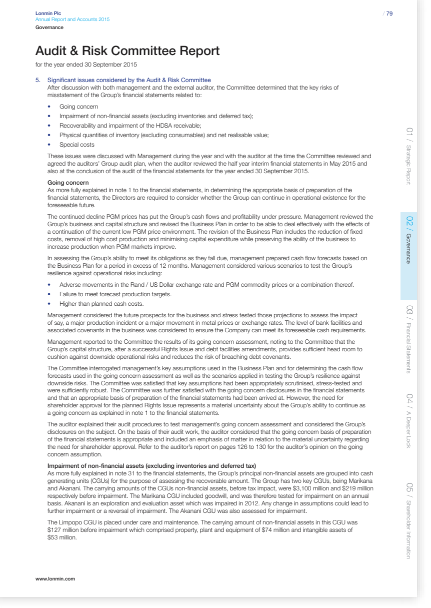




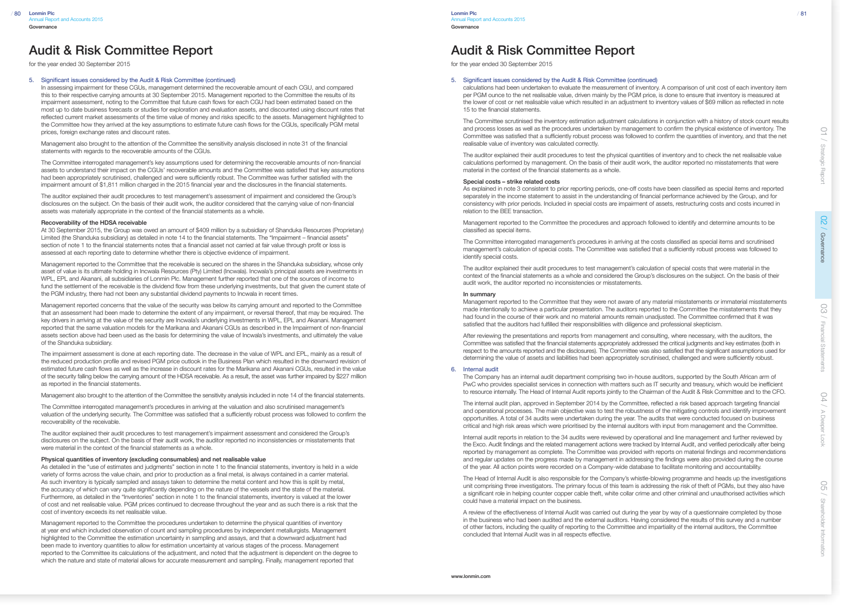
Example 12.2

[Lonmin Plc Annual Report and Accounts 2015 (p79-81)]

- Disclosure of significant issues relating to financial reporting.
- Cross-referencing to notes and accounting policies in the financial statements.
- Clear summary including discussion of misstatements with management and auditor.


Audit & Risk Committee Report

for the year ended 30 September 2015


Audit & Risk Committee Report

for the year ended 30 September 2015

Audit & Risk Committee Report

for the year ended 30 September 2015

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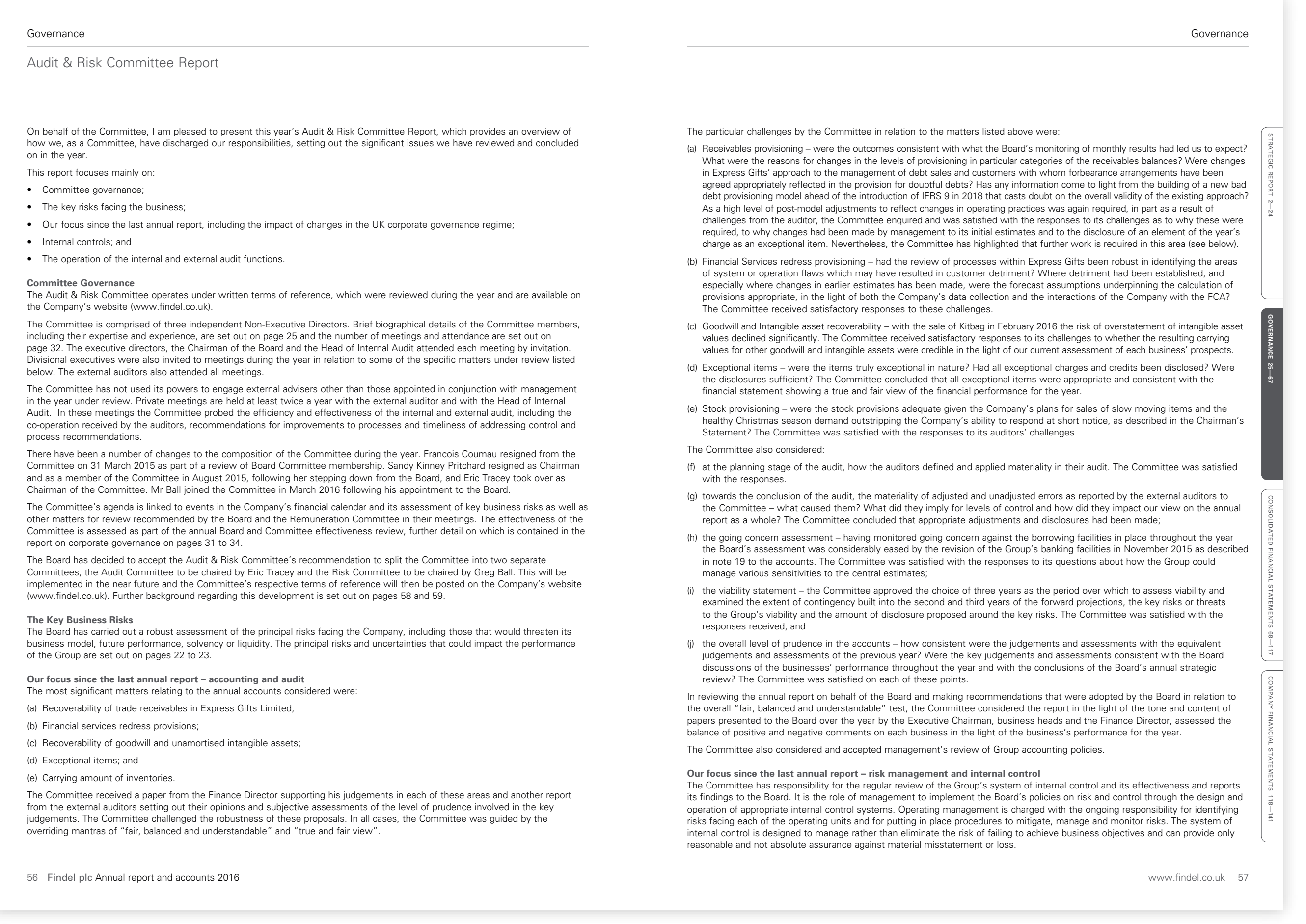
Example 12.3

[Findel plc Annual report and accounts 2016 (p56-57)](#)

- Executive summary of significant issues affecting the financial statements before the detail, explaining material reviewed by the audit committee.
- Clear detail on the way the committee challenged the robustness of the accounting judgements, the questions asked and the conclusions reached.
- Helpful comment in closing on how this interrelates with the fair, balanced and understandable requirement.



Governance

Audit & Risk Committee Report

On behalf of the Committee, I am pleased to present this year's Audit & Risk Committee Report, which provides an overview of how we, as a Committee, have discharged our responsibilities, setting out the significant issues we have reviewed and concluded on in the year.

This report focuses mainly on:

- Committee governance;
- The key risks facing the business;
- Our focus since the last annual report, including the impact of changes in the UK corporate governance regime;
- Internal controls; and
- The operation of the internal and external audit functions.

Committee Governance
The Audit & Risk Committee operates under written terms of reference, which were reviewed during the year and are available on the Company's website (www.findel.co.uk).

The Committee is comprised of three independent Non-Executive Directors. Brief biographical details of the Committee members, including their expertise and experience, are set out on page 25 and the number of meetings and attendance are set out on page 32. The executive directors, the Chairman of the Board and the Head of Internal Audit attended each meeting by invitation. Divisional executives were also invited to meetings during the year in relation to some of the specific matters under review listed below. The external auditors also attended all meetings.

The Committee has not used its powers to engage external advisers other than those appointed in conjunction with management in the year under review. Private meetings are held at least twice a year with the external auditor and with the Head of Internal Audit. In these meetings the Committee probed the efficiency and effectiveness of the internal and external audit, including the co-operation received by the auditors, recommendations for improvements to processes and timeliness of addressing control and process recommendations.

There have been a number of changes to the composition of the Committee during the year. Francois Coumau resigned from the Committee on 31 March 2015 as part of a review of Board Committee membership. Sandy Kinney Pritchard resigned as Chairman and as a member of the Committee in August 2015, following her stepping down from the Board, and Eric Tracey took over as Chairman of the Committee. Mr Ball joined the Committee in March 2016 following his appointment to the Board.

The Committee's agenda is linked to events in the Company's financial calendar and its assessment of key business risks as well as other matters for review recommended by the Board and the Remuneration Committee in their meetings. The effectiveness of the Committee is assessed as part of the annual Board and Committee effectiveness review, further detail on which is contained in the report on corporate governance on pages 31 to 34.

The Board has decided to accept the Audit & Risk Committee's recommendation to split the Committee into two separate Committees, the Audit Committee to be chaired by Eric Tracey and the Risk Committee to be chaired by Greg Ball. This will be implemented in the near future and the Committee's respective terms of reference will then be posted on the Company's website (www.findel.co.uk). Further background regarding this development is set out on pages 58 and 59.

The Key Business Risks
The Board has carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. The principal risks and uncertainties that could impact the performance of the Group are set out on pages 22 to 23.

Our focus since the last annual report – accounting and audit
The most significant matters relating to the annual accounts considered were:

(a) Recoverability of trade receivables in Express Gifts Limited;

(b) Financial services redress provisions;

(c) Recoverability of goodwill and unamortised intangible assets;

(d) Exceptional items; and

(e) Carrying amount of inventories.

The Committee received a paper from the Finance Director supporting his judgements in each of these areas and another report from the external auditors setting out their opinions and subjective assessments of the level of prudence involved in the key judgements. The Committee challenged the robustness of these proposals. In all cases, the Committee was guided by the overriding mantras of "fair, balanced and understandable" and "true and fair view".

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The particular challenges by the Committee in relation to the matters listed above were:

(a) Receivables provisioning – were the outcomes consistent with what the Board's monitoring of monthly results had led us to expect? What were the reasons for changes in the levels of provisioning in particular categories of the receivables balances? Were changes in Express Gifts' approach to the management of debt sales and customers with whom forbearance arrangements have been agreed appropriately reflected in the provision for doubtful debts? Has any information come to light from the building of a new bad debt provisioning model ahead of the introduction of IFRS 9 in 2018 that casts doubt on the overall validity of the existing approach? As a high level of post-model adjustments to reflect changes in operating practices was again required, in part as a result of challenges from the auditor, the Committee enquired and was satisfied with the responses to its challenges as to why these were required, to why changes had been made by management to its initial estimates and to the disclosure of an element of the year's charge as an exceptional item. Nevertheless, the Committee has highlighted that further work is required in this area (see below).

(b) Financial Services redress provisioning – had the review of processes within Express Gifts been robust in identifying the areas of system or operation flaws which may have resulted in customer detriment? Where detriment had been established, and especially where changes in earlier estimates has been made, were the forecast assumptions underpinning the calculation of provisions appropriate, in the light of both the Company's data collection and the interactions of the Company with the FCA? The Committee received satisfactory responses to these challenges.

(c) Goodwill and Intangible asset recoverability – with the sale of Kitbag in February 2016 the risk of overstatement of intangible asset values declined significantly. The Committee received satisfactory responses to its challenges to whether the resulting carrying values for other goodwill and intangible assets were credible in the light of our current assessment of each business' prospects.

(d) Exceptional items – were the items truly exceptional in nature? Had all exceptional charges and credits been disclosed? Were the disclosures sufficient? The Committee concluded that all exceptional items were appropriate and consistent with the financial statement showing a true and fair view of the financial performance for the year.

(e) Stock provisioning – were the stock provisions adequate given the Company's plans for sales of slow moving items and the healthy Christmas season demand outstripping the Company's ability to respond at short notice, as described in the Chairman's Statement? The Committee was satisfied with the responses to its auditors' challenges.

The Committee also considered:

(f) at the planning stage of the audit, how the auditors defined and applied materiality in their audit. The Committee was satisfied with the responses.

(g) towards the conclusion of the audit, the materiality of adjusted and unadjusted errors as reported by the external auditors to the Committee – what caused them? What did they imply for levels of control and how did they impact our view on the annual report as a whole? The Committee concluded that appropriate adjustments and disclosures had been made;

(h) the going concern assessment – having monitored going concern against the borrowing facilities in place throughout the year the Board's assessment was considerably eased by the revision of the Group's banking facilities in November 2015 as described in note 19 to the accounts. The Committee was satisfied with the responses to its questions about how the Group could manage various sensitivities to the central estimates;

(i) the viability statement – the Committee approved the choice of three years as the period over which to assess viability and examined the extent of contingency built into the second and third years of the forward projections, the key risks or threats to the Group's viability and the amount of disclosure proposed around the key risks. The Committee was satisfied with the responses received; and

(j) the overall level of prudence in the accounts – how consistent were the judgements and assessments with the equivalent judgements and assessments of the previous year? Were the key judgements and assessments consistent with the Board discussions of the businesses' performance throughout the year and with the conclusions of the Board's annual strategic review? The Committee was satisfied on each of these points.

In reviewing the annual report on behalf of the Board and making recommendations that were adopted by the Board in relation to the overall "fair, balanced and understandable" test, the Committee considered the report in the light of the tone and content of papers presented to the Board over the year by the Executive Chairman, business heads and the Finance Director, assessed the balance of positive and negative comments on each business in the light of the business's performance for the year.

The Committee also considered and accepted management's review of Group accounting policies.

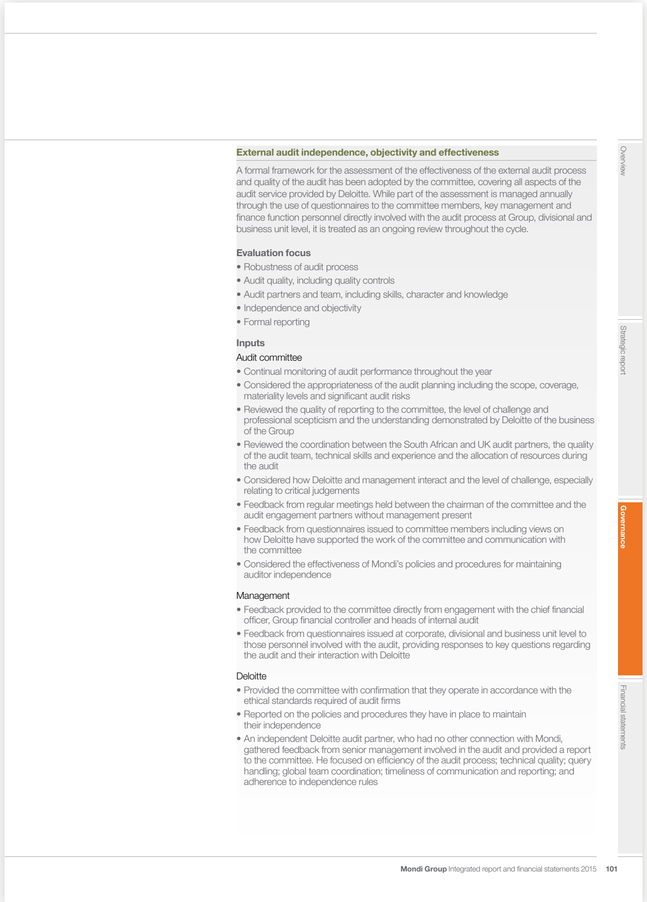
Our focus since the last annual report – risk management and internal control
The Committee has responsibility for the regular review of the Group's system of internal control and its effectiveness and reports its findings to the Board. It is the role of management to implement the Board's policies on risk and control through the design and operation of appropriate internal control systems. Operating management is charged with the ongoing responsibility for identifying risks facing each of the operating units and for putting in place procedures to mitigate, manage and monitor risks. The system of internal control is designed to manage rather than eliminate the risk of failing to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

www.findel.co.uk 57

Example 12.4

[Mondi Group Integrated report and financial statements 2015 (p101-102)]

- Comprehensive disclosure on how the audit committee assessed the effectiveness of the external audit process.
- Includes details on what was evaluated, who was involved, how the evaluation was conducted, external information used and conclusions reached.
- Recognises that the assessment is "an ongoing review throughout the cycle".



External audit independence, objectivity and effectiveness

A formal framework for the assessment of the effectiveness of the external audit process and quality of the audit has been adopted by the committee, covering all aspects of the audit service provided by Deloitte. While part of the assessment is managed annually through the use of questionnaires to the committee members, key management and finance function personnel directly involved with the audit process at Group, divisional and business unit level, it is treated as an ongoing review throughout the cycle.

Evaluation focus

- Robustness of audit process
- Audit quality, including quality controls
- Audit partners and team, including skills, character and knowledge
- Independence and objectivity
- Formal reporting

Inputs

Audit committee

- Continual monitoring of audit performance throughout the year
- Considered the appropriateness of the audit planning including the scope, coverage, materiality levels and significant audit risks
- Reviewed the quality of reporting to the committee, the level of challenge and professional scepticism and the understanding demonstrated by Deloitte of the business of the Group
- Reviewed the coordination between the South African and UK audit partners, the quality of the audit team, technical skills and experience and the allocation of resources during the audit
- Considered how Deloitte and management interact and the level of challenge, especially relating to critical judgements
- Feedback from regular meetings held between the chairman of the committee and the audit engagement partners without management present
- Feedback from questionnaires issued to committee members including views on how Deloitte have supported the work of the committee and communication with the committee
- Considered the effectiveness of Mondi's policies and procedures for maintaining auditor independence

Management

- Feedback provided to the committee directly from engagement with the chief financial officer, Group financial controller and heads of internal audit
- Feedback from questionnaires issued at corporate, divisional and business unit level to those personnel involved with the audit, providing responses to key questions regarding the audit and their interaction with Deloitte

Deloitte

- Provided the committee with confirmation that they operate in accordance with the ethical standards required of audit firms
- Reported on the policies and procedures they have in place to maintain their independence
- An independent Deloitte audit partner, who had no other connection with Mondi, gathered feedback from senior management involved in the audit and provided a report to the committee. He focused on efficiency of the audit process; technical quality; query handling; global team coordination; timeliness of communication and reporting; and adherence to independence rules

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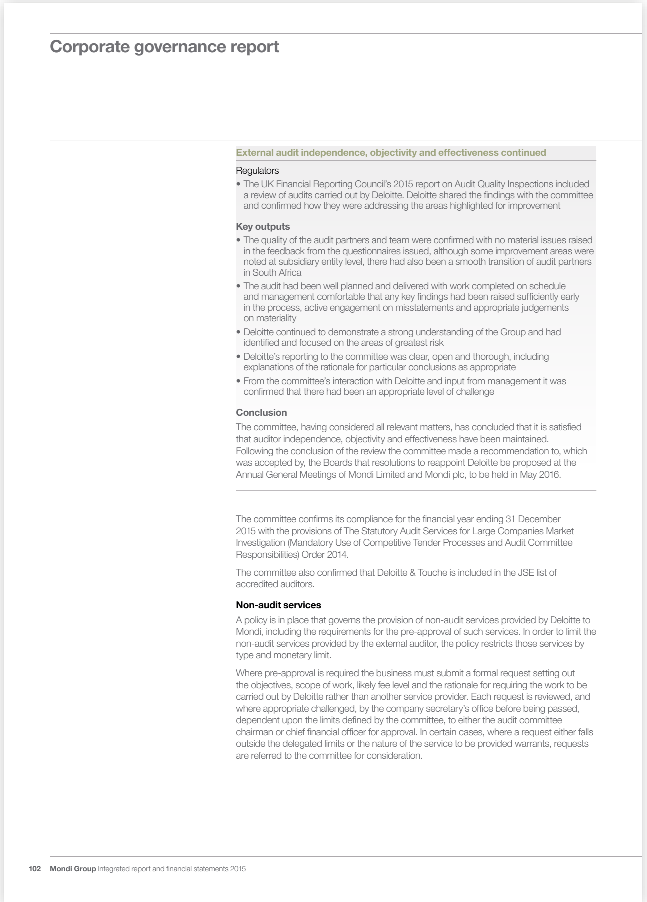
Mondi Group Integrated report and financial statements 2015 101



Corporate governance report

External audit independence, objectivity and effectiveness continued

Regulators

- The UK Financial Reporting Council's 2015 report on Audit Quality Inspections included a review of audits carried out by Deloitte. Deloitte shared the findings with the committee and confirmed how they were addressing the areas highlighted for improvement

Key outputs

- The quality of the audit partners and team were confirmed with no material issues raised in the feedback from the questionnaires issued, although some improvement areas were noted at subsidiary entity level, there had also been a smooth transition of audit partners in South Africa
- The audit had been well planned and delivered with work completed on schedule and management comfortable that any key findings had been raised sufficiently early in the process, active engagement on misstatements and appropriate judgements on materiality
- Deloitte continued to demonstrate a strong understanding of the Group and had identified and focused on the areas of greatest risk
- Deloitte's reporting to the committee was clear, open and thorough, including explanations of the rationale for particular conclusions as appropriate
- From the committee's interaction with Deloitte and input from management it was confirmed that there had been an appropriate level of challenge

Conclusion

The committee, having considered all relevant matters, has concluded that it is satisfied that auditor independence, objectivity and effectiveness have been maintained. Following the conclusion of the review the committee made a recommendation to, which was accepted by, the Boards that resolutions to reappoint Deloitte be proposed at the Annual General Meetings of Mondi Limited and Mondi plc, to be held in May 2016.

The committee confirms its compliance for the financial year ending 31 December 2015 with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

The committee also confirmed that Deloitte & Touche is included in the JSE list of accredited auditors.

Non-audit services

A policy is in place that governs the provision of non-audit services provided by Deloitte to Mondi, including the requirements for the pre-approval of such services. In order to limit the non-audit services provided by the external auditor, the policy restricts those services by type and monetary limit.

Where pre-approval is required the business must submit a formal request setting out the objectives, scope of work, likely fee level and the rationale for requiring the work to be carried out by Deloitte rather than another service provider. Each request is reviewed, and where appropriate challenged, by the company secretary's office before being passed, dependent upon the limits defined by the committee, to either the audit committee chairman or chief financial officer for approval. In certain cases, where a request either falls outside the delegated limits or the nature of the service to be provided warrants, requests are referred to the committee for consideration.

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Example 12.5

[Croda International Plc Annual Report and Accounts 2015 (p52)]

- Comprehensive disclosure on how the audit committee assessed the effectiveness of the external audit process.
- Includes details on what was evaluated, who was involved, how the evaluation was conducted, external information used and conclusions reached.
- Comments on additional insights received that added value.

Example 12.6

[Rotork Plc Annual Report 2015 (p71)]

- Statement of compliance with the Competition & Markets Authority's Order.
- Provides additional detail on the Order's requirements over and above tendering.

Example 12.5

Directors' Report | Corporate Governance | Audit Committee

Internal audit and risk management

In 2015 I met with the Vice President Risk and Control several times outside of the formal meetings to discuss the performance and output of the internal audit function and aspects of risk management. The Vice President Risk and Control attended each Committee meeting and presented an internal audit report that was fully reviewed and discussed, highlighting any major deviations from the annual plan agreed with the Committee.

At each meeting, the Committee considered the results of the audits undertaken and considered the adequacy of management's response to matters raised, including the time taken to resolve such matters. It also focused, in particular, on where there was a major divergence between the outcome of the internal audit and the scoring of the self-assessment questionnaire, completed annually by each business unit. In these instances it challenged management as to what actions it was taking to try to minimise the chances of divergences arising in the future. The Committee looked at recurring themes where issues are identified across a number of locations; such issues influence our planning for future years' audit work.

Internal audit reported on the successful IT project to implement automated access controls in SAP, which will further strengthen the control environment. The award of ISO 27001 certification for key IT systems required the external audit of the policies and controls relating to cyber security and the results of this were discussed with the Committee.

We also agreed the internal audit plan for 2016; this takes into account such factors as the results of previous audits, both external and internal, the self-assessment questionnaire, recurring themes from 2015, acquisitions, system changes and the views of Executive management.

In February, the Committee conducted its annual review of the internal auditor, including the approach to audit planning and risk assessment, communication within the Business and with the Committee and its relationship with the external auditors. Internal feedback is used in this process. This did not highlight any significant areas for development.

Details on how the Business implements its risk management and controls on a Group-wide basis are set out on pages 31 to 35 and page 46.

External auditors' effectiveness

During the year, the Committee assessed the effectiveness of PwC as Group external auditor. To assist in the assessment, the Committee examined the results of the internal survey completed by all senior financial management (approximately 20) across the Group, covering their views on the effectiveness of PwC in carrying out the 2015 audit. The approach was consistent with previous years and included 12 questions covering four broad areas:

→ Quality of planning, delivery and execution of the audit

→ Quality and knowledge of the audit team

→ Effectiveness of communications between management and the audit team

→ Robustness of the audit, including the audit team's ability to challenge management as well as demonstrate professional scepticism and independence.

The questions were graded from one to five and averaged a score of four. The Committee also considered the quality of reports from PwC and the additional insights provided by the audit team, particularly at partner level. It took account of the views of the Group Finance Director and Group Financial Controller, who had met local audit partners when visiting some of the Group's businesses, to gauge the quality of the team and their knowledge and understanding of the Business. The Committee considered how well the auditors assessed key accounting and audit judgements and the way they applied constructive challenge and professional scepticism in dealing with management. To assess the overall quality of PwC's work we also tabled the FRC's Audit Quality Inspection report on the firm and challenged PwC on the report's findings. A review of effectiveness also forms part of PwC's own system of quality control and these procedures, which are set out in PwC's 2015 Audit Quality and Transparency Report, were disclosed to the Committee.

Following the review, the Committee concluded that the audit was effective.

Audit tendering

The Statutory Audit Services Order 2014 (the Order) requires rotation of audit firms every ten years unless there is a tender, in which case the audit firm can remain as auditor for up to 20 years. The transitional provisions stagger the introduction of mandatory firm rotation depending on the length of audit tenure as at 17 June 2014. As PwC have been the Group's auditors for more than 20 years, we have a transition period that means PwC cannot be reappointed as our auditors after 17 June 2020.

We fully support the principle of audit tendering and the Group is in compliance with the provisions of the Order. The Committee has consistently said that it intends to tender the audit to coincide with the expiry of Ian Morrison's term as lead audit partner, when he would

52 Croda International Plc Annual Report and Accounts 2015

Example 12.6

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Primary statements

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Primary statements

Top tips

- Before preparing your annual report, it's important to think about which measures are helpful, understandable and transparent to the users of financial statements. This may not always be the same information that management are focussed on. Consider therefore, whether there are instances where a statutory measure provides more relevance to the users of your financial statements than adjusted non-GAAP measures. For instance, instead of disclosing non-GAAP measures on the face of the income statement, consider whether additional line items to describe specific items of income or expense may be more appropriate. 85% of the companies surveyed that included non-GAAP measures in their financial statements did so on the face of the income statement.

- When including non-GAAP measures, ensure that these are explained individually, and where items are deemed to be exceptional explain why they are regarded as such. Companies should have an accounting policy in relation to exceptional items, which should help them to consistently determine whether an item is exceptional by nature.

- Where you have restricted cash balances, make sure you disclose the amount that can't be used together with some commentary as to the nature of the restriction. 21% of companies surveyed disclosed restrictions on their cash balances.

Keep an eye on

- From December 2016 parents' separate FRS 101 accounts can use IFRS terms rather than Companies Act terms for line items. Companies may therefore want to either merge their parent accounts with their group accounts, or change their parent accounts to be presented in a manner consistent with the group. This may also aid companies in achieving more clear and concise reporting by giving them the opportunity to cut pages out of the report.

- If an adjusted EPS figure is presented, ensure that both basic and diluted figures under that basis are included – 11% of companies presenting adjusted EPS measures did not comply with IAS 33 in this regard. Of those companies 88% had a different basic and diluted number, and so an adjusted diluted EPS number appeared necessary.

Introduction

IFRSs require all companies to present the following primary statements in their annual report.

- An income statement, which contains the majority of the items that make up a company's financial performance. It can also include important subtotals such as gross profit, operating profit and profit before tax. Many companies choose to further analyse their income statement information into 'underlying' and 'non-underlying' items, resulting in the presentation of adjusted profit figures that management believe are helpful to allow users to understand the long-term performance of the business.

- A statement of comprehensive income, which can be combined with the income statement to form a single performance statement (although this is very rare in the UK). This includes specific items that certain IFRSs require to be excluded from the income statement, such as gains and losses on cash-flow hedges and actuarial movements in pension scheme balances. IAS 1 requires these items to be further subdivided into those that may be subsequently reclassified to profit or loss and those that will not.

- A statement of financial position, which sets out the assets, liabilities and equity balances of the group, identifying assets and liabilities as either current or non-current and analysing equity between amounts attributable to shareholders of the parent and those attributable to non-controlling interests.

- A statement of changes in equity, showing how the various components of the group's equity have been affected by the year's activities.

- A statement of cash flows, which presents the cash inflows and outflows that have occurred in the year, differentiating between whether they are operating, investing or financing cash flows. Operating cash flows arise from the principal revenue-generating activities of the group, while investing cash flows cover the acquisition and disposal of long term assets and other investments and financing cash flows are those that increase or decrease equity or borrowings.

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Income Statements

Non-GAAP measures

Non-GAAP measures, or alternative performance measures (APMs), are generally regarded to be financial metrics which are not defined by the relevant GAAP, in the case of our survey, IFRS. For the purposes of this section, metrics such as profit before exceptional items were always regarded as non-GAAP measures, even if they were consistent with the figures for segment results presented in the IFRS 8 note, whereas unadjusted operating profit lines were not considered to be non-GAAP measures.

Although many believe that the use of non-GAAP measures can be beneficial to a reader, their use has been an area of discussion and concern amongst regulators and standard setters alike over the past few years. Bodies such as the FRC[90], IOSCO[91], ESMA[92] and the IASB[93] have issued reports and guidelines in recent years which generally call for a greater level of consistency in the use and disclosure of non-GAAP measures. They have also focussed on how non-GAAP measures should be presented alongside the audited financial information and the level of prominence that companies currently present them with.

90 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/December/FRC-seeks-consistency-in-the-reporting-of-exceptio.aspx

91 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD532.pdf

92 https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf

93 http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/February/AP11A-Disclosure%20Initiative.pdf

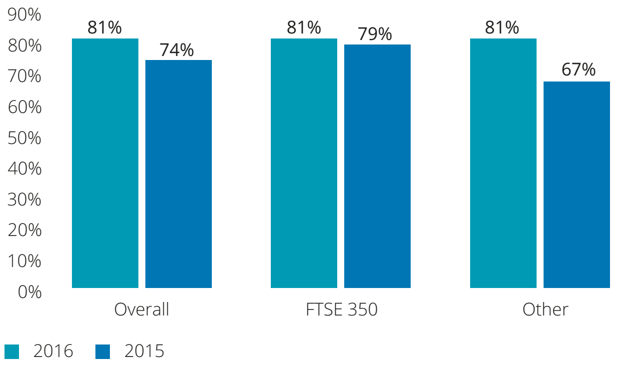
94 https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/May/FAQs-on-the-application-of-the-European-Securities.aspx

95 http://www.ifrs.org/About-us/IASB/Members/Documents/Hans-Hoogervorst-EAA-Annual-Conference-11-May-2016.pdf

Nevertheless, there is a clear and continuing upward trend of companies presenting information in the audited financial statements that is of a non-GAAP nature. This year we saw a 7% increase (2016: 81%; 2015: 74%) in companies disclosing non-GAAP measures in the audited financial statements (i.e. either on the face of the income statement or somewhere else in the back half of the report). This trend is also reflected throughout the annual report – indeed in one example we noted that a company used the word ‘underlying' 222 times in their 180 page annual report! In instances such as these the prominence of the non-GAAP information that is being conveyed to the users of the financial statements could be open to challenge.

Users who focus primarily on the front half of the report may be at particular risk of being misled as to how a company has performed where presentation of non-GAAP measures is not appropriately balanced by use of GAAP-compliant information. The FRC's FAQs[94] on the ESMA APM Guidelines remind us that strategic reports are required to be fair, balanced and comprehensive and that, per the aforementioned guidelines, APMs should not be given more prominence, emphasis or authority than measures directly stemming from financial statements. It is also worth noting that ESMA's guidelines specifically scope out the financial statements, but do apply to APMs used in the narrative part of companies' annual reports. The use of non-GAAP measures in the narrative sections of the annual report is discussed in chapters 4 and 7.

Figure 13.1 Is a non-GAAP measure disclosed in the financial statements ?



Our findings are consistent with a recent speech made by the chairman of the IASB, Hans Hoogervorst,[95] who expressed concern over the growing use of adjusted profit measures, particularly when they ultimately give a more favourable picture of performance than the statutory profit or loss. He stated that costs such as impairment and restructuring are “part of daily life of any big company” and so argued that underlying profit figures which exclude figures relating to those activities are potentially misleading. Additionally, ESMA's Guidelines on Alternative Performance Measures[96], which became applicable in July 2016, state that items that “affected past periods and will affect future periods will rarely be considered as non-recurring, infrequent or unusual” and specifically gives restructuring and impairment costs as examples of such items. This is, therefore, clearly an item of focus for standard setters and regulators alike and given the increase in companies disclosing impairment losses as per figure 13.2 this is a pertinent point.

The FRC has also previously highlighted the fact that reorganisations and restructurings are, for many large businesses, a recurring or commonplace cost. This is something that many companies should consider, with 54% (2015: 61%) stripping out such costs from their non-GAAP measures, as per figure 13.2.

One potential solution to the increasing and varied use of non-GAAP measures, suggested by Hans Hoogervorst in his aforementioned speech, would be for the IASB to define more subtotals in the income statement. Indeed our findings show that of the companies who disclosed non-GAAP measures, 85% did so on the face of the income statement, and so this may be an avenue worth exploring. Requiring more disaggregation and subtotals on the face of the income statement may reduce the need for management to define their own measures.

IAS 1 already requires that material items of income and expense are disclosed separately in the income statement, so as to bring items of individual significance to the attention of users. Generally we would therefore expect such items (often referred to as 'exceptional items') to be one-off and material either by size or nature. It is important therefore that companies don't separate out items which are clearly immaterial, something which we suspected in some cases.

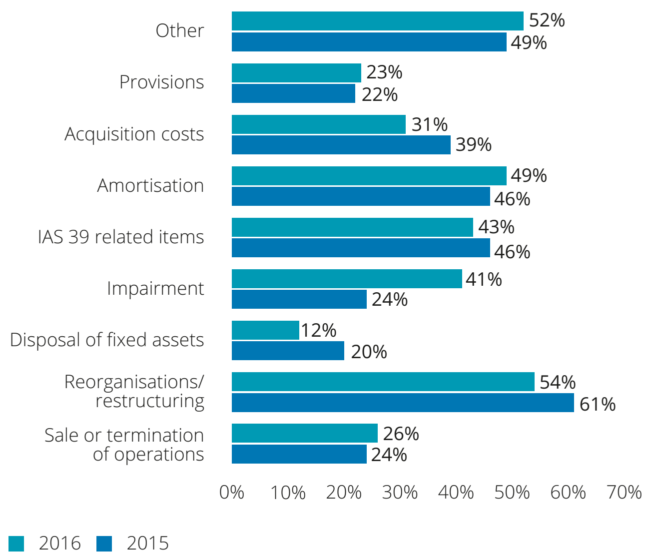
In our survey we noted several instances of companies describing items as exceptional or special where this description potentially seemed inappropriate. For example, one company included a list of 15 individual line items in their note to describe the different exceptional items incurred during the current and prior year. Whilst some of those certainly appeared to be valid exceptional items, a number of them were very small in quantum. In such cases a clear explanation of what is regarded as 'exceptional' is important for a reader.

We also noted one instance where a company disclosed exceptional items relating to sale of a subsidiary, but the only discussion of these exceptional costs in the whole of the front half of the accounts was in the audit committee report. We would typically have expected to see discussion of such an item in the strategic report if management believed that it was of such significance as to treat it as exceptional. We discuss the broader point on significant or exceptional items, and how they are linked between the front and back halves of annual reports in chapter 14.

The level of detail provided as to why certain items had been stripped out of non-GAAP measures varied considerably, with many explanations being relatively generic. Where explanations were provided they tended to include the objective and criteria for stripping out items.

Although figure 13.2 shows a 17% increase in the number of companies surveyed that have stripped out impairment losses (excluding those from trade receivables) from non-GAAP measures, this was primarily driven by a 20% increase in the number of companies surveyed reporting impairments. Looking ahead, it will be interesting to see how companies disclose any effects of the UK's decision to leave the EU (Brexit) and whether any such items will be described as exceptional.

Figure 13.2 What items are stripped out for non-GAAP measures?



We noted a slight reduction of 8% overall in our survey results relating to the number of companies that excluded acquisition costs from non-GAAP measures. As noted, our results showed that in the current and prior year 39 companies reported acquisitions in the year, and so the 8% drop represents a genuine reduction of these costs being stripped out of non-GAAP measures.

Kingfisher plc (example 13.1) provided a good example of well-defined and explained alternative performance measures, including the restatement of adjusted profit measures. **Barclays PLC (example 13.2)** also provided an example of a clear explanation of how a non-GAAP measure is calculated.

96 https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf

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Example 13.1

[Kingfisher plc Annual Report and Accounts 2015 (p92)]

- Good example of well-defined and explained alternative performance measures.
- Includes explanation of restatement of adjusted profit.

Example 13.2

[Barclays PLC Annual Report 2015 (p218)]

- Clear explanation of how a non-GAAP measure was calculated.

Example 13.1

Notes to the consolidated financial statements continued

2 Principal accounting policies continued

The preparation of financial statements in conformity with IFRS requires the use of certain accounting estimates and assumptions. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving critical accounting estimates and judgements, which are significant to the consolidated financial statements, are disclosed in note 3.

Use of non-GAAP measures

In the reporting of financial information, the Group uses certain measures that are not required under IFRS, the Generally Accepted Accounting Principles ('GAAP') under which the Group reports. Kingfisher believes that adjusted sales, retail profit, adjusted pre-tax profit, effective tax rate, adjusted earnings and adjusted earnings per share provide additional useful information on underlying trends to shareholders. These and other non-GAAP measures such as net debt/cash are used by Kingfisher for internal performance analysis and incentive compensation arrangements for employees. The terms 'retail profit', 'exceptional items', 'adjusted', 'effective tax rate' and 'net debt/cash' are not defined terms under IFRS and may therefore not be comparable with similarly titled measures reported by other companies. They are not intended to be a substitute for, or superior to, GAAP measures.

Retail profit is defined as continuing operating profit before central costs (principally the costs of the Group's head office), exceptional items, amortisation of acquisition intangibles and the Group's share of interest and tax of joint ventures and associates. 2014/15 comparatives have been restated to exclude B&Q China's operating results.

The separate reporting of non-recurring exceptional items, which are presented as exceptional within their relevant income statement category, helps provide an indication of the Group's underlying business performance. The principal items which are included as exceptional items are:

- non-trading items included in operating profit such as profits and losses on the disposal, closure or impairment of subsidiaries, joint ventures, associates and investments which do not form part of the Group's trading activities;
- profits and losses on the disposal of properties and impairment losses on non-operational assets; and
- the costs of significant restructuring and incremental acquisition integration costs.

The term 'adjusted' refers to the relevant measure being reported for continuing operations excluding exceptional items, financing fair value remeasurements, amortisation of acquisition intangibles, related tax items and prior year tax items (including the impact of changes in tax rates on deferred tax). 2014/15 comparatives have been restated to exclude B&Q China's operating results. Financing fair value remeasurements represent changes in the fair value of financing derivatives, excluding interest accruals, offset by fair value adjustments to the carrying amount of borrowings and other hedged items under fair value hedge relationships. Financing derivatives are those that relate to underlying items of a financing nature.

The effective tax rate is calculated as continuing income tax expense excluding tax on exceptional items and adjustments in respect of prior years and the impact of changes in tax rates on deferred tax, divided by continuing profit before taxation excluding exceptional items.

Net debt/cash comprises borrowings and financing derivatives (excluding accrued interest), less cash and cash equivalents and short-term deposits. It excludes balances classified as assets and liabilities held for sale.

b. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company, its subsidiaries, joint ventures and associates.

(i) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Subsidiaries acquired are recorded under the acquisition method of accounting and their results included from the date of acquisition. The results of subsidiaries which have been disposed are included up to the effective date of disposal.

The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

The excess of the consideration transferred, the amount of any non-controlling interests in the acquiree and the acquisition-date fair value of any previous equity interests in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the income statement.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of acquired subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(ii) Joint ventures and associates

Joint ventures are entities over which the Group has joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The equity method is used to account for the Group's investments in joint ventures.

Associates are entities over which the Group has the ability to exercise significant influence but not control, generally accompanied by a shareholding of between 20% and 50% of the voting rights. The equity method is used to account for the Group's investments in associates.

Under the equity method investments are initially recognised at cost. The Group's share of post-acquisition profits or losses is recognised in the income statement within operating profit, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses equals or exceeds its interest, including any other long-term receivables, the Group does not recognise any further losses, unless it has incurred obligations or made payments on behalf of the joint venture or associate.

Unrealised gains on transactions between the Group and its joint ventures and associates are eliminated to the extent of the Group's interest. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

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Example 13.2

Financial review
Key performance indicators

In assessing the financial performance of the Group, management uses a range of Key Performance Indicators (KPIs) which focus on the Group's financial strength, the delivery of sustainable returns and cost management.

Definition	Why is it important and how the Group performed	
CRD IV fully loaded Common Equity Tier 1 (CET1) ratio Capital requirements are part of the regulatory framework governing how banks and depository institutions are supervised. Capital ratios express a bank's capital as a percentage of its risk weighted assets (RWAs) as defined by the PRA. In the context of CRD IV, the fully loaded CET1 ratio is a measure of capital that is predominantly common equity as defined by the Capital Requirements Regulation.	The Group's capital management objective is to maximise shareholders' value by prudently optimising the level, mix, and distribution to businesses of its capital resources, while maintaining sufficient capital resources to: ensure the Group is well capitalised relative to its minimum regulatory capital requirements set by the PRA and other regulatory authorities; support its credit rating; and support its growth and strategic objectives. The Group's CRD IV fully loaded CET1 ratio increased to 11.4% (2014: 10.3%) due to a £44bn reduction in RWAs to £358bn, demonstrating continued progress on the Non-Core rundown together with reductions in the Investment Bank, which was partially offset by a decrease in CET1 capital to £40.7bn (2014: £41.5bn).	**2015:** 11.4% 2014: 10.3% 2013: 9.1%
Leverage ratio The ratio is calculated as fully loaded Tier 1 Capital divided by leverage exposure.	The leverage ratio is non-risk based and is intended to act as a supplementary measure to the risk based capital metrics such as the CET1 ratio. The leverage ratio increased to 4.5% (2014: 3.7%), reflecting a reduction in the leverage exposure of £205bn to £1,028bn and an increase in Tier 1 Capital to £46.2bn (2014: £46.0bn). Tier 1 Capital includes £5.4bn (2014: £4.6bn) of Additional Tier 1 (AT1) securities.	**2015:** 4.5% 2014: 3.7% 2013: n/a
Return on average shareholders' equity (RoE) RoE is calculated as profit for the year attributable to ordinary equity holders of the parent, divided by average shareholders' equity for the year excluding non-controlling and other equity interests. Adjusted RoE excludes post tax adjusting items for gains on US Lehman acquisition assets, movements in own credit, the revision to the Education, Social Housing and Local Authority (ESHLA) valuation methodology, provisions for UK customer redress, provisions for ongoing investigations and litigation including Foreign Exchange, the gain on valuation of a component of the defined retirement benefit liability, impairment of goodwill and other assets relating to businesses being disposed, and losses on sale relating to the Spanish, Portuguese and Italian businesses. Average shareholders' equity for adjusted RoE excludes the impact of own credit on retained earnings.	This measure indicates the return generated by the management of the business based on shareholders' equity. Achieving a target RoE demonstrates the Group's ability to execute its strategy and align management's interests with the shareholders'. RoE lies at the heart of the Group's capital allocation and performance management process. Adjusted RoE for the Group decreased to 4.9% (2014: 5.1%) driven by a 3% reduction in Group adjusted attributable profit, as average shareholders' equity remained in line at £56bn (2014: £56bn).	**Group adjusted RoE** **2015:** 4.9% 2014: 5.1% 2013: 4.3%[a]

Note
a 2013 adjusted total operating expenses and profit before tax have been revised to account for the reclassification of £173m of charges, relating to a US residential mortgage-related business settlement with the Federal Housing Finance Agency, to provisions for ongoing investigations and litigation including Foreign Exchange to aid comparability.

218 I Barclays PLC Annual Report 2015 home.barclays/annualreport

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Earnings per share
IAS 33 prescribes the requirements for determining and presenting earnings per share (EPS) amounts in order to improve performance comparisons between different entities in the same period and between different accounting periods for the same entity. EPS is seen by many companies, investors and analysts as a key measure of profitability in the year.

In the previous section, we noted that adjusted profit measures are presented by the majority of companies, and in the same vein companies often present an adjusted EPS figure, which often strips out the same items as the adjusted profit measures.

The results of our survey found that 71 (2015: 70) companies decided to present adjusted EPS figures in their financial statements, of which 45% (2015: 55%) presented the figures on the face of the income statement and 55% (2015: 45%) disclosed the adjusted figures in the notes only.

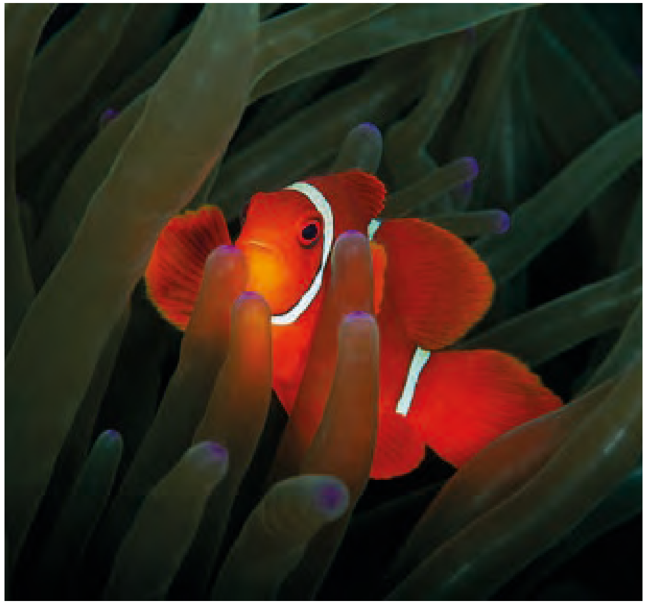
The trend of companies moving adjusted EPS figures from the face of the income statement to the notes represents a more prudent position, since IAS 33 mandates that adjusted figures should be included in the notes to the financial statements, whereas it is not clear whether presentation of adjusted measures on the face of the income statement is permitted. In addition, where adjusted EPS measures are disclosed, this should be done for both basic and diluted EPS.

87% (2015: 91%) of those that included an adjusted EPS figure in their financial statements provided a basic and diluted adjusted EPS. Only 13% did not provide a diluted adjusted EPS but this also highlights an area for potential increased compliance, since IAS 33 requires adjusted diluted figures to be presented with any adjusted basic measures. Of those few companies 88% had a different basic and diluted number, and so an adjusted diluted EPS number appeared necessary.

Other Income Statement observations

Other income statement observations	2016	2015
Companies presenting a combined statement of profit or loss and comprehensive income		
Overall	13%	14%
FTSE 350	10%	9%
Others	16%	21%
Companies overall continue to favour a separate approach for the income statement and statement of comprehensive income.		
Companies presenting an operating profit figure or equivalent		
Overall	92%	91%
FTSE 350	90%	96%
Others	95%	84%
The number of companies that presented a line called "operating profit" or an equivalent variant broadly remained the same as last year. Although there is no requirement to present an operating profit measure in IFRS and so its inclusion is somewhat of an old UK GAAP legacy, it represents a figure that users are generally comfortable understanding and is relatively consistently used by comparable companies (in part due to the guidance within IAS 1's basis for conclusions on how to present such a subtotal in the income statement).		
Companies with discontinued operations in the year		
Overall	12%	9%
FTSE 350	10%	9%
Others	14%	5%
Overall the number of companies that disclosed discontinued operations is relatively few. Of those companies, 11 had sold operations in the year or had operations for sale at the year end. The other one company had both sold operations in the year and closed operations in the year.		

Statement of Comprehensive Income
In July 2012, amendments to IAS 1 – Presentation of Financial Statements, came into force which addressed issues relating to the presentation of items of other comprehensive income. One of the most significant changes was a requirement to separately disclose those items which would be reclassified to the profit or loss in future periods from those items which will never be reclassified. Our survey found that of the companies that disclosed items of other comprehensive income, only 87% clearly disclosed the items that would or would not be reclassified to profit or loss. A good example of disclosing clearly which items would be reclassified to profit or loss was given by **Marks and Spencer Group plc (Example 13.3)**.



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Example 13.3

Marks and Spencer Group plc Annual Report and Financial Statements 2016 (p86)

Clearly distinguishes items of other comprehensive income that will be reclassified to profit or loss and those that will not.

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MARKS AND SPENCER GROUP PLC

FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

		53 weeks ended 2 April 2016			52 weeks ended 28 March 2015		
	Notes	Underlying £m	Non-underlying £m	Total £m	Underlying £m	Non-underlying £m	Total £m
Revenue	2, 3	**10,555.4**	**–**	**10,555.4**	10,311.4	–	10,311.4
Operating profit	2, 3, 5	**784.9**	**(200.8)**	**584.1**	762.5	(61.2)	701.3
Finance income	6	**21.1**	**–**	**21.1**	15.5	–	15.5
Finance costs	6	**(116.4)**	**–**	**(116.4)**	(116.8)	–	(116.8)
Profit before tax	4, 5	**689.6**	**(200.8)**	**488.8**	661.2	(61.2)	600.0
Income tax expense	7	**(118.8)**	**34.4**	**(84.4)**	(124.8)	6.5	(118.3)
Profit for the year		**570.8**	**(166.4)**	**404.4**	536.4	(54.7)	481.7
Attributable to:							
Owners of the parent		**573.3**	**(166.4)**	**406.9**	541.2	(54.7)	486.5
Non-controlling interests		**(2.5)**	**–**	**(2.5)**	(4.8)	–	(4.8)
		570.8	**(166.4)**	**404.4**	536.4	(54.7)	481.7
Basic earnings per share	8	**35.0p**		**24.9p**	33.1p		29.7p
Diluted earnings per share	8	**34.9p**		**24.8p**	32.9p		29.5p

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	53 weeks ended 2 April 2016 £m	52 weeks ended 28 March 2015 £m
Profit for the year		**404.4**	481.7
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Remeasurements of retirement benefit schemes	11	**346.2**	193.7
Tax charge on items that will not be reclassified		**(45.6)**	(40.2)
		300.6	153.5
Items that will be reclassified subsequently to profit or loss			
Foreign currency translation differences		**7.3**	(7.5)
Cash flow hedges and net investment hedges			
– fair value movements recognised in other comprehensive income		**(30.1)**	221.2
– reclassified and reported in profit or loss		**(22.1)**	(60.0)
– amount recognised in inventories		**5.9**	(21.6)
Tax credit/(charge) on cash flow hedges and net investment hedges		**6.5**	(21.2)
		(32.5)	110.9
Other comprehensive income for the year, net of tax		**268.1**	264.4
Total comprehensive income for the year		**672.5**	746.1
Attributable to:			
Owners of the parent		**675.0**	750.9
Non-controlling interests		**(2.5)**	(4.8)
		672.5	746.1

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Balance sheet

An area in which we have seen relatively little change over the past few years has been in the title of the balance sheet. Despite amending the terminology used in IAS 1 to refer to 'statement of financial position' as opposed to 'balance sheet' and giving companies the option of which title they use for periods commencing 1 January 2009, most companies surveyed by us have continued to use the term 'balance sheet' in their accounts (2016: 70%; 2015: 75%). There has been a small shift towards the term statement of financial position during FY15/16 in the companies that we surveyed, with 30% of companies surveyed using the newer terminology. That shift was most notable in companies outside of the FTSE 350, with 31% (2015: 21%) using statement of financial position – a 10% overall increase on last year.

Another point to bear in mind when preparing your balance sheet is the FRC's continued focus on the concept of clear and concise reporting. The aggregation of immaterial line items is one of a number of factors that companies should consider when preparing their primary statements with the aim of cutting clutter, as noted in the technical findings slide deck that accompanied the FRC's most recent Corporate Reporting Review Annual Report.

Use of Net Assets in balance sheet presentation	2016	2015
Overall	76	75
FTSE 350	42	39
Others	34	36

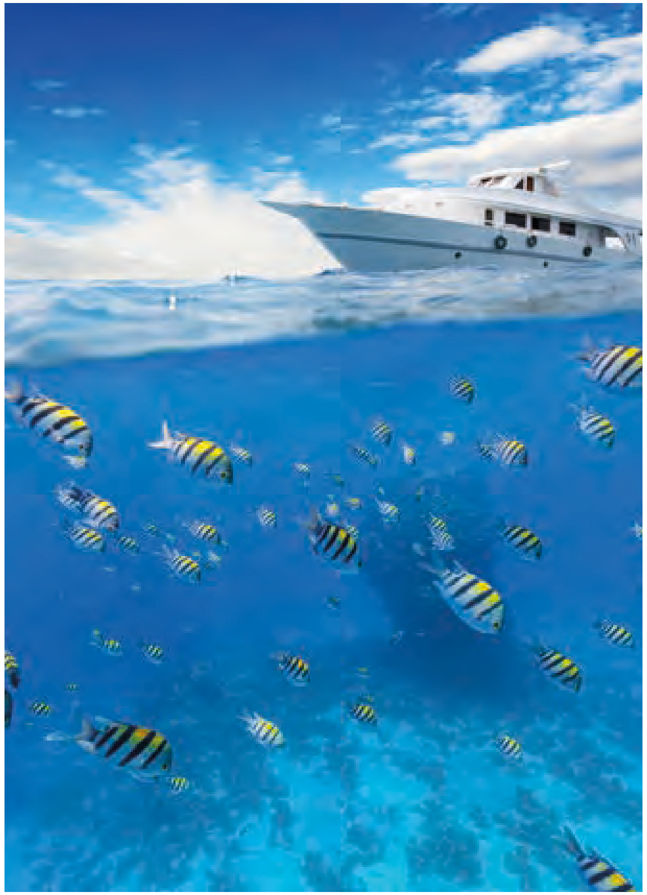
IAS 1 does not dictate the format of how the balance sheet should be structured. Either a Net Asset (NA) presentation or Total Equity and Liabilities (TEL) presentation is therefore acceptable. Consistent with previous years, our survey found that the majority of companies prefer the NA approach, with only 23 (2015: 24) preferring to use TEL. One company disclosed the sub totals total assets less current liabilities and total equity, which is unusual.

Restricted cash

Restrictions on the use of cash continues to be an area of focus for regulators, despite proposals to amend IAS 7's disclosure requirements around liquidity being dropped for the time being.

Our survey this year found that 21 (2015: 19) companies disclosed restrictions in relation to the cash that they had available. Whilst there has been a slight increase in the number of companies that have disclosed restrictions in relation to their cash balances, only one company did not state the reason for the restriction, which is an improvement in the level of disclosure compared to last year. Of those companies that did give some reason for the restriction, eight (2015: four) were due to cash being pledged as security, five (2015: one) companies disclosed overseas exchange restrictions and two (2015: three) companies stated that balances were being held in escrow.

Thomas Cook Group plc (Example 13.4) displayed a good example of how to report restricted cash, clearly demonstrating the amounts in the context of the total cash balance, and with a clear comparative.



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Example 13.4

[Thomas Cook Group plc Annual Report and Accounts 2016 (p147)]

- Good example of reporting restricted cash.
- Clearly shows restricted amounts in the context of total cash.
- Clear comparatives.

16 TRADE AND OTHER RECEIVABLES CONTINUED

Movement in allowances for doubtful receivables

	2015 £m	2014 £m
At beginning of year	38	44
Additional provisions	9	14
Exchange differences	(1)	–
Receivables written off	(9)	(12)
Unused amounts released	(8)	(8)
At end of year	29	38

At the year end, trade and other receivables of £88m (2014: £69m) were past due but not impaired.

The analysis of the age of these financial assets is set out below:

Ageing analysis of overdue trade and other receivables

	2015 £m	2014 £m
Less than one month overdue	42	42
Between one and three months overdue	15	15
Between three and 12 months overdue	21	10
More than 12 months overdue	10	2
	88	69

Trade and other receivables are not subject to restrictions on title and no collateral is held as security.

The Directors consider that the carrying amounts of trade and other receivables approximate to their fair values.

17 CASH AND CASH EQUIVALENTS

	2015 £m	2014 £m
Cash at bank and in hand	573	403
Term deposits with a maturity of less than three months	728	616
	1,301	1,019

Cash and cash equivalents largely comprise bank balances denominated in Sterling, Euro and other currencies for the purpose of settling current liabilities as well as balances arising from agency collection on behalf of the Group's travel agencies.

Included within the above balance are the following amounts considered to be restricted:

- £7m (2014: £38m) held within escrow accounts in respect of local regulatory requirements;
- £18m (2014: £18m) of cash held by White Horse Insurance Ireland Limited, and Voyager Android Insurance Services the Group's captive insurance companies; and
- £1m (2014: £1m) of cash held in countries where exchange control restrictions are in force.

The Directors consider that the carrying amounts of these assets approximate to their fair value.

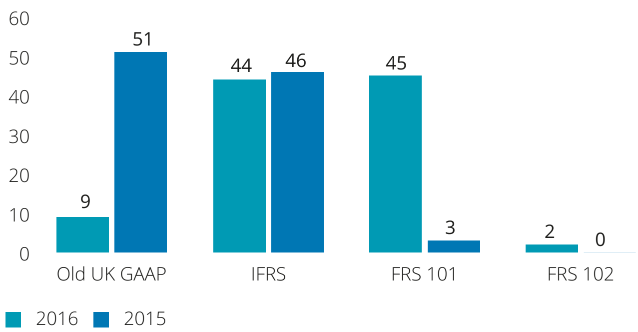
FINANCIAL STATEMENTS

Parent company reporting

Companies that had been applying old UK GAAP with a 31 December or later year end were required to transition their accounts to a new accounting framework – either new UK GAAP (FRS 101 or FRS 102) or IFRSs, following the withdrawal of old UK GAAP as of 1 January 2015. As illustrated by figure 13.3, of the companies surveyed 45% chose to use FRS 101 in the accounts we surveyed. This is unsurprisingly popular for groups reporting under IFRSs, since it allows them to use the same recognition and measurement principles for their parent (or subsidiaries) without such extensive disclosure requirements. However, almost as popular is full IFRSs, with 44% of parent companies applying this in their separate financial statements.

It was interesting to note that relatively few companies applying IFRS last year seemed inclined to move to FRS 101. Instead, most of the 45 now adopting FRS 101 were companies that had bade farewell to old UK GAAP. Looking at the 45 companies in our sample both this year and last that reported under old UK GAAP in last year's survey, 35 had moved to FRS 101. At the time of writing, companies transitioning to FRS 101 were required to inform their shareholders about their intention to move to that framework. However, the FRC issued draft amendments to FRS 101[97] in July 2016 that propose to remove this requirement. If approved this may lead to an increase in parent companies moving from full IFRSs to FRS 101.

Figure 13.3 Parent accounting framework



The fact that FRS 102 was adopted by so few parent companies likely reflects the fact that given the consolidated accounts for listed groups need to be prepared under IFRSs, FRS 101 or full IFRS would appear a more obvious choice for them.

Of the nine companies surveyed that were still applying UK GAAP in their parent accounts, four stated in their accounts that they would be transitioning to FRS 101 in the next financial statements. The remaining five did not disclose which accounting framework they would be transitioning to next year.

Of the 45 companies that had moved to FRS 101 for their parent accounts, only 11 early adopted the new 2015 accounting regulations, which allowed them to present their primary financial statements using line item terminology in accordance with an IFRS format. We expect that this is a helpful option to companies, and expect to see more companies use IFRS formats in the future once the accounting regulations have been fully adopted by all companies. Companies may also decide to integrate their FRS 101 parent accounts with their Group IFRS accounts in the future as a result of the flexibility to use an IFRS format for their primary statements, although of the ten companies that early adopted the 2015 accounting regulations, none decided to integrate their parent accounts with their group accounts this year

97 https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRED-65-Draft-amendments-to-FRS-101-Reduced-Discl-File.pdf

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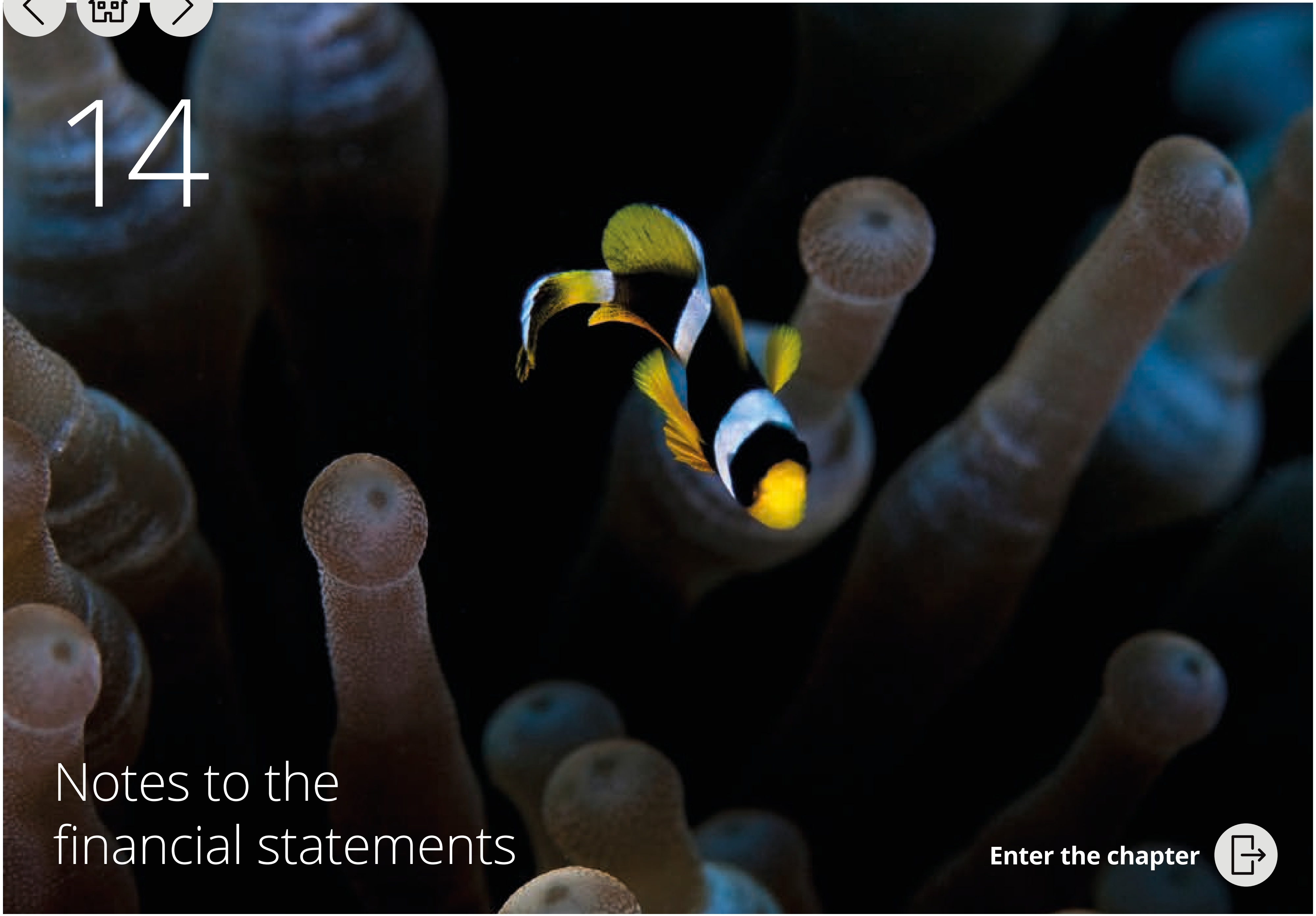
Other findings

Companies taking the audit exemption for subsidiaries by guaranteeing their liabilities	2016	2015
Overall	10%	8%
FTSE 350	14%	11%
Others	5%	5%

Only ten companies (2015:8) have taken advantage of the ability to guarantee the liabilities of their subsidiaries, which we might expect to be more appealing to companies.

Companies taking the exemption from disclosing a parent single company income statement	2016	2015
Overall	93%	94%
FTSE 350	91%	95%
Others	95%	93%

The vast majority of companies do not present a parent company income statement, as permitted by company law. However, of the 93% that do not present such a statement, seven do present a company only statement of other comprehensive income, despite the fact that it is generally accepted practice that the law does not require this statement either. However, this exemption does not extend to the company-only statement of changes in equity – a primary statement that is required for the first time for companies adopting IFRSs, FRS 101 or FRS 102. Of the companies applying these standards, 9 did not present a company-only SOCE as a primary statement, an oversight that they should look to rectify next year.



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Notes to the financial statements

Enter the chapter

Notes to the financial statements

Top tips

- Where you expect to be significantly impacted by a new accounting standard which is not yet effective, give specific information about how and the extent to which your company will be affected as early as possible so that users know what to expect. Of the 16 companies noting a potentially significant impact in respect of IFRS 15, only 20% gave specific information as to how they would be impacted. ESMA has recently published a position paper setting out what they expect to see companies disclosing regarding the expected effect of IFRS 15 adoption and is expected to publish another on IFRS 9 very soon.

- Ensure that you provide all information as required by IAS 1 in respect of capital management. Only 39 companies gave quantitative information about what the entity regards as capital, and only 46 clearly described their processes and procedures in relation to capital management. This is a current focus area for the FRC and for investors. Such information should also be presented within the audited financial statements.

- While keeping your explanations concise, don't skip those that are necessary: they help the users of the accounts understand why certain judgements have been made and why items are being accounted for in a certain way. For example, explain why impairments, or reversals thereof, arose – only 60% of companies surveyed with impairments did so.

- Use discount and growth rates in impairment testing that reflect a CGU's specific risks, its products, industry, locations and market. Of the companies surveyed, 22 used the same growth rate across all their CGUs with goodwill, and 21 the same discount rate. It is possible that these 21 companies chose to risk-adjust their forecast cash flows rather than the discount rate used, although a statement to that effect may be helpful in such cases.

- Check that divisions identified and discussed in the front half of the report are suitably consistent with the segments reported under IFRS 8. 16% of the companies surveyed had differences in these, usually a result of a higher level of detail in the front half.

Keep an eye on

- Whether adequate sensitivity disclosures are provided where economic uncertainty is giving rise to a risk of impairment. The number of companies surveyed reporting impairments, other than on trade receivables, has increased to 63, compared to 43 in 2015.

- Consistency between sensitivity disclosures and key sources of estimation uncertainty disclosed under IAS 1. Of the 31 companies stating that there were no reasonably possible changes in key assumptions that could cause a goodwill impairment 26 nevertheless identified the exercise as a key source of estimation uncertainty.

- Identifying separable intangible assets in a business combination. Of those companies surveyed with acquisitions, the percentage of companies recognising goodwill but no intangibles rose from 8% last year to 23% this year.

- Disclosing a description of the inputs used for fair values classified as level 3 in the fair value hierarchy. Only 75% of the 51 companies surveyed with level 3 valuations did this.

Introduction

The notes to the financial statements include all of the various analysis required by IFRSs to support the information provided in the primary statements, as well as narrative information to explain them in more detail. The notes broadly fall into four categories.

- The accounting policies and similar information, such as the basis of preparation, critical judgements and key sources of estimation uncertainty. These also include an assessment of the impact that future changes in IFRSs will have on the company, an area of regulatory focus with the implementation dates for IFRSs 15, 16 and 9 all approaching.

- Information supplementing the profit and loss account, such as analysis of operating expenses incurred or details of finance income and expenses.

- Information supplementing the balance sheet, such as details about defined benefit pension obligations or borrowings.

- Other supplementary information, such as disclosure about capital management or the use of financial instruments.

This chapter focusses on certain aspects of the notes that have been highlighted by the FRC as areas that companies could improve.

Accounting policies

As in previous years, the disclosure of accounting policies – where they are placed, what information they contain and to what level of detail and how they meet the needs of the users of the financial statements – has been a topic of interest for regulators and standard setters during the year. The FRC Lab has previously issued a detailed report[98] covering these topics and integrating the theme of clear and concise reporting into those discussions. More recently they have covered the topic of accounting policies in their 2015 Corporate Reporting Review (CRR) Annual Report[99], addressing points on materiality and completeness of accounting policies.

Apart from one company including commentary from the audit committee stating that they encouraged management to be aware of findings from recent Lab reports, no other explicit references to the Lab or their findings were noted in the annual reports surveyed.

New standards not yet effective

In addition to these themes, both the FRC, in their year-end advice to preparers of financial statements and audit committees,[100] and ESMA, in their public statement on issues for consideration when implementing IFRS 15 ***Revenue from Contracts with Customers***[101], have called for companies to carefully assess the impact of new standards in issue but not yet effective (including IFRS 15 ***Revenue from Contracts with Customers***, IFRS 16 ***Leases*** and IFRS 9 ***Financial Instruments***). Issuers "should be able to provide progressively more entity-specific qualitative and quantitative information".

IFRS 15 will become effective for companies from 1 January 2018, and as we approach that date we would expect the level of disclosure given by those companies who expect to be impacted by this change to increase. In their public statement, ESMA have stated that companies that expect to be significantly affected by the application of IFRS 15 should provide information about the accounting policy choices that are to be taken on first application, a disaggregation of the expected impact by revenue stream and an explanation of the nature of the impacts when compared to their existing practices.

ESMA has also stated that for most companies they would expect information about the impacts to be provided before the 2017 annual reports. They go on to state that any reasonably estimable quantitative information should not be withheld solely due to concerns that the actual figures might ultimately be different as a result of changes in the contracts in place or different economic conditions.

Only 16 companies surveyed disclosed that they believed the impact of adopting IFRS 15 was potentially significant. Of those 16, six gave no rationale at all as to why they had assessed that the impact was potentially significant, and seven gave fairly generic rationale about how they would be impacted. Given ESMA's recent public statement we would expect those companies to significantly increase the level of disclosure they provide to become increasingly specific and clear as they get closer to the adoption of the standard. Indeed we would expect most companies – and certainly those who have not yet assessed the impact of IFRS 15 - to increase the level of disclosure with regards to this standard as the effective date becomes closer. The remaining three companies surveyed gave a relatively detailed rationale as to why they expected a significant impact on adoption of IFRS 15. Notably, two of those companies operated in the telecommunications industry – an industry that will be significantly impacted in several ways. A good example of the expected impact was provided by **BT Group plc (Example 14.1)** who went into a good level of detail about how various different revenue streams were likely to be affected.

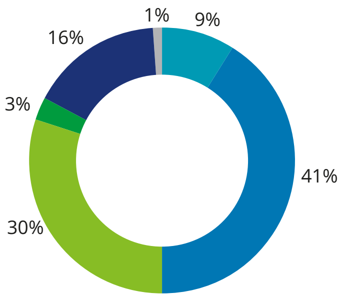
98 https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Year-end-advice-to-preparers-larger-listed-compa.pdf

99 https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf

100 https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Year-end-advice-to-preparers-larger-listed-compa.pdf

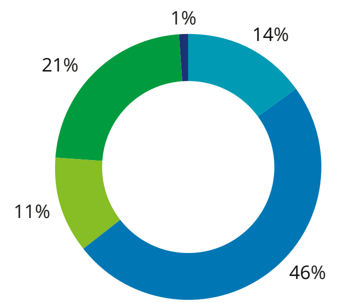
101 https://www.esma.europa.eu/sites/default/files/library/2016-1148_public_statement_ifrs_15.pdf

Figure 14.1 How much disclosure have companies given about the expected impact of IFRS 15?



As per figure 14.1, 41 of the companies that we surveyed stated that they had still not assessed the impact of IFRS 15, while 33 stated that they did not think the adoption of IFRS 15 would have a material impact on the Group. Only three of those companies gave a reasonable level of information as to why they perceived the impact to be immaterial. A brief statement explaining why anticipated impacts are not material may be helpful to evidence and reassure readers that an appropriate assessment has actually been undertaken.

Figure 14.2 How much disclosure have companies given about the expected impact of IFRS 16?

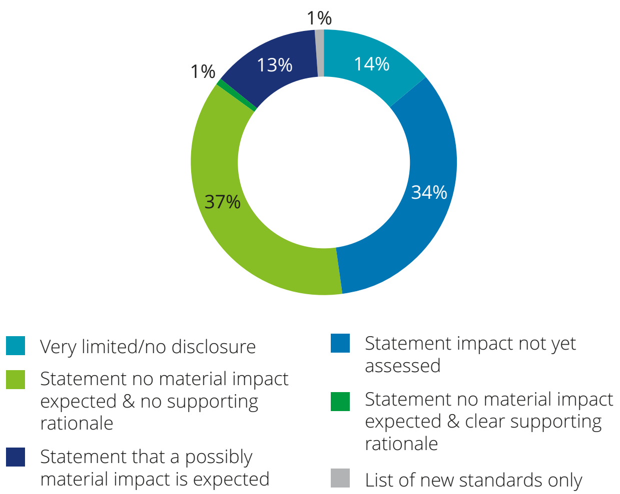


Note that 7 companies surveyed completed published their annual report before the final publication of IFRS 16 and therefore were excluded from this assessment

IFRS 16 *Leases* was only published in January 2016 and will be effective for periods beginning on or after 1 January 2019 subject to EU endorsement. As such, we would expect that companies are further behind in their assessment of the impact of this standard. That is certainly true of the companies that we surveyed, 46 of which stated that they had not yet assessed the impact of IFRS 16 as shown by figure 14.2. Despite companies having less time for their assessment given the relatively recent publication of IFRS 16, it is perhaps easier to identify an indicative impact in many cases, with IFRS 16 essentially meaning that existing operating leases will be coming on balance sheet.

Our survey revealed that the average amount of operating lease commitments that companies disclosed was almost £500m, although this figure was significantly higher amongst the FTSE 100 companies surveyed (almost £2bn), which skewed the overall average. In the companies outside the FTSE 350 the average operating lease commitment was £41m. Given the significant of these numbers it is no surprise that 21 companies stated that a potentially material impact was expected once IFRS 16 was adopted. Amongst those 21 companies, almost all explained that more assets would be on the balance sheet. Similarly to IFRS 15, we would expect these companies to give more specific and clear disclosure of the expected impact in future periods prior to the standard becoming effective.

Figure 14.3 How much disclosure have companies given about the expected impact of IFRS 9?



The last of the three major new standards which has been issued but is not yet effective is IFRS 9. Like IFRS 16, IFRS 9 has not yet been endorsed by the EU, but it is expected to become effective for periods commencing on or after 1 January 2018, and we would therefore expect companies to be more prepared in their assessment of IFRS 9. Figure 14.3 shows our findings in this respect. Out of our surveyed companies, 34 stated that they had not yet assessed the impact of the new financial instruments standard. 16 companies however made no disclosure at all in respect of IFRS 9. 13 companies stated that a possibly material impact is expected, although five of those companies gave no further disclosure as to why, and only one company gave something other than a relatively generic assessment of the impact.

Of the other standards or amendments not yet effective, 49% of companies surveyed provided a partial listing, 28% gave a full list, 12% simply stated that the remaining standards not yet effective would not have a material impact on the Group, and 11% companies provided no disclosure at all. Even if it is relatively obvious that a new standard will not affect a company, those companies should still make an explicit blanket statement of some sort covering such standards – this is consistent with the FRC Lab's guidance which noted that investors suggest that companies state that they have considered all the upcoming changes and only specifically disclosed those with a material or potentially material impact to the company.

Changes to accounting policies

IAS 8 *Accounting Policies, Changes in Accounting Estimates, and Errors*, requires companies to disclose if there have been any changes in accounting policies during the year. This may be due to new IFRS requirements or for voluntary changes in accounting policies. In its 2014 report on accounting policies the FRC Lab stated that investors like to see a clear rationale if a standard has been adopted early or voluntarily as well as a concise summary of any impact, including on prior periods. In our sample, 25 companies restated prior year amounts in their reports and 2 companies disclosed the early adoption of new standards (some annual improvements and IAS 1 amendments made under the IASB's disclosure initiative).

Of those companies that had restatements, eleven were due to a change in segment analysis, six were as a result of a change in accounting policy and four appeared to be as a result of errors. The remaining four companies restated their balance sheets as a result of changes to acquisition values. Only three of these presented a restated balance sheet at the beginning of the comparative period, as required by IAS 1 where the restatement has a material impact. Even so it may be advisable for companies to state where no material impact is noted and therefore no third balance sheet prepared.

Other accounting policy items

One of the main focus areas of the accounting policies report produced by the FRC Lab was the significance of accounting policies. The report found that although different users had different views and requirements when it came to the disclosure of accounting policies, overall there was a clear message that the most significant accounting policies should be more prominent and easily accessible, and that the content of all policies included should be specific and not 'boilerplate'. With this in mind it was encouraging to see an increase in the number of companies that made reference to materiality in their accounting policies note from two companies last year to eight in the current survey.

Companies who put the accounting policies note directly after the primary statements	2016	2015
Overall	88	88
FTSE 350	48	51
Others	40	37

The same number of companies surveyed in the current and prior year chose to present their accounting policies note directly after the primary statements. The most popular alternative to this is combining the accounting policy with the relevant note, although only five companies surveyed presented their accounts in this way this year. This is potentially a good alternative, especially if significant accounting policies are still displayed prominently separately, since those users who do not want to review the detail of all the individual notes can understand the key policies and review information they are interested alongside the policy for that particular section. Other locations included before the primary statements (three companies) and in the final note (also three companies). One company in our survey disclosed their significant accounting policies directly after the primary statements, and disclosed all of the other accounting policies alongside the relevant note. The benefit of this is that it highlights to users which policies the company considers to be most significant.

Average length of accounting policy note (pages)	2016	2015
Overall	6.7	6.4
FTSE 350	6.8	6.5
Others	6.5	6.2

The average length of accounting policies (where provided in a separate note) increased by 5% overall. It is difficult to say whether the FRC's clear and concise project and the IASB's disclosure initiative are making an impact in this area without looking at each set of accounts in detail, but it is clear that there is the potential for companies to at least consider whether they could remove some of their immaterial accounting policy disclosures, or at least relegate them to a later note/section. The shortest note in this year's survey was three (2015: three) pages long whilst the longest had 19 (2015: 17) pages.

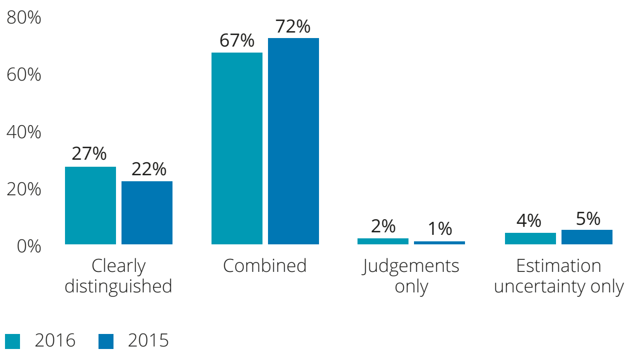
Critical accounting judgements and key sources of estimation uncertainty

Companies are required to disclose those sources of estimation uncertainty and assumptions about the future that have a significant risk of causing a material adjustment to the assets and liabilities within the next financial year. Those judgments made in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements should also be disclosed.

In practice, many companies combine the disclosure of these items although our survey findings this year showed a 6% increase in the number of companies that clearly distinguished the two concepts as per figure 14.4. The majority (67) of companies continue to combine their judgements and estimation disclosures, with a small amount only appearing to disclose one or the other. Notably, the FRC in their 2015 CRR report have stated that, in their eyes, for these disclosures to be meaningful it's important that judgements and estimations are identified and disclosed separately, so while investors may not differentiate, the regulators do. Whilst the Financial Reporting Lab report found that many investors do not differentiate between judgements and estimates in the same way that accounting standards do, they also noted that investors were specifically focussed on estimates, demonstrating the importance of the disclosures around this area. Investors also stated that an understanding of the "sensitivity of the balances and earnings amounts stemming from elements of estimation and judgement" was important. Whilst companies tend to be relatively good at this when it comes to areas such as impairment and pensions, where other standards explicitly require sensitivity disclosures to be provided in certain instances, other areas tend to be less well analysed in terms of their sensitivities.

Preparers should remember that IAS 1 explicitly cites sensitivity information as an example of something useful in helping readers understand the sources of estimation uncertainty.

Figure 14.4 How are critical accounting judgements and key sources of estimation uncertainty presented?



On average, companies in total disclosed between five and six areas of judgement and estimation uncertainty in both the current and prior year. More granularly speaking the average rose by 7% this year, though this did not impact the rounded amount of six. However, the appropriateness of the number of items disclosed will naturally vary from company to company. At either extreme, one company disclosed 15 items that they considered to be significant, and three companies only identified one item, although the appropriateness of either extreme in these examples is questionable. What is really important here is identifying all material areas and ensuring that the quality of the disclosures in these areas is sufficient for users. For more detail about what companies included within their identification of estimates and judgements refer to chapter four.

Structure of the notes

In the 2015 CRR report, the FRC continues to stress its commitment to clear and concise reporting, especially in relation to the removal of immaterial or irrelevant information from the annual report.

They continue to encourage companies to consider the disclosure principles of a particular standard when performing their 'cutting clutter' exercise. An assessment of the appropriateness of certain disclosures therefore remains an important exercise in this process. Where appropriate the removal of 'clutter' is not only encouraged but is deemed necessary.

The areas in which the FRC identified the potential for improvement, in terms of clear and concise reporting, in their 2015 CRR report were:

- accounting policies – e.g. for items or transactions that were not material, for repetitive information or disclosure of new requirements with little or no future impact expected;
- tables with immaterial information – which could be eliminated or replaced with narrative;
- disaggregation of immaterial items included individually within primary statements;
- repetitive information that could be cross referenced elsewhere; and
- disclosures that have become irrelevant because the company's circumstances have changed.

In our survey, we found that only five companies made reference to the fact that they had omitted some disclosure on the basis of materiality. This is much lower than last year where 16 companies made such a statement. This is perhaps due to the fact that the FRC has made it clear that companies do not need to include detail about what they have removed or a feeling that in the first year of omission an explanation is necessary but not in subsequent years.

It's also worth bearing in mind that Amendments to IAS 1 – Disclosure Initiative becomes effective for annual periods beginning on or after 1 January 2016. These amendments add additional examples of possible ways of ordering the notes, clarifying that understandability and comparability should be considered when determining the order of the notes and that they need not be presented in the order listed in paragraph 114 of IAS 1.

Revenue recognition

In defining revenue recognition policies it was noticeable that companies in our survey varied widely in both the way in which they presented their revenue recognition policies and which items of income they included under this policy. For example, it sometimes contained interest income or dividends as opposed to purely what the company recorded as revenue in the income statement. This could potentially add to the level of 'clutter' in the accounting policies if those other income items are not material. We noted one company that combined their disclosure on revenue recognition with their critical accounting judgement on this area. Whilst this is a perfectly acceptable approach we would expect to see clear demarcation of what the accounting policy is and what the judgement is. Indeed in the previously mentioned Lab report it was noted that investors find it useful when the accounting policies also cover the judgements and estimates, provided a list of those items is also disclosed in a single place.

Number of companies disclosing a clearly company-specific revenue recognition policy	2016	2015
Overall	77%	
FTSE 350	78%	Not surveyed
Others	76%	

Overall, 77 companies in the year disclosed a revenue recognition policy that was at least in some way specific to that company. Of those 77, 57% gave detailed company information, whereas the remaining 43% gave relatively high level information which was still specific to the company. Overall therefore, 56% of companies surveyed could have given more detailed revenue disclosures.

Average revenue recognition disclosure length (number of words)	2016	2015
Overall	259	244
FTSE 350	271	246
Others	243	242

Our findings from this year's survey showed an increase in the average length of revenue recognition policies of 6%, the vast majority of which was driven by an average increase in the FTSE 350 disclosure (by 10%). An overall increase isn't necessarily an indication that the quality of the disclosure has increased – management should consider the best way of indicating the nature of all of their material revenue streams.

Capital management

Disclosures regarding the composition of capital, the objectives set by the board and the policies and processes that management follow in managing their capital are required by IAS 1 *Presentation of financial statements*. Companies should also be clear that 'capital management' isn't synonymous with working capital, capital investment or share capital structure – during our survey we saw several references from the capital management note to such disclosures in the front half without appearing to give sufficient disclosure under the requirements of IAS 1. Indeed, the FRC has continually identified capital management disclosures as an area that requires improvement, most recently in the technical findings accompanying their 2015 Corporate Reporting Review annual report[102], particularly in relation to disclosures about what is managed as capital and the quantitative and qualitative disclosures relating to capital.

The structure and linkage of disclosures is also something that preparers should consider when thinking about capital management. Companies often give information about capital management in their front half, and this should be consistent with and supplementary to the information disclosed in the back half.

We noted several instances where groups had disclosed information in relation to capital management in line with the requirements of IAS 1, however that information was only presented in the front half whereas for IAS 1 purposes it must be included in the financial statements, which are of course audited. **Capita plc (Example 14.2)** provide a good example of capital management disclosure.

102 https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Technical-Findings-of-the-Conduct-Committee-s-Fina.pdf

Number of companies discussing capital management in front and back half	2016	2015
Overall	40%	45%
FTSE 350	53%	58%
Others	21%	28%

Overall, we found that there was a fairly significant variety of practice across companies. Whilst it is encouraging that every company bar one had some discussion of capital management somewhere in the annual report, the number of companies that disclosed information in both the front and back halves was only 40, with 31 of those within the FTSE 350. In such cases, companies should take care to effectively link the two disclosures together, especially where they rely on one another in some way. This appeared to be an area where a number of companies could improve.

Companies who disclosed capital management objectives (in the front half or back half)	2016	2015
Overall	92	Not surveyed
FTSE 350	54	
Others	38	

Most companies met the requirement to disclose the capital management objectives of the company (92), and 77 companies were able to give a clear definition of what it was that they managed as capital. However only 39 companies explicitly gave quantitative information about the level of capital at the year end, and only 46 companies gave clear and specific information about the policies and processes that they follow when managing capital. This shows that there is plenty of room for improvement in disclosure in this area.

Debt reconciliations

In January 2016 the IASB published amendments[103] to IAS 7 ***Statement of Cash Flows***. The amendments' objective is for entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, similar to old UK GAAP's net debt reconciliations (albeit cash is not required to be included in the IAS 7 reconciliation). Under the amendments, the following changes in liabilities arising from financing activities are to be disclosed (to the extent applicable): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes. These amendments become effective for periods commencing on or after 1 January 2017, subject to EU endorsement, so this is an area that companies will need to get to grips with soon, albeit comparatives are not required. Prior to this, companies who disclose information about net debt have been doing so on a voluntary basis.

Companies with debt providing a net or gross debt reconciliation	2016	2015
Overall	55%	Not surveyed
FTSE 350	66%	
Others	38%	

Encouragingly, over half of all companies surveyed with financing arrangements disclosed a debt reconciliation of sorts. For these companies there should be less work to do in preparing for the forthcoming IAS 7 amendments.

An example of comprehensive information on net debt reconciliations was provided by **Mondi Group (Example 14.3)**.

103 http://www.ifrs.org/Alerts/PressRelease/Pages/IASB-responds-to-investors-call-for-improved-disclosures.aspx

Distributable reserves

Although there is no requirement under the law or accounting standards for a separate figure of distributable profits to be disclosed, 38 companies (2015: 40) in our sample (24 from the FTSE 350 (2015: 25) and 14 from the other group (2015: 15)) presented some information about distributable reserves in their financial statements. Of those companies 14 stated the actual amounts of distributable reserves available, the other 24 including some disclosure – for instance that a particular reserve is not available for distribution. See chapter 6 for more discussion of dividend reporting.

Segments

Companies are required by IFRS 8 *Operating Segments* to report segmental information to shareholders in line with the way it is reported internally to management. It was therefore surprising to see that 16% (2015: 12%) of reports surveyed discussed different reporting segments in the front half to those included in the notes to the financial statements. The average for the FTSE 350 was less, at 12% (2015: 11%) than for the companies outside this group at 21% (2015: 14%). The FRC is likely to challenge such differences, for example questioning the use of materiality or IFRS 8's aggregation criteria where the front half shows a greater level of disaggregation than is presented in the notes to the accounts.

Companies with just one reportable segment	2016	2015
Overall	16%	12%
FTSE 350	16%	14%
Others	17%	9%

A single reportable segment is justifiable where the chief operating decision maker is only presented with aggregated information in order to make decisions about the allocation of resources and review performance; but the FRC will often approach such a conclusion with a degree of scepticism. There has been a slight rise in the number of companies with just one reportable segment; over half of these did give a clear justification of why this conclusion was reached. A good example of such disclosure is in the report of **Electronic Data Processing PLC (Example 14.4).**

Companies with just one reportable segment without justification	2016	2016
Overall	38%	
FTSE 350	44%	Not surveyed
Others	29%	

Including a clear justification for why this conclusion was reached is advisable, to pre-empt challenge on why only a single reportable segment has been identified.

Goodwill

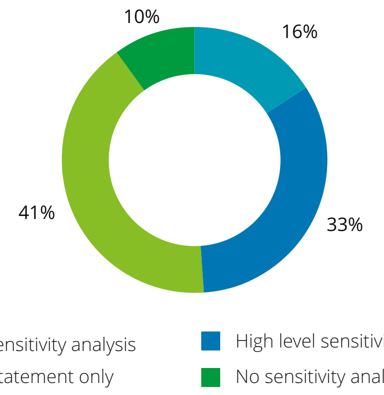
In a business combination, companies are required to recognise the difference between purchase price and the value of identifiable assets and liabilities as goodwill. This must then be assessed each year to ascertain that its value has not been impaired. The percentage of companies we surveyed that held goodwill at the year-end has remained fairly static for those we surveyed in the FTSE 350 at 91% (2015: 89%), whereas for the other companies surveyed the number has decreased to 57% (2015: 72%). This is at least partly as a result of impairments seen in goodwill compared to last year (see following section), as three of the companies surveyed outside the FTSE 350 recorded an impairment to goodwill during the year such that the year-end balance was nil.

All but two of the companies in our sample based their recoverable amounts on value in use, as opposed to fair value less costs to sell. IAS 36 requires that where value in use is used as the recoverable amount of a Cash Generating Unit (CGU) with significant goodwill, information is given about the period over which cash flow projections were based on budgets and forecasts (before potentially extrapolating over a longer period). There is an assumption that the period based on budgets and forecasts should not be longer than five years unless there is a good reason, in which case an explanation for this should be given. Only two companies surveyed had projections that utilised budgets or forecasts for a period exceeding 5 years.

1 2 3 4 5 6 7 8 9 10 11 12 13 14 Appx. 1 Appx. 2 Contacts Resources

Clear and specific sensitivity disclosures should be provided where a reasonably possible change in a key assumption would cause an impairment. This is done at varying levels of detail, as shown in figure 14.5. Where there is no reasonably possible change that would lead to an impairment, users of the accounts may appreciate a negative statement to this effect. **Hill & Smith Holdings PLC (Example 14.5)** and **Findel plc (Example 14.6)** give good examples of sensitivity disclosures.

Figure 14.5 How do companies disclose the sensitivity analysis they have done for impairment testing purposes?



Interestingly, of the 31 companies providing a negative statement that there was no reasonably possible change in a key assumption that could cause an impairment, 26 nevertheless described it as a key source of estimation uncertainty under IAS 1. Given that IAS 1 requires disclosure of those sources of estimation uncertainty "that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities" it seemed like there could be a disconnect here.

% of companies surveyed with goodwill which disclose the allocation of goodwill to CGUs or groups of CGUs, not higher than segmental level	2016	2015
Overall	92%	96%
FTSE 350	92%	100%
Others	92%	90%

Where significant, IAS 36 requires that companies disclose the allocation of goodwill to each CGU or group of CGUs. IAS 36 requires that a group of CGUs for this purpose must not be bigger than an operating segment or the level at which goodwill is monitored internally. There remains a small number of companies surveyed who did not disclose any allocation of the value of goodwill.

% companies surveyed with more than one CGU where the same growth rate had been used to extrapolate cash flows beyond the forecast period for all CGUs	2016	2015
Overall	38%	33%
FTSE 350	29%	21%
Others	59%	63%

The growth rate for each CGU should reflect their specific products, industry, locations and market. Companies should determine the appropriate growth rate(s), which may not be the same across different CGUs.

% of the above who provide an explanation for the same growth rate being used	2016	2015
Overall	45%	Not measured

% of companies surveyed with growth rates more than nil where growth rates have been justified with regards to the relevant long term average growth rate	2016	2015
Overall	40%	53%

% of companies with more than one CGU using different discount rates for different groups of CGUs	2016	2015
Overall	70%	77%
FTSE 350	75%	85%
Others	57%	61%

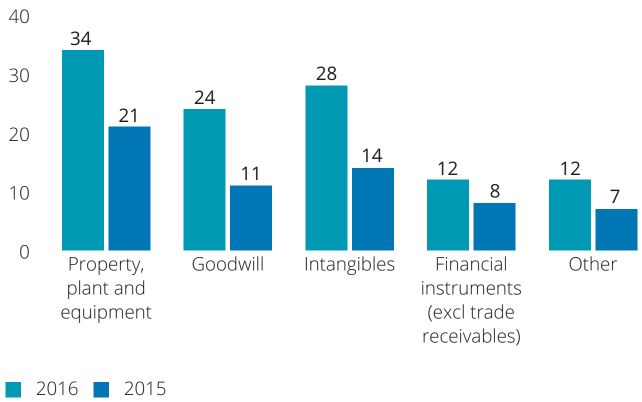
As for growth rates, companies should determine an appropriate discount rate that may not be the same across different CGUs, due to the different risk factors to which they are exposed. As an alternative to risk-adjusting discount rates companies may instead risk-adjust their cashflows.

% of companies using different discount rates that disclosed them as ranges	2016	2015
Overall	35%	39%
FTSE 350	44%	40%
Others	8%	36%

Impairments

Impairment disclosures continue to be an area where regulators focus their attention, and asset impairment calculations and the disclosures around these are a common area of challenge. The percentage of companies recording an impairment, excluding impairments of trade receivables (given how common these are) increased from 43% in 2015 to 63% this year, the increase being comparable across FTSE 350 companies (46% to 67%) and other companies (40% to 57%). This may indicate a drop in economic confidence in these companies. The split of different areas where companies have recognised impairments is shown in figure 14.6.

Figure 14.6 In what areas have companies recognised an impairment?



Impairment	2016	2015
Companies with an impairment loss not disclosing the events and circumstances that led to its recognition		
Overall	40%	40%
FTSE 350	33%	38%
Others	50%	41%
Companies with an impairment reversal in the year (excluding trade debtors)		
Overall	4%	4%
FTSE 350	5%	4%
Others	2%	5%

A large minority of companies reporting impairment losses did not report the events and circumstances that led to the recognition of the impairment loss. This may be due to materiality considerations. A good example of disclosure of the events and circumstances leading to an impairment is given in the **Intertek Group plc (Example 14.7)** report.

Levels of impairment reversals (again excluding trade receivables) remained at the same low level as last year. IAS 36 restricts some reversals of impairments, for example an impairment of goodwill can never be reversed.

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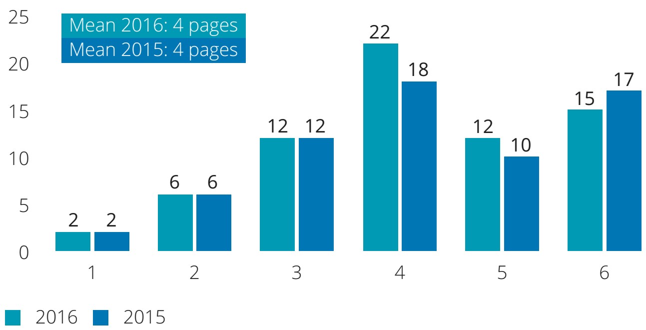
Pensions

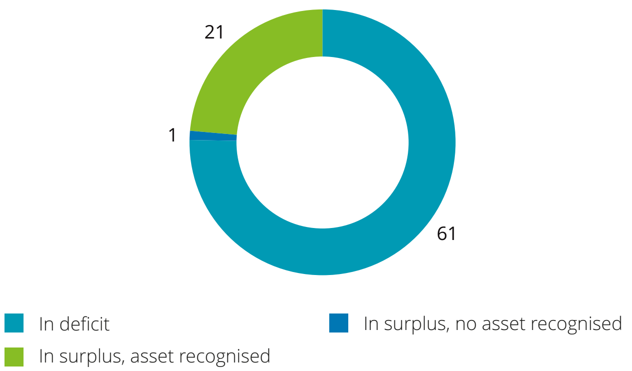
There are extensive disclosures required for companies with defined benefit schemes, including the regulatory framework, related risks and funding arrangements. Figure 14.7 shows the space that these disclosures take up in the report.

Figure 14.7 How many pages of notes do companies include for the IAS 19 disclosures?



More companies surveyed (69) had a defined benefit schemes than those surveyed in 2015 (66) – see figure 14.8 for analysis of the funding positions of these (note that some companies had more than one scheme). The proportion of those schemes in surplus that recognised an asset has increased from 82% to 95%. Companies with schemes in surplus should pay careful attention to IFRIC 14's requirements to limit the recognition of plan surpluses, particularly in light of the proposed change which will require that gradual settlement cannot be assumed where trustees have a unilateral right to wind up a scheme. An example of a company explaining why they made the decision to recognise a surplus, and in this case particularly commenting on the potential IFRIC 14 changes was **BTG plc (Example 14.8).**

Figure 14.8 What is the status of defined benefit pension schemes?



The inclusion of sensitivity analyses within the pensions disclosure is a current area of focus from the FRC. 91% of the companies surveyed provided sensitivity analyses covering their actuarial assumptions. A good example of this disclosure is shown in the report of **Vodafone Group Plc (Example 14.9)**.

Provisions

None of the companies surveyed took advantage of the exemption available in IAS 37 to not disclose information about a provision, contingent liability or contingent asset where it would seriously prejudice its position. This is in line with our expectation in this area, as such a situation is likely to be rare; additionally the FRC has stated that it is likely to challenge companies making use of this exemption.

Another regulatory hotspot is the discussion around uncertainty related to amounts or timing required for each class of provision under IAS 37. A wide variety was noted in terms of the level of detail companies were providing in this regard, although it appeared that there was room for improvement by many.

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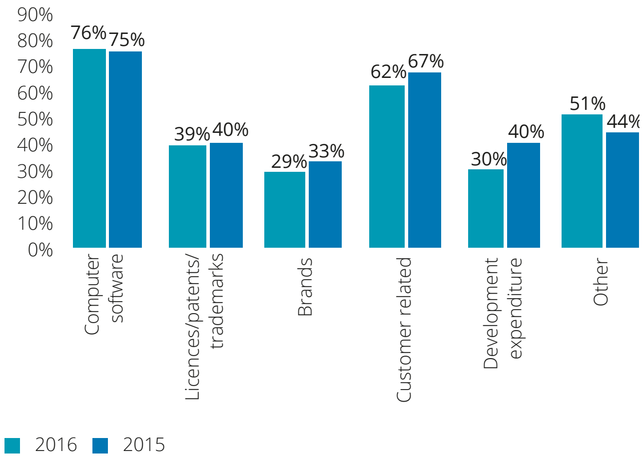
Companies disclosing increases in provisions, utilisation of provisions, releases of provisions and unwind of discounts on provisions separately	2016
Overall	45%
FTSE 350	51%
Others	36%

Companies are required by IAS 37 to disclose a detailed split of movements in provisions, including increases to provisions, amounts used, unused amount reversed, and the unwind of discounts on provisions. Of these, the most common disclosure excluded was that of the unwind of discounts, presumably on materiality grounds. The **KAZ Minerals Plc (Example 14.10)** accounts give a good example of this.

Intangibles

IAS 38 requires companies to identify intangible assets and amortise them over their useful life. Companies recognise a variety of intangible assets, as shown in figure 14.9.

Figure 14.9 What classes of intangible assets do companies record?



Intangibles	2016
Companies recognising intangibles other than goodwill	
Overall	89%
Companies with intangibles assessed as having an indefinite life	
Overall	20%
FTSE 350	21%
Others	19%
Companies with intangibles assessed as having an indefinite life that disclose the justification for this assessment	
Overall	44%
FTSE 350	36%
Others	57%

IAS 38 requires companies to disclose the carrying amount of any assets held with an indefinite useful life, together with the reasons for the assessment that its life is indefinite; a description of factors that played a significant role in determining that the asset has an indefinite useful life should also be given. Over 50% of companies with intangible assets assessed as having an indefinite useful life failed to give this assessment. An example of a good explanation in this area is shown by **LSL Property Services Plc (Example 14.11)**.

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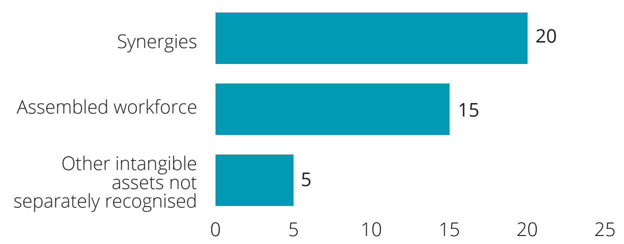
Business combinations

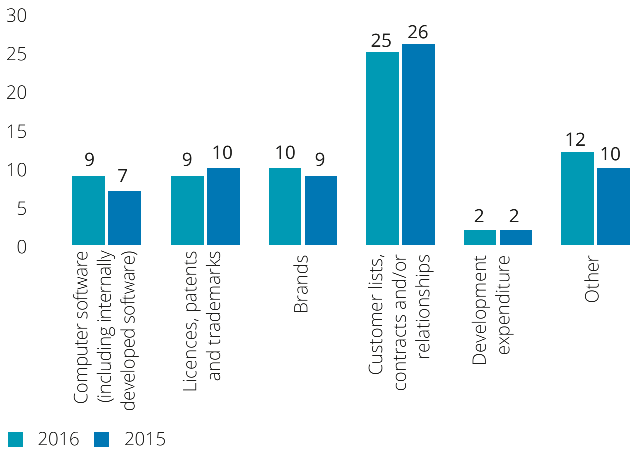
The number of business combinations (39 of the companies surveyed) has remained consistent with the prior year (39) and indeed with 2014 (36), indicating a relatively stable period of acquisition activity. The percentage of companies surveyed with combinations that did not identify what gave rise to goodwill increased from 16% last year to 19% this year. In accordance with IFRS 3, users of the accounts will want to know why the company paid a premium for the acquisition and a good description in this area will increase transparency. Companies who did identify what gave rise to goodwill mostly identified synergies as the main factor, as shown in figure 14.10. A good example in this area is that of **The Weir Group PLC (Example 14.12)**, which distinguished between detailed information given for a large business combination and a high level summary for a smaller business combination.

Figure 14.10 How many companies recognised goodwill in business combinations as a result of stated factors?



The types of intangibles recognised as part of acquisitions remained comparable to the previous year, as shown in figure 14.11.

Figure 14.11 What types of intangibles did companies recognise as part of acquisitions in the year?



Business combinations	2016	2015
% companies reporting business combinations that recognised goodwill		
Overall	95%	82%
% companies reporting business combinations that recognised intangibles other than goodwill		
Overall	77%	79%
Companies reporting business combinations with goodwill but no intangibles		
Overall	23%	8%

The FRC has a focus on companies recording goodwill but no separate intangibles in business combinations. Despite this, the percentage of companies recognising goodwill on business combinations increased while the percentage recognising intangible assets remained the same.

Average value of intangible assets compared to intangible assets and goodwill combined		
Overall	44%	42%
FTSE 350	42%	43%
Others	49%	42%

1 2 3 4 5 6 7 8 9 10 11 12 13 14 Appx. 1 Appx. 2 Contacts Resources

Business combinations	2016	2015
% companies with contingent consideration where the nature of contingent considerations has been discussed		
Overall	48%	Not surveyed
FTSE 350	38%	
Others	80%	

As in other areas, companies did not always provide the appropriate level of detailed explanation, including in this case what kind of contingent consideration was agreed.

Companies with business combinations after the year end		
Overall	9	Not surveyed
% companies with post year end combinations that did not give disclosures required by IFRS 3		
Overall	33%	Not surveyed

On a similar note, three of the companies with business combinations after the balance sheet date failed to give the disclosures required by IFRS 3 and did not state that the initial accounting was incomplete.

'Package of five' consolidation standards

As required by IFRS 12 *Disclosure of interests in other entities*, six companies disclosed significant judgements about whether an entity was a subsidiary or an associate; six disclosed significant judgements about whether a joint arrangement was a joint venture or a joint operation. An example of the latter deliberation is shown in **Anglo American plc (Example 14.13).**

Joint ventures	2016	2015
Companies with joint ventures		
Overall	42	40
FTSE 350 (58 surveyed)	32	29
Other (42 surveyed)	10	11
Companies with joint operations		
Overall	8	5
FTSE 350 (58 surveyed)	5	1
Other (42 surveyed)	3	4

As would be expected, the number of companies recognising JVs and JOs under IFRS 11 increased very slightly, since three of the companies surveyed last year had not yet adopted the standard. Otherwise these figures remain roughly consistent with last year.

Share based payments

Share schemes are becoming an increasingly common part of remuneration packages, with the number of companies surveyed using them increasing from 86 in 2014 to 91 last year and 96 in this year's reports.

Share based payments	2016	2015
Companies with share based payments where these have been aggregated for disclosure		
Overall	34%	Not surveyed
FTSE 350	45%	
Other	18%	

The larger listed entities tend to have more share based schemes and tend to aggregate disclosures for their share schemes where permitted by IFRS 2. Aggregation can help keep this area of complex disclosure concise.

Consider aggregating some of the information: the descriptive disclosures such as vesting requirements, the maximum term of options granted, and the method of settlement can potentially be aggregated per IFRS 2.

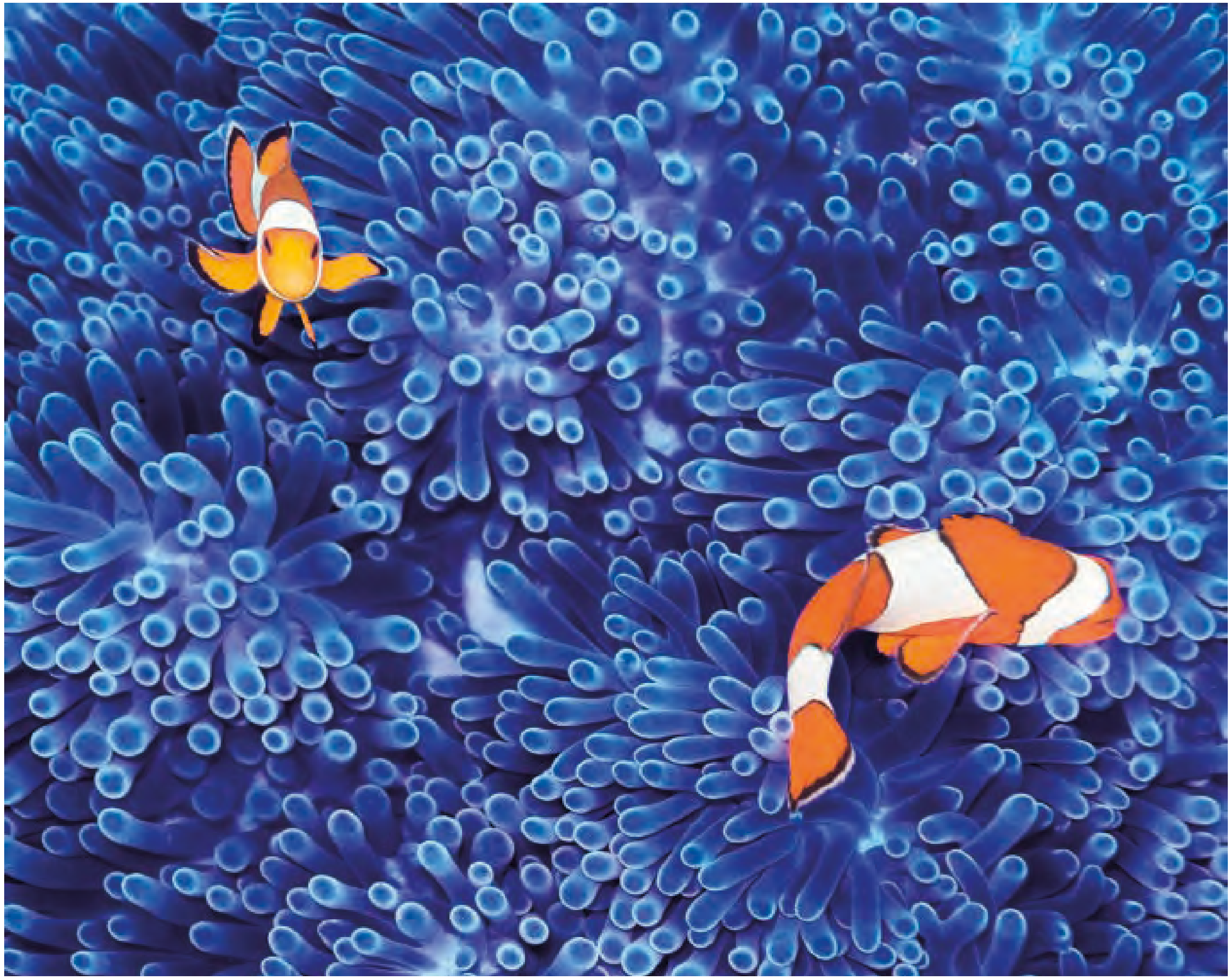
1 2 3 4 5 6 7 8 9 10 11 12 13 14 Appx. 1 Appx. 2 Contacts Resources

Financial instruments

Both IFRS 7 and IFRS 13 require potentially extensive disclosures to be provided for financial instruments, the latter standard in relation to fair value measurements, especially where there are significant unobservable inputs i.e. measurements are level 3 in the fair value hierarchy. Our findings revealed that some companies appeared to be omitting all the necessary information on such items, resonating with calls from the regulator to improve disclosure in this area.

Joint ventures	2016	2015
Companies with items classified as level three in the IFRS 13 fair value hierarchy		
Overall	51	40
FTSE 350	35	28
Other	16	12
% of the above not disclosing information on unobservable inputs and quantitative factors (where amounts exceeded audit materiality)		
Overall	25%	20%
FTSE 350	23%	21%
Other	31%	17%

IFRS 13's fair value hierarchy indicates that items classified as level three have significant unobservable inputs used in determining fair value. The number of companies surveyed who recorded items classified as level three increased this year. A quarter of companies surveyed who had material level three items did not disclose information on the unobservable inputs used. A good example of clear disclosure of these unobservable inputs is shown in the accounts of **Mondi Group (Example 14.14)**.



Good practice examples

Example 14.1

[BT Group plc Annual Report 2016 (p170)]

- Identification of different revenue streams with an assessment of what the likely qualitative impact of IFRS 15 will be.
- Clearly explained the fact that the assessment was an ongoing process and that management are continuing to assess the impact.
- Included detailed company specific information.

Example 14.2

[Capita plc Annual report and accounts 2015 (p147)]

- Provide clear capital management objectives.
- Clearly define what is managed as capital.
- Provide quantitative information in respect of the capital managed including comparative figures.
- Provide detailed disclosure as to what management processes are performed in respect of capital management.

Example 14.1

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Annual Report 2016

Notes to the consolidated financial statements

1. Basis of preparation

Preparation of the financial statements
These consolidated financial statements have been prepared in accordance with the Companies Act 2006, Article 4 of the IAS Regulation and International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) and related interpretations, as adopted by the European Union. The consolidated financial statements are also in compliance with IFRS as issued by the International Accounting Standards Board (the IASB). The consolidated financial statements are prepared on a going concern basis.

The consolidated financial statements are prepared on the historical cost basis, except for certain financial and equity instruments that have been measured at fair value. The consolidated financial statements are presented in Sterling, the functional currency of BT Group plc, the parent company.

New and amended accounting standards adopted with no significant impact on the group
The group has applied the following standards and amendments for the first time for its annual reporting period commencing 1 April 2015:

– Annual Improvements to IFRSs – 2010–12 Cycle and 2011–13 Cycle.
– Defined Benefit Plans: Employee contributions – Amendments to IAS 19.

The adoption of these amendments did not have any impact on the current or prior periods.

New and amended accounting standards that have been issued but are not yet effective
The following standards have been issued and are effective for accounting periods ending on or after 1 April 2016 and are expected to have an impact on the group financial statements.

IFRS 15 'Revenue from Contracts with Customers'
In May 2014, IFRS 15 'Revenue from Contracts with Customers' was issued and will be effective for periods beginning on or after 1 January 2018, following the July 2015 decision to delay the effective date by one year. For the group, transition to IFRS 15 will take place on 1 April 2018. Quarterly results in the 2018/19 financial year will be IFRS 15 compliant, with the first Annual Report and Form 20-F published in accordance with IFRS 15 being the 31 March 2019 report.

IFRS 15 sets out the requirements for recognising revenue from contracts with customers. The standard requires entities to apportion revenue earned from contracts to individual promises, or performance obligations, on a relative standalone selling price basis, based on a five-step model.

The group is still in the process of quantifying the implications of this standard, however we expect the following indicative impacts:

– Currently, the group recognises connections revenue upon performance of the connection activity. The transition to IFRS 15 will result in this revenue being deferred and recognised on a straight-line basis over the associated line/circuit contractual period. This leads to the recognition of what is known as a contract liability – a liability arising from secured revenue flows – on the balance sheet.
– Under the current accounting policy, revenue recognised in relation to equipment and mobile handsets is based on the corresponding customer charge when the asset is transferred to the customer. Generally customer premises equipment is provided for free, and mobile handsets are either provided for free or for a small upfront charge. Under IFRS 15, additional revenue will be allocated to all equipment and handsets with reference to the asset's relative standalone value within the contract, regardless of contract pricing. As a result, on adoption of IFRS 15, there will be an acceleration of revenue for these items, with a corresponding reduction in ongoing service revenue over the contract period. The difference between the revenue and the customer charge will be recognised as a contract asset – a receivable arising from secured cash flows – on the balance sheet.
– Sales commissions and other third party acquisition costs resulting directly from securing contracts with customers are currently expensed when incurred. IFRS 15 will require these costs of acquiring contracts to be recognised as an asset when incurred, to be expensed over the associated contract period.
– IFRS 15 will also result in some contract fulfilment costs which are currently expensed at a point in time to be deferred on the balance sheet where they relate to a performance obligation which is satisfied over time.
– IFRS 15 gives far greater detail on how to account for contract modifications than current revenue standards IAS 18 and IAS 11. Changes must be accounted for either as a retrospective change (creating either a catch up or deferral of past revenues), prospectively with a reallocation of revenues amongst identified performance obligations, or prospectively as separate contracts which will not require any reallocation.
– There will be a corresponding effect on tax liabilities in relation to all of the above impacts.

The group is continuing its analysis of the expected impacts of transition to IFRS 15.

IFRS 9 'Financial instruments'
IFRS 9 was published in July 2014 and will be effective for BT from 1 April 2018 subject to EU endorsement. It is applicable to financial assets and financial liabilities, and covers the classification, measurement, impairment and de-recognition of financial assets and financial liabilities together with a new hedge accounting model.

We do not expect this to have a material impact on our results, with the key changes for BT being around documentation of policies, hedging strategy and new hedge documentation. However, the provision for lifetime expected losses on all financial assets will be reviewed as part of quantifying the impact of the standard.

IFRS 16 'Leases'
IFRS 16 was published in January 2016 and will be effective for BT from 1 April 2019, replacing IAS 17 'Leases' subject to EU endorsement. The standard requires lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset is of low value.

Example 14.2

Strategic report Governance **Accounts** Capita plc 147

Notes to the consolidated financial statements continued

26 Financial instruments (continued)

Capital management
The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios to support its business operations, its acquisition strategy and maximise shareholder value. The Group manages its capital structure, and makes adjustments to it, in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. Focus on capital management forms an important component of the monthly Board meetings with attention on various matters including: return on capital employed, ensuring a mix of funding sources to ensure continuity and flexibility, a balance between fixed and floating borrowings and a broad spread of maturities together with attention to ensuring adequate liquidity headroom.

The Group's capital management process ensures that it meets financial covenants in its borrowing arrangements. Breaches in meeting the financial covenants could permit the lenders to immediately accelerate repayment of loans and borrowings. The Group monitors, as part of its monthly Board review, that it will adhere to specified consolidated leverage ratios and consolidated net interest expense coverage ratios. There have been no breaches in the financial covenants of any loans and borrowings in the period.

The Group has a business model that is driven by organic growth and through the acquisition of small- and medium-sized entities which enhance existing portfolios or provide access to new markets. The availability of funds for this acquisition activity is thus a key consideration when determining the use and management of capital. The Group therefore uses longer dated debt, generally bonds and long-term bank facilities, to enable it to finance these purchases.

Capita plc supports the growth of its various financial services businesses, which form a key part of its overall strategy and business plan. These financial firms are subject to various capital requirements imposed by financial services regulators. These requirements do not apply to Capita plc itself and the Group is not required to provide consolidated returns for regulatory purposes. The board of each regulated firm is responsible for ensuring it has embedded capital management frameworks that test there are adequate financial resources at all times. During the year, they complied with all externally imposed financial services regulatory capital requirements.

The Group seeks to maintain a conservative and efficient capital structure with an appropriate level of gearing. It is Group policy to target a long term net debt to EBITDA ratio in the range of 2.0 to 2.5 and maintain interest cover above 7.0 times. At 31 December 2015, our annualised net debt to EBITDA ratio was 2.5 (2014: 2.2) with annualised interest cover at 13.7 times (2014: 16.3 times). These ratios are monitored monthly by the Board. As the Group considers a long-term net debt to EBITDA ratio the most appropriate measure for gearing, it does not maintain or monitor a targeted debt/equity ratio.

The Group raises debt in a number of markets including the bank loan market, bank overdraft, finance lease and bond markets. The Group has available to it a committed Revolving Credit Facility of £600m maturing in August 2020 and a £600m Credit Facility maturing in June 2017, of which £nil was drawn down as at 31 December 2015 (2014: £nil drawn down on a £600m Revolving Credit Facility). These facilities are both available for the Group's immediate use.

During the year the Group issued a total of US$293.5m and £97.0m of new bonds. In addition, the Group issued bonds with a total face value of EUR310.0m at a discount, receiving net proceeds of EUR304.4m.

The Group has a spread of bond maturities over many years to 2027 (see note 22).

The Group's dividend policy is to return surplus cash to shareholders through a mixture of progressive dividends and, when appropriate, capital returns. Total dividends have grown at a compound rate of 9.6% over the 5 years to 31 December 2015 whilst dividend cover in the year is 2.23 times. The Group returned £155m capital to shareholders by means of a special dividend in 2007 and undertakes share buybacks on an opportunistic basis, as market conditions allow, in order to maintain an efficient capital structure and to minimise its long-term cost of capital. Shareholder approval is sought annually for authority to purchase up to 10% of issued share capital and it is Group policy to continue to evaluate any attractive opportunities for share buybacks as they arise.

No changes were made in the objectives, policies or processes during the years ended 31 December 2015 and 31 December 2014.

The table below presents quantitative data for the components the Group manages as capital:

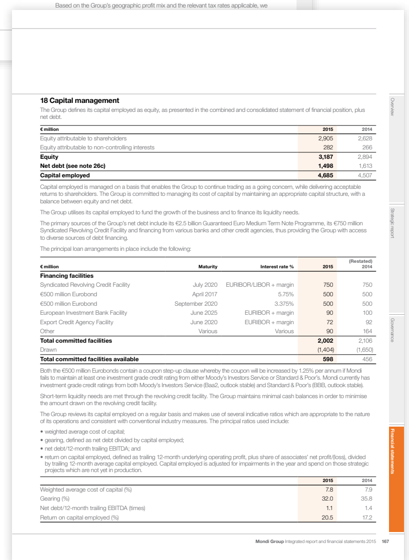
	2015 £m	2014 £m
Shareholders' funds	753.3	915.5
Cash in hand	(534.0)	(458.9)
Overdraft	448.7	429.8
Unsecured loan notes	–	0.2
Obligations under finance leases	7.0	11.9
Bonds	1,749.4	1,306.8
Term loan	300.0	300.0
Currency and interest rate swaps	(220.8)	(184.8)
At 31 December	2,503.6	2,320.5

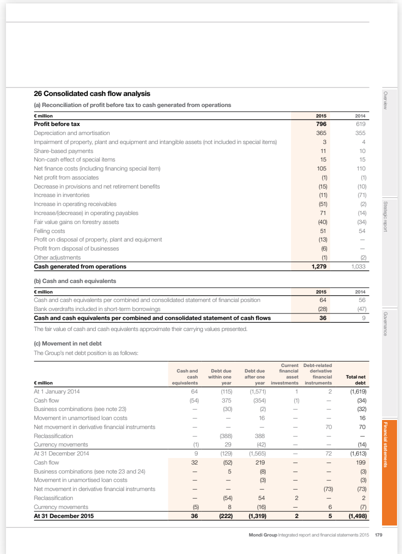
Example 14.3

Mondi Group Integrated report and financial statements 2015 (p28-29, 167, 179)

- Provided comprehensive information about the level of net debt in the company, for instance by showing the maturity profile of their net debt and the currency split.
- They also provided a clear definition of what they managed as capital, and how much that amounted to at the year end.
- Provided clear linkage between the front and back half that was understandable and consistent.


Chief financial officer's review


18 Capital management


26 Consolidated cash flow analysis

Example 14.4

[Electronic Data Processing PLC Annual Report and Accounts 30 September 2015 (p34)]

Segmental information – clear explanation of why a single operating segment was chosen.

Example 14.5

[Hill & Smith Holdings PLC Annual Report 2015 (p110)]

Goodwill - disclosure of sensitivity in impairment testing.

Example 14.4

Notes to the Consolidated Financial Statements continued

(forming part of the financial statements)

2. Significant accounting policies continued

New standards not applied

The IASB has issued the following standards with an effective date after the date of these financial statements and early adoption has not been applied:

International Accounting Standards (IFRS/IAS)		Effective for accounting periods beginning on or after
IFRS 9	Financial Instruments	1 January 2018
IFRS 10 (amended September 2014)	Consolidated Financial Statements	1 January 2016
IFRS 11 (amended May 2014)	Joint Arrangements	1 January 2016
IFRS 12 (amended December 2014)	Disclosure of Interests in Other Entities	1 January 2016
IFRS 14	Regulatory Deferral Accounts	1 January 2016
IFRS 15	Revenue from Contracts with Customers	1 January 2018
IAS 1 (amended December 2014)	Presentation of Financial Statements	1 January 2016
IAS 16 (amended May and June 2014)	Property, Plant and Equipment	1 January 2016
IAS 27 (amended August 2014)	Separate Financial Statements	1 January 2016
IAS 28 (amended December 2014)	Investments in Associates and Joint Ventures	1 January 2016
IAS 38 (amended May 2014)	Intangible Assets	1 January 2016
IAS 41 (amended June 2014)	Agriculture	1 January 2016
Amendments to various standards resulting from Annual Improvements 2012–2014 Cycle		1 January 2016

The Directors are currently assessing the likely impact that adoption of IFRS 15 Revenue from Contracts with Customers will have on the Group's financial statements in the period of initial application.

It is not anticipated that application of the remaining new standards, interpretations and amendments to existing standards will have a material effect on the Group's financial statements when first applied.

3. Segmental analysis

The Group has identified its reportable segment based on the financial reports that internally are provided to the Group's chief operating decision maker (CODM). In line with its management structure, the Executive Directors collectively make the key operating decisions and review internal monthly management accounts and budgets as part of this process. Accordingly, the Executive Directors collectively are considered to be the CODM. The information reported regularly to the CODM presents the Group as a single segment supplying software and related services to customers operating in similar markets. The Group's software products share a common sales, development and implementation resource. Consequently the Group has determined that there is one operating segment and therefore one reportable segment, Software.

Segment performance is measured based on segment profit before tax excluding IAS 19 defined benefit pension scheme adjustments and profits or losses on property disposals or revaluations.

	Software 2015 £'000	Software 2014 £'000
Revenue – external customers	**5,157**	5,508
Profit		
Adjusted operating profit	**459**	553
Restructuring costs	**(76)**	—
Segment non-cash net IFRS credit/(charge)	**71**	(41)
Interest revenue	**42**	46
Segment profit before tax	**496**	558
Profit on sale of property	**117**	—
Write-down of property value	**(189)**	—
Defined benefit pension scheme charge net of employer contributions	**(77)**	(157)
Consolidated profit before tax	**347**	401
Other segment items		
Interest revenue	**42**	46
Depreciation and amortisation	**309**	374
Capital expenditure	**184**	257

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Example 14.5

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Notes to the Consolidated Financial Statements (continued)

10. Intangible assets continued

Cash generating units with significant amounts of goodwill

	2015 £m	2014 £m
Infrastructure Products - Utilities		
The Paterson Group	-	8.0
Creative Pultrusions	**7.4**	7.1
Others <£5m individually	**6.5**	5.1
Infrastructure Products - Roads		
Others <£5m individually	**13.6**	13.6
Galvanizing Services		
France Galva SA	**25.4**	26.8
USA	**23.0**	21.8
UK	**24.8**	17.7
	100.7	100.1

Goodwill impairment reviews have been carried out at an operating segment level on all cash generating units to which goodwill is allocated.

Impairment tests on the carrying values of goodwill and certain US Galvanizing brand names of £6.9m (2014: £10.4m), which are the Group's only other indefinite life intangible assets, are performed by analysing the carrying value allocated to each significant cash generating unit against its value in use. All goodwill is allocated to specific cash generating units which are in all cases no larger than operating segments. Value in use is calculated for each cash generating unit as the net present value of that unit's discounted future cash flows. These cash flows are based on budget cash flow information for a period of one year and an average growth rate of 3% applied subsequently based on management's estimate for revenue and associated cost growth, other than where specific market or business conditions support a different outlook. Budgets are prepared taking into account past experience and the Group's overall strategic direction.

The calculated headroom between value in use and carrying value of each of the cash generating units with significant amounts of goodwill is set out below, together with the pre-tax discount rates applied.

	2015		2014	
	Headroom £m	Discount rate	Headroom £m	Discount rate
Creative Pultrusions	**21.2**	**12.6%**	22.9	13.0%
France Galva SA	**2.5**	**14.4%**	16.3	14.3%
Galvanizing Services - USA	**134.5**	**13.5%**	105.0	13.5%
Galvanizing Services - UK	**25.7**	**12.2%**	29.6	12.0%

The pre-tax discount rates detailed above equate to post-tax discount rates of between 9.4% and 10.4%, derived from a market participant's cost of capital and risk adjusted for individual cash generating units' circumstances. Similar discount rates are applied in determining the recoverable amounts of other cash generating units. The discount rates applied in determining headroom in both 2015 and 2014 are broadly consistent.

The Group has applied sensitivities to assess whether any reasonable possible changes in assumptions could cause an impairment that would be material to these Consolidated Financial Statements. The sensitivity analyses did not identify any material impairments with the exception of the goodwill attributed to France Galva SA.

France Galva SA

The key assumptions used in the France Galva SA impairment review relate to the 2016 budgeted cash flows and the future growth rates assumed thereafter.

The budget for 2016 assumes a 3% reduction in galvanizing volumes compared with 2015, driven by market conditions in France. Subsequently the calculations assume future annual growth in galvanizing volumes of between 1% and 2%, resulting in calculated headroom of £2.5m. A reduction of 1% in the 2016 budgeted volumes would reduce the headroom to zero. In the event that budgeted volumes for 2016 are achieved but that there is no subsequent growth, a goodwill impairment charge of £18.1m would arise. The carrying value of goodwill of £25.4m would be fully impaired if future volumes were assumed to fall by 1.5% per annum.

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Example 14.6

[Findel plc Annual Report & Accounts 2016 (p97)]

Goodwill – disclosure of sensitivity in impairment testing.

Example 14.7

[Intertek Group plc Annual Report and Accounts 2015 (p110)]

Impairments – explanation of why an impairment was incurred.

Example 14.6

Consolidated Financial Statements

13 Goodwill and other intangible assets – continued

Significant judgements, assumptions and estimates
In determining the value in use of CGUs it is necessary to make a series of assumptions to estimate the present value of future cash flows. In each case, these key assumptions have been made by management reflecting past experience, current trends, and where applicable, are consistent with relevant external sources of information. The key assumptions are as follows:

Operating cash flows
Management has prepared cash flow forecasts for a three year period derived from the approved budget for financial year 2016/17. These forecasts include assumptions around sales prices and volumes, specific customer relationships and operating costs and working capital movements.

Risk adjusted discount rates
The pre-tax rates used to discount the forecast cash flows are between 12.0% and 15.0% (2015: 12.2% and 16.5%). These discount rates are derived from the Group's weighted average cost of capital as adjusted for the specific risks related to each CGU.

Long-term growth rate
To forecast beyond the detailed cash flows into perpetuity, a long-term average growth rate which is not greater than the published International Monetary Fund average growth rate in gross domestic product for the next five year period in the territories where the CGUs operate has been used. The growth rate was assessed separately for each CGU however a rate of 2.1% (2015: 2.5%) has been deemed appropriate in both cases.

Results
The estimated recoverable amount of the Express Gifts and Findel Education CGUs exceed their carrying value by approximately £24,300,000 (2015: £19,500,000) and £6,700,000 (2015: impairment of £19,900,000 recorded) respectively and as such no impairment was necessary.

Sensitivity analysis
The results of the Group's impairment tests are dependent upon estimates and judgements made by management, particularly in relation to the key assumptions described above. A reasonably possible change in key assumptions could lead to the carrying value of the Findel Education CGU exceeding its recoverable amount. Sensitivity analysis to potential changes in operating cash flows and risk adjusted discount rates has therefore been reviewed.

The table below shows the risk adjusted discount rate and forecast operating cash flow assumptions used in the calculation of value in use for the Findel Education CGU and the amount by which each assumption must change in isolation in order for the estimated recoverable amount to equal the carrying value:

CGU	Findel Education
Value in excess over carrying value (£000)	6,700
Assumptions used in the calculation of value in use	
Pre-tax discount rate	15.0%
Total pre-discounted forecast operating cash flow (£000)	94,574
Change required for the recoverable amount to equal the carrying value	
Pre-tax discount rate	1.0%
Total pre-discounted forecast operating cash flow	(11%)

Based on the results of the impairment test for the Express Gifts CGU, management are satisfied that there is sufficient headroom such that a reasonably possible change in assumption would not lead to an impairment. Consequently, no sensitivity analysis has been disclosed.

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www.findel.co.uk 97

Example 14.7

Financial statements
Notes to the financial statements continued

9 Goodwill and other intangible assets (continued)
The total carrying amount of goodwill by operating segment is as follows, which is also used for the disclosure of the Group's impairment review:

	2015 £m	2014 £m
Industry Services	**13.2**	467.4
Exploration & Production	**3.5**	3.6
Business Assurance	**6.2**	3.1
Food & Agriculture Services	**17.8**	17.7
Cargo & Analytical Assessment	**17.2**	18.5
Government & Trade Services	**0.2**	0.2
Minerals	**45.3**	46.9
Softlines	**3.4**	3.5
Hardlines	**6.5**	7.5
Product Intelligence	**2.4**	2.6
Electrical & Wireless	**46.3**	43.0
Transportation Technologies	**12.2**	13.0
Building Products	**194.5**	52.4
Chemicals & Pharma/Health, Environmental & Regulatory	**102.4**	100.5
Net book value at 31 December*	**471.1**	779.9

* All goodwill is recorded in local currency. Additions during the year are converted at the exchange rate on the date of the transaction and the goodwill at the end of the year is stated at closing exchange rates.

Impairment review
In order to determine whether impairments are required, the Group estimates the recoverable amount of each operating segment or CGU. The calculation is based on projecting future cash flows over a five-year period and using a terminal value to incorporate expectations of growth thereafter. A discount factor is applied to obtain a value in use which is the recoverable amount.

Key assumptions
The key assumptions include the rate of revenue and profit growth within each of the territories and business lines in which the Group operates. These are based on the Group's approved budget and five year Strategic Plan. The long-term growth rate is also key since it is used in the perpetuity calculations. Finally, the discount rate used to bring the cash flow back to a present value varies depending on the location of the operation and the nature of the operations. The estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

The calculation of the value in use is sensitive to long-term growth rates and discount rates. Long-term growth rates predict growth beyond the Group's planning cycle, and range from 1.7% to 3.5% (2014: 2.5% to 4.5%). The higher long-term growth rates reflect the weighting of a CGU's operations within China. The discount rate for each CGU reflects the Group's weighted average cost of capital adjusted for the risks specific to the CGU. Discount rates ranged from 8.4% to 10.3% (2014: 9.1% to 12.7%).

Sensitivity analysis
None of the reasonable downside sensitivity scenarios on key assumptions would cause the carrying amount of each CGU to exceed its recoverable amount, with the exception of Industry Services. The sensitivities modelled by management include:

i) Assuming revenues decline each year by 1% in 2017 to 2020 from the 2016 budgeted revenues, with margins increasing with base assumptions.

ii) Assuming zero growth in operating profit margins in 2016 to 2020 with revenues increasing per base assumptions.

iii) Assuming an increase in the discount rates used by 1%.

Management considers that the likelihood of any or all of the above scenarios occurring is low.

Impairment
At 31 December 2015, before impairment testing, goodwill of £494.6m was allocated to the Industry Services CGU. The oil and gas sector in which this CGU operates has experienced a significant downturn with a material reduction in capital and operating expenditure by its main customers. As a result, the Group revised its cash flow forecasts for Industry Services and has therefore reduced the CGU value to its recoverable amount. This has resulted in an impairment loss against goodwill of £481.4m, against intangible assets of £60.3m and against property, plant and equipment of £35.6m, in total £577.3m.

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Example 14.8

BTG plc Annual Report and Accounts 2016 (p109)

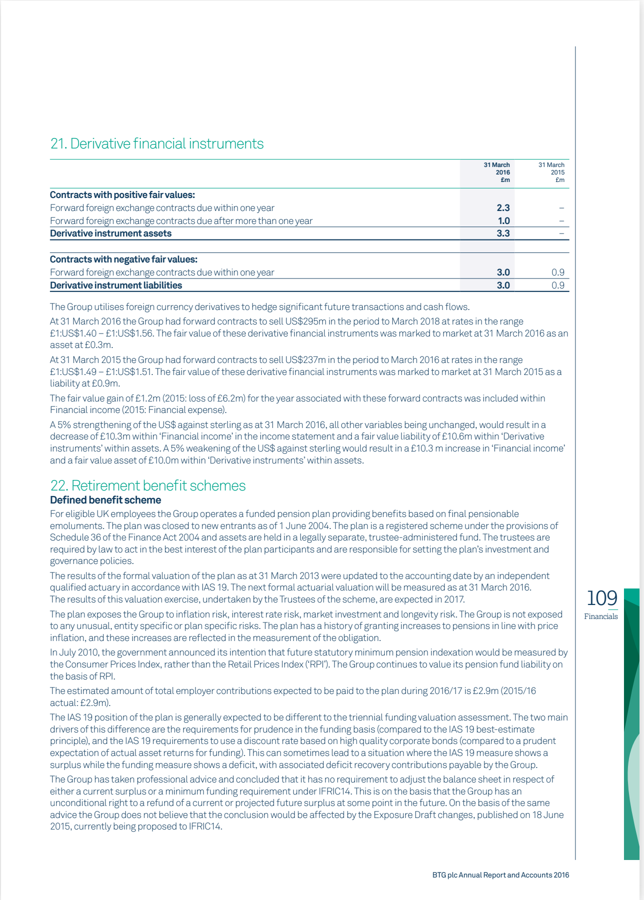
- Giving an explanation of why the company chose to recognise a defined benefit scheme surplus as an asset.
- Commenting on potential changes to this decision as a result of proposed changes to IFRIC 14.

Example 14.9

Vodafone Group Plc Annual Report 2016 (p144)

Pensions - Sensitivity analysis on key assumptions in measuring defined benefit obligation.

Example 14.8



21. Derivative financial instruments

	31 March 2016 £m	31 March 2015 £m
Contracts with positive fair values:		
Forward foreign exchange contracts due within one year	2.3	–
Forward foreign exchange contracts due after more than one year	1.0	–
Derivative instrument assets	3.3	–
Contracts with negative fair values:		
Forward foreign exchange contracts due within one year	3.0	0.9
Derivative instrument liabilities	3.0	0.9

The Group utilises foreign currency derivatives to hedge significant future transactions and cash flows.

At 31 March 2016 the Group had forward contracts to sell US$295m in the period to March 2018 at rates in the range £1:US$1.40 – £1:US$1.56. The fair value of these derivative financial instruments was marked to market at 31 March 2016 as an asset at £0.3m.

At 31 March 2015 the Group had forward contracts to sell US$237m in the period to March 2016 at rates in the range £1:US$1.49 – £1:US$1.51. The fair value of these derivative financial instruments was marked to market at 31 March 2015 as a liability at £0.9m.

The fair value gain of £1.2m (2015: loss of £6.2m) for the year associated with these forward contracts was included within Financial income (2015: Financial expense).

A 5% strengthening of the US$ against sterling as at 31 March 2016, all other variables being unchanged, would result in a decrease of £10.3m within 'Financial income' in the income statement and a fair value liability of £10.6m within 'Derivative instruments' within assets. A 5% weakening of the US$ against sterling would result in a £10.3 m increase in 'Financial income' and a fair value asset of £10.0m within 'Derivative instruments' within assets.

22. Retirement benefit schemes

Defined benefit scheme

For eligible UK employees the Group operates a funded pension plan providing benefits based on final pensionable emoluments. The plan was closed to new entrants as of 1 June 2004. The plan is a registered scheme under the provisions of Schedule 36 of the Finance Act 2004 and assets are held in a legally separate, trustee-administered fund. The trustees are required by law to act in the best interest of the plan participants and are responsible for setting the plan's investment and governance policies.

The results of the formal valuation of the plan as at 31 March 2013 were updated to the accounting date by an independent qualified actuary in accordance with IAS 19. The next formal actuarial valuation will be measured as at 31 March 2016. The results of this valuation exercise, undertaken by the Trustees of the scheme, are expected in 2017.

The plan exposes the Group to inflation risk, interest rate risk, market investment and longevity risk. The Group is not exposed to any unusual, entity specific or plan specific risks. The plan has a history of granting increases to pensions in line with price inflation, and these increases are reflected in the measurement of the obligation.

In July 2010, the government announced its intention that future statutory minimum pension indexation would be measured by the Consumer Prices Index, rather than the Retail Prices Index ('RPI'). The Group continues to value its pension fund liability on the basis of RPI.

The estimated amount of total employer contributions expected to be paid to the plan during 2016/17 is £2.9m (2015/16 actual: £2.9m).

The IAS 19 position of the plan is generally expected to be different to the triennial funding valuation assessment. The two main drivers of this difference are the requirements for prudence in the funding basis (compared to the IAS 19 best-estimate principle), and the IAS 19 requirements to use a discount rate based on high quality corporate bonds (compared to a prudent expectation of actual asset returns for funding). This can sometimes lead to a situation where the IAS 19 measure shows a surplus while the funding measure shows a deficit, with associated deficit recovery contributions payable by the Group.

The Group has taken professional advice and concluded that it has no requirement to adjust the balance sheet in respect of either a current surplus or a minimum funding requirement under IFRIC14. This is on the basis that the Group has an unconditional right to a refund of a current or projected future surplus at some point in the future. On the basis of the same advice the Group does not believe that the conclusion would be affected by the Exposure Draft changes, published on 18 June 2015, currently being proposed to IFRIC14.

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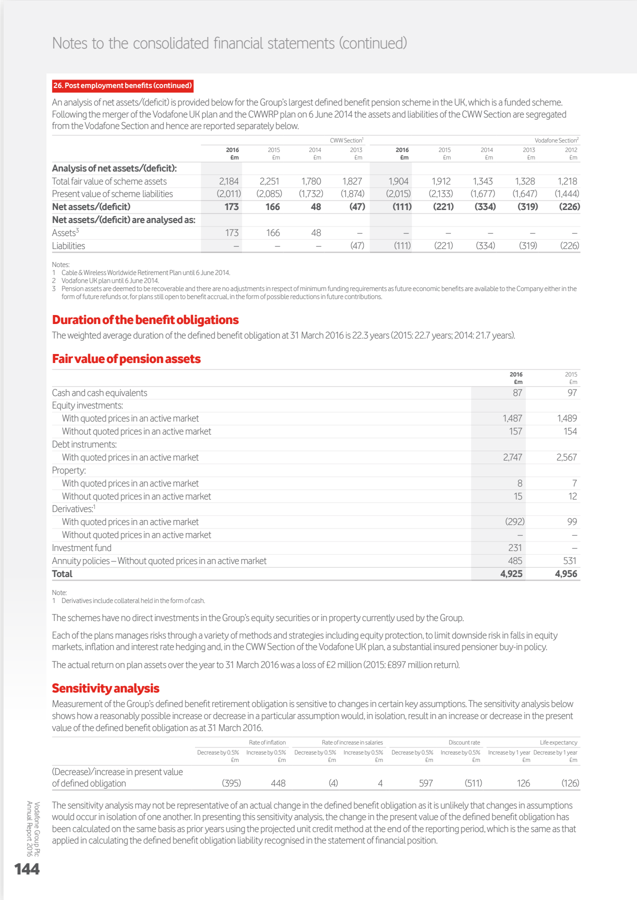
Example 14.9



Notes to the consolidated financial statements (continued)

26. Post employment benefits (continued)

An analysis of net assets/(deficit) is provided below for the Group's largest defined benefit pension scheme in the UK, which is a funded scheme. Following the merger of the Vodafone UK plan and the CWWRP plan on 6 June 2014 the assets and liabilities of the CWW Section are segregated from the Vodafone Section and hence are reported separately below.

	CWW Section[1]				Vodafone Section[2]				
	2016 £m	2015 £m	2014 £m	2013 £m	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Analysis of net assets/(deficit):									
Total fair value of scheme assets	2,184	2,251	1,780	1,827	1,904	1,912	1,343	1,328	1,218
Present value of scheme liabilities	(2,011)	(2,085)	(1,732)	(1,874)	(2,015)	(2,133)	(1,677)	(1,647)	(1,444)
Net assets/(deficit)	**173**	**166**	**48**	**(47)**	**(111)**	**(221)**	**(334)**	**(319)**	**(226)**
Net assets/(deficit) are analysed as:									
Assets[3]	173	166	48	–	–	–	–	–	–
Liabilities	–	–	–	(47)	(111)	(221)	(334)	(319)	(226)

Notes:
1 Cable & Wireless Worldwide Retirement Plan until 6 June 2014.
2 Vodafone UK plan until 6 June 2014.
3 Pension assets are deemed to be recoverable and there are no adjustments in respect of minimum funding requirements as future economic benefits are available to the Company either in the form of future refunds or, for plans still open to benefit accrual, in the form of possible reductions in future contributions.

Duration of the benefit obligations

The weighted average duration of the defined benefit obligation at 31 March 2016 is 22.3 years (2015: 22.7 years; 2014: 21.7 years).

Fair value of pension assets

	2016 £m	2015 £m
Cash and cash equivalents	87	97
Equity investments:		
With quoted prices in an active market	1,487	1,489
Without quoted prices in an active market	157	154
Debt instruments:		
With quoted prices in an active market	2,747	2,567
Property:		
With quoted prices in an active market	8	7
Without quoted prices in an active market	15	12
Derivatives:[1]		
With quoted prices in an active market	(292)	99
Without quoted prices in an active market	–	–
Investment fund	231	–
Annuity policies – Without quoted prices in an active market	485	531
Total	**4,925**	**4,956**

Note:
1 Derivatives include collateral held in the form of cash.

The schemes have no direct investments in the Group's equity securities or in property currently used by the Group.

Each of the plans manages risks through a variety of methods and strategies including equity protection, to limit downside risk in falls in equity markets, inflation and interest rate hedging and, in the CWW Section of the Vodafone UK plan, a substantial insured pensioner buy-in policy.

The actual return on plan assets over the year to 31 March 2016 was a loss of £2 million (2015: £897 million return).

Sensitivity analysis

Measurement of the Group's defined benefit retirement obligation is sensitive to changes in certain key assumptions. The sensitivity analysis below shows how a reasonably possible increase or decrease in a particular assumption would, in isolation, result in an increase or decrease in the present value of the defined benefit obligation as at 31 March 2016.

	Rate of inflation		Rate of increase in salaries		Discount rate		Life expectancy	
	Decrease by 0.5% £m	Increase by 0.5% £m	Decrease by 0.5% £m	Increase by 0.5% £m	Decrease by 0.5% £m	Increase by 0.5% £m	Increase by 1 year £m	Decrease by 1 year £m
(Decrease)/increase in present value of defined obligation	(395)	448	(4)	4	597	(511)	126	(126)

The sensitivity analysis may not be representative of an actual change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation of one another. In presenting this sensitivity analysis, the change in the present value of the defined benefit obligation has been calculated on the same basis as prior years using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the statement of financial position.

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Example 14.10

[KAZ Minerals PLC Annual Report and Accounts 2015 (p137)]

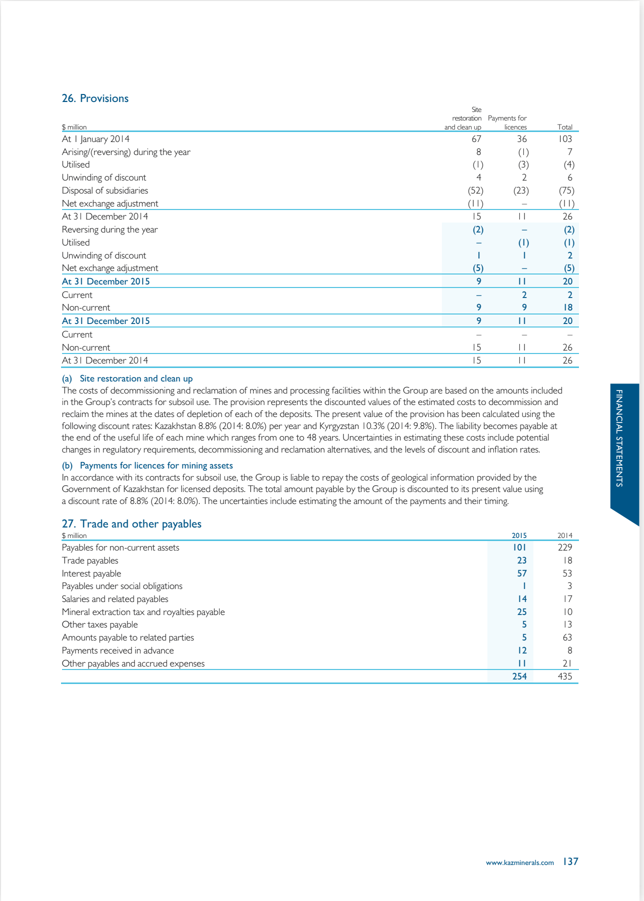
Provisions – disclosure showing all required movements during the year, including the unwinding of discount.

Example 14.11

[LSL Property Services plc Annual Report and Accounts 2015 (p91)]

Intangible assets – explanation for where an indefinite life was selected for intangible assets.

Example 14.10



26. Provisions

$ million	Site restoration and clean up	Payments for licences	Total
At 1 January 2014	67	36	103
Arising/(reversing) during the year	8	(1)	7
Utilised	(1)	(3)	(4)
Unwinding of discount	4	2	6
Disposal of subsidiaries	(52)	(23)	(75)
Net exchange adjustment	(11)	–	(11)
At 31 December 2014	15	11	26
Reversing during the year	(2)	–	(2)
Utilised	–	(1)	(1)
Unwinding of discount	1	1	2
Net exchange adjustment	(5)	–	(5)
At 31 December 2015	9	11	20
Current	–	2	2
Non-current	9	9	18
At 31 December 2015	9	11	20
Current	–	–	–
Non-current	15	11	26
At 31 December 2014	15	11	26

(a) Site restoration and clean up

The costs of decommissioning and reclamation of mines and processing facilities within the Group are based on the amounts included in the Group's contracts for subsoil use. The provision represents the discounted values of the estimated costs to decommission and reclaim the mines at the dates of depletion of each of the deposits. The present value of the provision has been calculated using the following discount rates: Kazakhstan 8.8% (2014: 8.0%) per year and Kyrgyzstan 10.3% (2014: 9.8%). The liability becomes payable at the end of the useful life of each mine which ranges from one to 48 years. Uncertainties in estimating these costs include potential changes in regulatory requirements, decommissioning and reclamation alternatives, and the levels of discount and inflation rates.

(b) Payments for licences for mining assets

In accordance with its contracts for subsoil use, the Group is liable to repay the costs of geological information provided by the Government of Kazakhstan for licensed deposits. The total amount payable by the Group is discounted to its present value using a discount rate of 8.8% (2014: 8.0%). The uncertainties include estimating the amount of the payments and their timing.

27. Trade and other payables

$ million	2015	2014
Payables for non-current assets	101	229
Trade payables	23	18
Interest payable	57	53
Payables under social obligations	1	3
Salaries and related payables	14	17
Mineral extraction tax and royalties payable	25	10
Other taxes payable	5	13
Amounts payable to related parties	5	63
Payments received in advance	12	8
Other payables and accrued expenses	11	21
	254	435

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Example 14.11

2. Accounting policies (continued)

Amortisation

Amortisation is charged to the Income Statement on a straight line basis over the estimated useful lives of intangible assets (unless such lives are indefinite) as follows:

Customer contracts:	
Residential Sales customer contracts	– three to ten years
Surveying and Valuation customer contracts	– between three and five years
Lettings contracts	– five years
Order book:	
Estate Agency pipeline	– three months
Surveying pipeline	– one week
Estate Agency register	– twelve months
Others:	
Franchise agreements	– ten years
In-house software	– between three and five years

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and are treated as changes in accounting estimates.

Brand names are not amortised as the Directors are of the opinion that they each have an indefinite useful life. This is based on the expectation of the Directors that there is no foreseeable limit to the period over which each of the assets are expected to generate net cash inflows to the businesses and the Directors are confident that trademark registration renewals will be filed at the appropriate time and sufficient investment will be made in terms of marketing and communication to maintain the value inherent in the brands, without incurring significant cost. All brands recognised have been in existence for a number of years and are not considered to be at risk of obsolescence from technical, technological nor commercial change. Whilst operating in competitive markets they have demonstrated that they can continue to operate in the face of such competition and that there is expected to remain an underlying market demand for the services offered. The lives of these brands are not dependent on the useful lives of other assets of the entity.

Impairment

Intangible assets with indefinite useful lives are not amortised but tested for impairment annually either individually or at the cash generating unit level. The useful life of such intangible assets is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's fair value less costs to sell and its value in use, and is determined for an individual asset unless the asset does not generate cash inflows that are largely independent of those from other assets or Groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Group estimates the assets' or cash generating unit's recoverable amount.

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Example 14.12

[The Weir Group PLC Annual Report and Financial Statements 2015 (p153)]

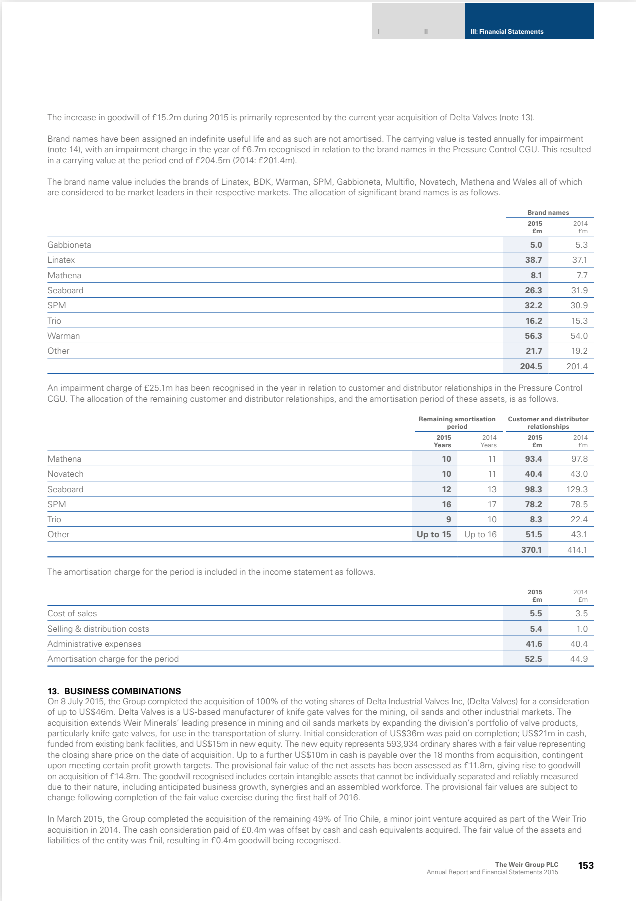
Business combinations – a description of what gave rise to the goodwill acquired in current year business combinations.

Example 14.13

[Anglo American plc Annual Report 2015 (p118)]

'Package of five' – joint venture assessment.

Example 14.12



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The increase in goodwill of £15.2m during 2015 is primarily represented by the current year acquisition of Delta Valves (note 13).

Brand names have been assigned an indefinite useful life and as such are not amortised. The carrying value is tested annually for impairment (note 14), with an impairment charge in the year of £6.7m recognised in relation to the brand names in the Pressure Control CGU. This resulted in a carrying value at the period end of £204.5m (2014: £201.4m).

The brand name value includes the brands of Linatex, BDK, Warman, SPM, Gabbioneta, Multiflo, Novatech, Mathena and Wales all of which are considered to be market leaders in their respective markets. The allocation of significant brand names is as follows.

	Brand names	
	2015 £m	2014 £m
Gabbioneta	**5.0**	5.3
Linatex	**38.7**	37.1
Mathena	**8.1**	7.7
Seaboard	**26.3**	31.9
SPM	**32.2**	30.9
Trio	**16.2**	15.3
Warman	**56.3**	54.0
Other	**21.7**	19.2
	204.5	201.4

An impairment charge of £25.1m has been recognised in the year in relation to customer and distributor relationships in the Pressure Control CGU. The allocation of the remaining customer and distributor relationships, and the amortisation period of these assets, is as follows.

	Remaining amortisation period		Customer and distributor relationships	
	2015 Years	2014 Years	**2015 £m**	2014 £m
Mathena	**10**	11	**93.4**	97.8
Novatech	**10**	11	**40.4**	43.0
Seaboard	**12**	13	**98.3**	129.3
SPM	**16**	17	**78.2**	78.5
Trio	**9**	10	**8.3**	22.4
Other	**Up to 15**	Up to 16	**51.5**	43.1
			370.1	414.1

The amortisation charge for the period is included in the income statement as follows.

	2015 £m	2014 £m
Cost of sales	**5.5**	3.5
Selling & distribution costs	**5.4**	1.0
Administrative expenses	**41.6**	40.4
Amortisation charge for the period	**52.5**	44.9

13. BUSINESS COMBINATIONS

On 8 July 2015, the Group completed the acquisition of 100% of the voting shares of Delta Industrial Valves Inc, (Delta Valves) for a consideration of up to US$46m. Delta Valves is a US-based manufacturer of knife gate valves for the mining, oil sands and other industrial markets. The acquisition extends Weir Minerals' leading presence in mining and oil sands markets by expanding the division's portfolio of valve products, particularly knife gate valves, for use in the transportation of slurry. Initial consideration of US$36m was paid on completion; US$21m in cash, funded from existing bank facilities, and US$15m in new equity. The new equity represents 593,934 ordinary shares with a fair value representing the closing share price on the date of acquisition. Up to a further US$10m in cash is payable over the 18 months from acquisition, contingent upon meeting certain profit growth targets. The provisional fair value of the net assets has been assessed as £11.8m, giving rise to goodwill on acquisition of £14.8m. The goodwill recognised includes certain intangible assets that cannot be individually separated and reliably measured due to their nature, including anticipated business growth, synergies and an assembled workforce. The provisional fair values are subject to change following completion of the fair value exercise during the first half of 2016.

In March 2015, the Group completed the acquisition of the remaining 49% of Trio Chile, a minor joint venture acquired as part of the Weir Trio acquisition in 2014. The cash consideration paid of £0.4m was offset by cash and cash equivalents acquired. The fair value of the assets and liabilities of the entity was £nil, resulting in £0.4m goodwill being recognised.

The Weir Group PLC Annual Report and Financial Statements 2015 **153**

Example 14.13

FINANCIAL STATEMENTS AND OTHER FINANCIAL INFORMATION

NOTES TO THE FINANCIAL STATEMENTS

1. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the course of preparing financial statements, management necessarily makes judgements and estimates that can have a significant impact on the financial statements. The most critical of these relate to impairment of assets, taxation, retirement benefits, contingent liabilities, joint arrangements, estimation of Ore Reserves, assessment of fair value, restoration, rehabilitation and environmental costs and deferred stripping. The use of inaccurate assumptions in assessments made for any of these judgements and estimates could result in a significant impact on financial results.

Critical accounting judgements

Impairment of assets

Mining operations are large, scarce assets requiring significant technical and financial resources to operate. Their value may be sensitive to a range of characteristics unique to each asset and key sources of estimation uncertainty include ore reserve estimates and cash flow projections.

In performing impairment reviews, the Group assesses the recoverable amount of its operating assets principally with reference to fair value less costs of disposal, assessed using discounted cash flow models. There is judgement in determining the assumptions that are considered to be reasonable and consistent with those that would be applied by market participants as outlined above.

In addition, in making assessments for impairment, management necessarily applies its judgement in allocating assets, including goodwill, that do not generate independent cash flows to appropriate cash generating units (CGUs).

Subsequent changes to the CGU allocation, to the timing of cash flows or to the assumptions used to determine the cash flows could impact the carrying value of the respective assets.

Taxation

The Group's tax affairs are governed by complex domestic tax legislations interlaced with the override of international tax treaties between countries and the interpretation of both by tax authorities and courts. Given the many uncertainties that could arise from these factors, judgement is often required in determining the tax that is due. Where management is aware of potential uncertainties that are more likely than not to result in a liability for additional tax, a provision is made for management's best estimate of the liability, determined with reference to similar transactions and, in some cases, reports from independent experts.

In addition, the recognition and measurement of deferred tax requires the application of judgement in assessing the amount, timing and probability of future taxable profits and repatriation of retained earnings. These factors affect the determination of the appropriate rates of tax to apply and the recoverability of deferred tax assets. These judgements are influenced, *inter alia*, by factors such as estimates of future production, commodity lines, operating costs, future capital expenditure, and dividend policies.

Contingent liabilities

On an ongoing basis the Group is a party to various legal disputes, the outcomes of which cannot be assessed with a high degree of certainty.

A provision is recognised where, based on the Group's legal views and advice, it is considered probable that an outflow of resources will be required to settle a present obligation that can be measured reliably. Disclosure of contingent liabilities is made in note 34 unless the possibility of a loss arising is considered remote. Management applies its judgement in determining whether or not a provision or contingent liability should be recorded.

Joint arrangements

Joint arrangements are classified as joint operations or joint ventures according to the rights and obligations of the parties, as described in note 39k. Judgement is required in determining this classification through an evaluation of the facts and circumstances arising from each individual arrangement. When a joint arrangement has been structured through a separate vehicle, consideration has been given to the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, other facts and circumstances. When the activities of an arrangement are primarily designed for the provision of output to the parties and, the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties to the arrangement have rights to the assets and obligations for the liabilities. Certain joint arrangements that are structured through separate vehicles including Collahuasi, Debswana and Namdeb are accounted for as joint operations. These arrangements are primarily designed for the provision of output to the parties sharing joint control, indicating that the parties have rights to substantially all the economic benefits of the assets. The liabilities of the arrangements are in substance satisfied by cash flows received from the parties; this dependence indicates that the parties effectively have obligations for the liabilities. It is primarily these facts and circumstances that give rise to the classification as joint operations.

Key sources of estimation uncertainty

Ore Reserves

When determining Ore Reserves, which may be used to calculate useful economic lives of assets and depreciation on the Group's mining properties, assumptions that were valid at the time of estimation may change when new information becomes available. In addition, the calculation of the unit of production rate of amortisation could be impacted to the extent that actual production in the future is different from current forecast production.

Any changes in estimate could affect prospective depreciation rates and asset carrying values and, as a result, the determination of Ore Reserves is considered a key source of estimation uncertainty.

Factors which could impact useful economic lives of assets and Ore Reserve estimates include:

- the grade of Ore Reserves varying significantly from time to time
- differences between actual commodity prices and commodity price assumptions used in the estimation of Ore Reserves
- renewal of mining licences
- unforeseen operational issues at mine sites
- adverse changes in capital, operating, mining, processing and reclamation costs, discount rates and foreign exchange rates used to determine Ore Reserves.

For further information refer to the unaudited Ore Reserves and Mineral Resources Report 2015.

Assessment of fair value

The assessment of fair value is principally used in accounting for business combinations, impairment testing and the valuation of certain financial assets and liabilities.

The fair value of an asset or liability is the price that would be received to sell the asset, or paid to transfer a liability in an orderly transaction between market participants. Fair value is determined based on observable market data including market share price at 31 December of the respective entity, discounted cash flow models (and other valuation techniques), where relevant signed sales agreements and assumptions considered to be reasonable and consistent with those that would be applied by a market participant. Where discounted cash flow models based on management's assumptions are used, the resulting fair value measurements are considered to be at level 3 in the fair value hierarchy, as defined in IFRS 13 *Fair Value Measurement*, as they depend to a significant extent on unobservable valuation inputs.

The determination of assumptions used in assessing the fair value of identifiable assets and liabilities is subjective and the use of different valuation assumptions could have a significant impact on financial results.

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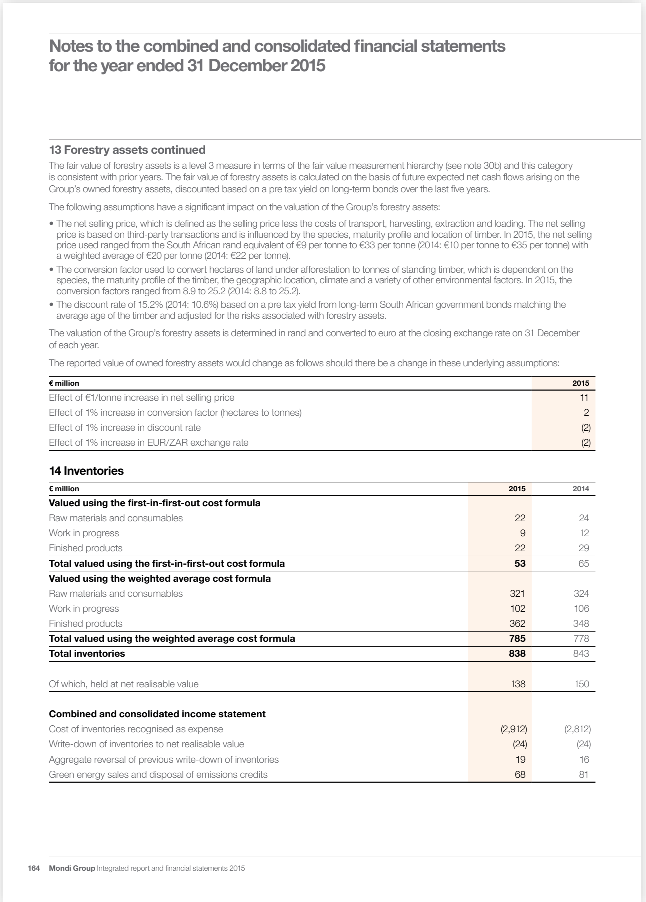
Example 14.14

Mondi Group Integrated report and financial statements 2015 (p164)

Financial instruments – showing the unobservable inputs to level 3 valuations.



Notes to the combined and consolidated financial statements for the year ended 31 December 2015

13 Forestry assets continued

The fair value of forestry assets is a level 3 measure in terms of the fair value measurement hierarchy (see note 30b) and this category is consistent with prior years. The fair value of forestry assets is calculated on the basis of future expected net cash flows arising on the Group's owned forestry assets, discounted based on a pre tax yield on long-term bonds over the last five years.

The following assumptions have a significant impact on the valuation of the Group's forestry assets:

- The net selling price, which is defined as the selling price less the costs of transport, harvesting, extraction and loading. The net selling price is based on third-party transactions and is influenced by the species, maturity profile and location of timber. In 2015, the net selling price used ranged from the South African rand equivalent of €9 per tonne to €33 per tonne (2014: €10 per tonne to €35 per tonne) with a weighted average of €20 per tonne (2014: €22 per tonne).
- The conversion factor used to convert hectares of land under afforestation to tonnes of standing timber, which is dependent on the species, the maturity profile of the timber, the geographic location, climate and a variety of other environmental factors. In 2015, the conversion factors ranged from 8.9 to 25.2 (2014: 8.8 to 25.2).
- The discount rate of 15.2% (2014: 10.6%) based on a pre tax yield from long-term South African government bonds matching the average age of the timber and adjusted for the risks associated with forestry assets.

The valuation of the Group's forestry assets is determined in rand and converted to euro at the closing exchange rate on 31 December of each year.

The reported value of owned forestry assets would change as follows should there be a change in these underlying assumptions:

€ million	2015
Effect of €1/tonne increase in net selling price	11
Effect of 1% increase in conversion factor (hectares to tonnes)	2
Effect of 1% increase in discount rate	(2)
Effect of 1% increase in EUR/ZAR exchange rate	(2)

14 Inventories

€ million	2015	2014
Valued using the first-in-first-out cost formula		
Raw materials and consumables	22	24
Work in progress	9	12
Finished products	22	29
Total valued using the first-in-first-out cost formula	**53**	65
Valued using the weighted average cost formula		
Raw materials and consumables	321	324
Work in progress	102	106
Finished products	362	348
Total valued using the weighted average cost formula	**785**	778
Total inventories	**838**	843
Of which, held at net realisable value	138	150
Combined and consolidated income statement		
Cost of inventories recognised as expense	(2,912)	(2,812)
Write-down of inventories to net realisable value	(24)	(24)
Aggregate reversal of previous write-down of inventories	19	16
Green energy sales and disposal of emissions credits	68	81

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Appendix 1 – Survey methodology

To put together this document, the annual reports of 100 UK listed companies were surveyed to determine current practice. Our sample was selected from among all of the UK incorporated companies with a premium listing of equity shares on the London Stock Exchange. We excluded investment trusts (apart from real estate investment trusts) from our sample, due to their specialised nature. Investment trusts are those companies classified by the London Stock Exchange in the 'Equity Investment Instruments' sector.

In the current year we have updated our sample to reflect the composition of the market at 30 April 2016. This year our sample includes 19 FTSE 100 companies, 39 FTSE 250 companies and 42 companies outside the FTSE 350. Although the overall sample is, as far as possible, consistent with that used in last year's survey, as a result of takeovers, mergers, de-listings, changes in market capitalisations over the last 12 months and late publication of reports, it could not be identical. Replacements and additional reports were selected to ensure that overall the composition of our sample remains consistent with that of the market as a whole. The annual reports used are those for years ending on or after 30 September 2015 and published before 28 June 2016.

Although our survey data uses only companies from this sample, when selecting examples of good practice we have used material from the reports of companies that, in our view, best illustrate a particular requirement or innovation, regardless of whether they are in our sample or not.

Appendix 2

Appendix 2 – Glossary of terms and abbreviations

Act
Companies Act 2006

BIS
The Department for Business, Innovation and Skills

CEO
Chief Executive Officer

CGU
Cash generating unit

CODM
Chief Operating Decision Maker

Conduct Committee
A body established by the FRC with legal authority to ensure that the annual accounts of public and large private companies comply with the Act and applicable accounting standards.

CMA
Competition and Markets Authority
An independent public body which helps to ensure healthy competition between companies in the UK for the ultimate benefit of consumers and the economy.

CR Corporate responsibility
Corporate responsibility is about how businesses take account of their economic, social and environmental impact.

DTR
Disclosure Guidance and Transparency Rules
These rules of the FCA include requirements for periodic financial reporting to meet the requirements of the EU Transparency Directive.

EBITDA
Earnings before interest, tax and amortisation

EC
European Commission

EPS
Earnings per share

ESMA
European Securities and Markets Authority
An independent EU Authority that seeks to ensure the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.

ESMA Guidelines
Guidelines on Alternative Performance Measures, a set of rules concerning the presentation of APMS, published by ESMA.

EU
European Union

FCA
Financial Conduct Authority
The FCA acts as the UK Competent Authority for setting and enforcing the rules applicable to listed companies and those admitted to trading on a regulated market.

FRC's Financial Reporting Lab
Facilitated by a steering group and FRC staff, the Lab provides an environment where investors and companies can come together to develop pragmatic solutions to reporting needs.

FRC
Financial Reporting Council
The UK's independent regulator responsible for promoting confidence in corporate reporting and governance and issuing accounting standards.

FRC Guidance
Guidance on the Strategic Report, issued by the FRC, setting out recommendations on how to produce an effective strategic report.

FTSE 100/250/350
Indices ranking listed companies by size, published by the FTSE Group.

GAAP
Generally accepted accounting practice

<IR>
International Integrated Reporting Framework
A framework produced by the IIRC to bring greater cohesion and efficiency to the reporting process, and help companies adopt 'integrated thinking' as a way of breaking down internal silos and reducing duplication.

IAS
International Accounting Standard

IASB
International Accounting Standards Board
The IASB is an independent body that issues International Financial Reporting Standards.

IFRS IC
International Financial Reporting Standards Interpretations Committee (formerly IFRIC)
IFRIC is the term given to describe Interpretations issued by the Committee which has been renamed the IFRS Interpretation Committee (IFRSIC). It develops interpretations of IFRSs and IASs, works on the annual improvements process and provides timely guidance on financial reporting issues not specifically addressed by the existing standards.

IFRS
International Financial Reporting Standard(s)

IIRC
International Integrated Reporting Council
A global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs, which maintains and updates the <IR> framework.

KPI
Key performance indicator
A factor by reference to which the development, performance or position of the company's business can be measured effectively.

Listed company
A company, any class of whose securities is listed (i.e. admitted to the Official List of the UK Listing Authority).

Listing Rules
The Listing Rules made by the UK Listing Authority for the purposes of Part VI of the Financial Services and Markets Act 2000.

Market capitalisation
A measure of company size calculated as share price multiplied by the number of shares in issue at a certain point in time.

PPE
Property, plant and equipment

Quoted company
Section 385 of the Companies Act 2006 defines a quoted company as a company whose equity share capital:

a. *has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000; or*

b. *is officially listed in an EEA State; or*

c. *is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.*

Regulated market
Regulated market is defined in the Markets in Financial Instruments Directive. The European Commission website also includes a list of regulated markets at: http://ec.europa.eu/internal_market/securities/isd/index_en.htm

SEC
U.S. Securities and Exchange Commission
Regulator of all securities exchanges within the United States of America.

SOCIE
Statement of Changes in Equity

UK Corporate Governance Code
The UK Corporate Governance Code sets out standards of good practice on issues such as board composition and development, remuneration, accountability and audit, and relations with shareholders.

UKLA
UK Listing Authority
The FCA acting in its capacity as the Competent Authority for the purposes of Part VI of the Financial Services and Markets Act 2000.

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If you would like further, more detailed information or advice on specific application of the principles set out in this publication, or would like to meet with us to discuss your reporting issues, please contact your local Deloitte partner or:

Tracy Gordon
trgordon@deloitte.co.uk

Joanna Mithen
jmithen@deloitte.co.uk

James Rogers
jrogers@deloitte.co.uk

Corinne Sheriff
csheriff@deloitte.co.uk

Amanda Swaffield
aswaffield@deloitte.co.uk

Peter Westaway
pwestaway@deloitte.co.uk

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UK Accounting Plus

For the latest news and resources on UK accounting, reporting and corporate governance, go to www.ukaccountingplus.co.uk. UK Accounting Plus is the UK-focused version of Deloitte's hugely successful and long-established global accounting news and comment service, IAS Plus.

GAAP 2017 Model annual report and financial statements for UK listed groups (due out around the end of 2016)

This Deloitte publication illustrates the disclosures in force for December 2016 year ends, including material encompassing all of the revised reporting requirements discussed herein. If you would like to obtain a copy of this publication please speak to your Deloitte contact.

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

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