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On the board agenda – half year 2021

June 2021

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Dear Board Member,

This half year edition of "On the Board Agenda" has two objectives – first, to act as a reminder of key matters for the half year, and, second, to help you set the agenda for the second half: We provide a reminder of the FRC's hot topics for interim reports; as various options for UK SOX are considered, we provide a reminder of the current high bar already on internal controls set out in the UK Corporate Governance Code in "What's all the fuss about?"; and we provide an update on the accelerating pace of developments in ESG and climate reporting to help you become more "Climate Savvy".

The board agenda never gets simpler or easier, does it? The accelerating digital transformation of our economy continues to create new highly valued businesses seemingly out of nowhere to challenge traditional business models; many companies are grappling with demand and pricing, supply chain disruption, input cost pressures and resource planning and people challenges as economies open up; the UK is signing more trade deals and is examining the regulations and opportunities for London as a world financial sector given its major contribution to the economy; a new international tax landscape is beginning to take shape, but has yet to address the transition from carbon based taxes in many economies. And just as the pandemic has accelerated digital adoption, it seems its solution, the vaccine and vaccine passports, may accelerate digital identity.

Now also, the BEIS White Paper "Restoring trust in audit and corporate governance" (the White Paper) proposes a once in a generation codification of corporate and audit responsibilities, the formation of a new companies' regulator and a new audit profession. When we reflect on all these big topics, let us also reflect on the privilege of being at the helm to witness and shape the reaction. Our promise, as you know, is to keep you current at the Deloitte Academy.

William Touche
Vice-Chair
Leader of Deloitte UK Centre for Corporate Governance
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Areas of focus for your half-yearly report

This section is a reminder of the requirements for listed companies for the 2021 interims season and some of the key matters to consider when reporting in the current environment. Investors will be expecting clear and robust disclosure around the continuing impact of the pandemic and the board's response for the rest of the year and, where relevant, beyond.

A reminder of what needs to be included

Interim management report	Condensed set of financial statements
The interim management report must include **at least**: • an indication of **important events** that have occurred during the first six months of the financial year, and their impact on the condensed set of financial statements; • a description of the **principal risks and uncertainties** for the remaining six months of the financial year; and • for issuers of shares, disclosures on any relevant **related party transactions** which took place during the period. **Responsibility statement** - the interim management report includes a **fair review** of the information required.	The condensed set of financial statements must be prepared in accordance with IAS34 and must contain: • a condensed balance sheet; • a condensed profit and loss account; and • explanatory notes on these accounts. The financial statements must be prepared using consistent policies and principles for presentation as for the annual financial reports except where new policies are to be applied to the next annual financial statements. **Responsibility statement -** the condensed set of financial statements, which has been prepared in accordance with the applicable set of accounting standards, gives a **true and fair view** of the assets, liabilities, financial position and profit or loss of the company.

The FRC's expectations for a good interim report

The FRC published its Interim Thematic Review in May 2021, which covers the findings of a review of 20 interim review reports for periods ended between June and September 2020. It is largely positive about how informative and compliant the reports were, but does highlight certain areas for improved focus and also examples of good disclosure.

The review highlights the following seven key expectations for 2021 interim reports:

Ensure that management commentaries detail important events that have occurred during the first six months of the financial year, and their impact on the financial statements.

Provide a comprehensive update of the principal risks and uncertainties for the remaining six months of the financial year.

Make sure APMs are explained, reconciled to IFRS measures and not given undue prominence.

Give going concern disclosures that explain the basis of any significant judgements, including whether there are any associated material uncertainties, and the matters considered when confirming the preparation of the financial statements on a going concern basis.

Detail changes to key judgements and estimates with reasons that enable users to understand management's views about the future, and their impact on the interim financial statements.

Explain in sufficient detail events and transactions that have a material impact on the financial position and performance of the company, such as impairments.

Focus on providing material disclosures that are clear and concise.

Further considerations on some of these are set out below.

The interim management report

"Ensure that management commentaries detail important events that have occurred during the first six months of the financial year, and their impact on the financial statements."

When considering the **"important events"** which have occurred during the year, the continuing impact of COVID-19 and the decisions the board has taken in response to the pandemic will feature heavily. The focus of the requirement is the impact these events had on the condensed set of financial statements, however in the current environment the board may well consider it appropriate to explain the impact through the lens of the section 172 factors. This will provide helpful context for the decisions taken and build towards the full section 172(1) statement which will be required in the year-end annual report. As a reminder, the section 172 factors are as follows:

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

b. the interests of the company's employees;

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

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

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

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

In combination with these explanations, and anticipating the year end disclosures on climate change in the annual report now required under the Listing Rules, the directors may also wish to consider any material developments in environmental, social and governance matters.

Principal risks and uncertainties

"Provide a comprehensive update of the principal risks and uncertainties for the remaining six months of the financial year."

There remains a substantial level of uncertainty facing companies and the economy as we emerge from lockdown in the UK. Companies will need to carry out a robust assessment of the principal **risks and uncertainties** for the remaining six months of the year and consider carefully any changes that may have come about since the most recent annual report, particularly in the light of countries where the pandemic is escalating or where lockdowns are easing.

Further guidance on reporting in times of uncertainty is provided in the following section.

The condensed set of financial statements

"Detail changes to key judgements and estimates with reasons that enable users to understand management's views about the future, and their impact on the interim financial statements."

"Explain in sufficient detail events and transactions that have a material impact on the financial position and performance of the company, such as impairments."

"Focus on providing material disclosures that are clear and concise."

The significant events and transactions resulting from the COVID-19 pandemic that may warrant disclosure in the condensed set of financial statements include the following:

- Government assistance received or repaid
- Write down of inventories to net realisable value
- Recognition of a loss from the impairment of financial assets, property, plant and equipment, right of use assets, intangible assets, contract assets, or other assets
- Disposal or impairment of property, plant and equipment
- Changes in the fair value of investment properties
- Changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities (regardless of whether they are recognised at fair value or amortised cost)
- Any default or breach of a loan agreement that has not been remedied on, or before, the end of the interim reporting period
- Changes in the classification of financial assets as a result of a change in the purpose or use of those assets
- Employee termination costs
- Recognition of onerous contracts
- Change in contingent liabilities or assets

The FRC's consolidated company guidance on COVID-19 highlights the difficulty of making forward-looking assessments and estimates at the present time and suggests the following areas of focus for boards when ensuring reporting covers the areas of most interest to investors and provides clarity on the use of key forward-looking judgements, all of which are relevant to the condensed set of financial statements:

- **Forward-looking information**, which should be specific to the entity and provide insights into the board's assessment of business viability and the methods and assumptions underlying that assessment.
- **Going concern** and any associated material uncertainties along with the basis of any significant judgements.
- **Information on significant judgements** applied in preparing the reporting, sources of estimation uncertainty and other assumptions.

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- Judgement required in determining the appropriate reporting **response to events after the reporting date.**

Investors are also keen to see disclosures regarding ongoing resilience in the face of continued uncertainty, with sufficient focus on the key assumptions and judgements used by the board when assessing resilience.

Going concern

> "Give going concern disclosures that explain the basis of any significant judgements, including whether there are any associated material uncertainties, and the matters considered when confirming the preparation of the financial statements on a going concern basis."

In relation to going concern, management will need to consider the extent to which the disruption of operations as a result of the COVID 19 pandemic, and any other events or circumstances that affect the entity, give rise to material uncertainties that cast a significant doubt on the entity's ability to continue as a going concern for a period of at least 12 months from the date the interim financial report is authorised for issue. In making this assessment, management will need to take into account all information available up to the date of authorisation of the interim financial report.

The FRC's consolidated company guidance on COVID-19 emphasised the following in relation to going concern at an interim reporting stage:

Directors will need to exercise judgment about the nature and extent of the procedures that they apply to assess the going concern assumption at the half-yearly date.

Issues that may need to be considered when making this going concern assessment, and when making going concern and liquidity risk disclosures include:

- a significant adverse variation in operating cash flows between prior budgets and forecasts and the outturn in the first half of the year;
- a significant reduction in projected revenues for the second half of the year based on plausible scenarios for the COVID-19 pandemic and public health responses, and taking into account government support measures;
- a failure to obtain renewal or extension of committed financing facilities; and
- a failure to sell capital assets for their expected amounts or within previously forecast time frames.

If going concern has become a significant issue since the previous annual financial statements, directors should undertake procedures similar to those that they would have carried out for annual financial statements to ensure that all relevant issues have been identified and considered.

Disclosures made in the interim financial information may include: any material uncertainties to going concern; assumptions made about the future path of COVID-19 and the public health responses; the projected impact on business activities; use of government support measures; and access to bank and other financing.

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The accounting implications of the matters described on the previous pages can be complex and Deloitte guidance is being updated regularly, please access the latest version of Need to know – accounting considerations related to the coronavirus 2019 disease.

A reminder about the requirements in relation to interim reviews by auditors

Under the Disclosure & Transparency Rules (DTR 4.2.9), if the half-yearly financial report has been audited or reviewed by auditors, the audit report or review report must be reproduced in full. If the half-yearly financial report has not been audited or reviewed by auditors, an issuer must make a statement to this effect in its report. The FRC's Interim Thematic Review reminds companies that regardless of the level of assurance gained on the interim management report, this needs to be **clearly disclosed** – not all companies in their sample did this.

The FRC has provided the following guidance in relation to the decision on whether to engage auditors to perform an interim review engagement based on feedback from investors:

> It is a matter for a company to decide whether to engage their auditors to perform an interim review engagement– it is not a legal or regulatory requirement. However, feedback we have received from investors indicates that such a review provides valuable assurance, and this may be particularly so in the current environment.

A reminder about filing requirements

A joint statement from the FRC and FCA, published in January 2021, reminds companies about the continuing temporary reliefs for delayed publication of financial statements in light of the disruption caused by the COVID-19 pandemic. The two bodies indicate that companies will be given plenty of notice when it is decided to bring any of these measures to an end. Companies have:

- An additional two months to publish annual financial reports (i.e. within six rather than four months of the financial year end date); and
- An additional month to publish half yearly financial reports (i.e. within four rather than three months of the financial half year end date).

The temporary measures are summarised by the FCA here.

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This section is a short summary of some of the areas for boards and audit committees to be aware of for the year ahead when contemplating planning activities for year-end reporting. The commentary below establishes the context of the FRC's own transition to becoming a new regulator with increased responsibilities, current and upcoming corporate reporting review (CRR) activity and recent changes to auditing standards that will affect your year-end audit and audit report. These are areas you may wish to consider when discussing this year's annual reporting process and external audit.

Transition to ARGA

The FRC has been active in working towards its transition into the new Audit, Reporting and Governance Authority (ARGA), which it expects to be completed by April 2023 once new legislative powers have been granted.

It has undertaken outreach activities regarding the White Paper and has been recruiting and reshaping its existing organisation and procedures.

The FRC published its 2021/2022 strategy in April 2021 explaining that 34 out of the 155 recommendations from the Kingman, Brydon and CMA reviews have been implemented so far. It sets out plans for continuing change that does not require legislation.

Corporate reporting review activity

The FRC's Corporate Reporting Review team (CRR) is now publishing, with agreement from the companies concerned, short summaries of reviews where they have entered into substantive correspondence including the nature of the matters concerned. This is an interim step towards the greater transparency outlined in the White Paper which proposes publication of the full correspondence, in line with practice in the USA. Analysis of the summary information shows consistency with the CRR highlights, with common topics relating to impairments, revenue recognition, alternative performance measures and cash flow statements.

The CRR has highlighted the following areas of focus for their ongoing monitoring of annual reports and accounts and encourages companies to articulate their expectations of the possible impacts of these factors on their specific business:

- Disclosures addressing risk, judgement and uncertainty in the face of the ongoing economic and social impact of Covid-19
- The potential consequences of geopolitical tensions and the UK's exit from the European Union
- Climate-related risks.

The financial reporting implications of specific circumstances, such as a change in business model affecting operating segments, should also be considered.

The FRC's Strategy, Plan and Budget for 2021/2022 includes plans for the following monitoring activity:

- Undertake assessments of performance against the UK Corporate Governance Code, the UK Stewardship Code and the Wates Corporate Governance Principles for Large Private Companies.
- 240-260 Corporate Reporting Reviews (CRR) in 2021/22.
- Use thematic and cross-market reviews to promote improvements in corporate reporting, audit quality and audit market resilience.

Changes to auditing standards: going concern
The FRC has introduced certain changes to UK standards on auditing, known as ISA (UK), which reflect some of the key focus areas from the various reviews that have culminated in the Government's current White Paper.

Published in September 2019 ISA (UK) 570 "Going concern" took effect for December 2020 year ends and later (periods commencing on or after 15 December 2019). The changes permeate all parts of the audit, from the initial risk assessment activities to concluding and reporting and the auditor's expectations of management documentation. As explained by the FRC in its press release, the updated standard means that the UK follows "significantly stronger requirements than those required by current international standards."

The audit report's discussion of going concern in an extended audit report should now be in line with what would be required if going concern was a key audit matter – i.e. there is tailored narrative disclosure in the audit report.

Changes to auditing standards: fraud
The FRC has published an update to ISA (UK) 240 "The auditor's responsibilities relating to fraud in an audit of financial statements". The new standard was published in May 2021 and takes effect for periods commencing on or after 15 December 2021, with early adoption permitted.

This update is designed to address stakeholder concerns and matters raised in the Brydon review and is planned to include more clarity in the audit report around specific procedures performed by the auditor when understanding the risk of fraud, alongside a requirement to consider communicating matters, if any, regarding management's process for identifying and responding to risks of fraud to those charged with governance. There are new specific requirements for the auditor to consider whether the responses of those charged with governance to queries about fraud are consistent with those received from management. Boards will wish to consider a formal documented risk assessment from management that can be challenged by those charged with governance and ultimately provided to the auditor.

The updated standard does not reflect the further proposals currently under consultation in the White Paper for statutory requirements for directors to report on the steps they have taken to prevent and detect material fraud and for auditors to report in relation to such a director's statement.

Changes to audit reports
There have been a series of changes implemented for audit reports for December 2020 year ends and thereafter and further evolution in the audit report is anticipated over the next two years, including the fraud standard referred to above.

The changes largely relate to areas of investor and stakeholder focus, including new reporting on irregularities (instances of non-compliance with laws and regulations, including fraud), going concern (as described above) and performance materiality.

In addition, entities applying the UK Corporate Governance Code will have noticed more detail around the auditor's report on areas of the Code relating to the audit committee remit, where there is now a requirement for the auditor to report on whether the following are materially consistent with the financial statements and the auditor's knowledge obtained in the audit:

- The section of the annual report that describes the r**eview of the effectiveness of entity's risk management and internal control systems**, covering all material controls, including financial, operational and compliance controls;
- The section of the annual report that describes the work of the audit committee, including the **significant issues** that the audit committee considered relating to the financial statements, and **how these issues were addressed.**

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FRC's expectations for the quality of reporting on corporate governance

During February, the FRC published new guidance material, "Improving the quality of 'comply or explain' reporting". This is aimed at companies that report on their compliance with the UK Corporate Governance Code and provides details about the FRC's expectations regarding the quality and transparency of reporting of the degree of compliance with the Provisions of the Code.

Comply or explain reporting

The FRC strongly encourages companies to aim for high quality reporting of good governance practice, rather than an attempt to declare full compliance with the Code when that may not in fact be the case.

In summary, the FRC explains that when a company departs from a Provision of the Code, the annual report should clearly demonstrate both:

01. The action taken by the company: What Provision it has departed from and what alternative approach it has chosen; and

02. The outcome: How is that alternative approach more efficient and appropriate than that prescribed by the Code, and how is it helping the company to achieve good governance

The publication includes examples of good practice and descriptions of ineffective practice. The FRC's publication can be found here and proposes a three step process to good disclosure:

1 Make it easy for a reader to find information about non-compliance in their annual reports

In compliance with the Listing Rules and the Code's requirements, state whether the company has:

- fully complied with all elements of the Provisions of the Code; or
- departed from any of the Provisions of the Code citing any Provisions that they have not complied with and state where in the report the explanation can be found.

Explanations can be:

- part of the compliance statement; or
- signposted to another page / section of the annual report.

2 Report any departure from any Provision of the Code

The FRC's research shows areas where non-compliance is not always reported, including:

- **Provision 19** – where the Chair has been in place for more than 9 years.
- **Provision 38** – where not all executive director pension contributions are in line with those of the workforce.

Other Provisions mentioned for particular attention include:

- **Provision 5** – stakeholders' interests and workforce engagement – comply with both and fully explain alternative arrangements. Provision 36 – post-employment shareholding requirements should be in place.
- **Provisions 23, 26 and 41** – must meet all of the multiple disclosure elements to each of these Provisions on the work of Committees
- **Provisions 40 and 41** – must include clear disclosure on two-way dialogue with the workforce and with shareholders

3 Provide clear and meaningful explanations for departures from the Code

Proposed structure for meaningful explanations:

- Set the context and background
- Give a convincing rationale for the approach being taken
- Consider any risks and describe any mitigating actions
- Set out when the company intends to comply (timescales)
- Explanations should be understandable and persuasive

Consultation with shareholders is also useful disclosure but does not replace any element of the proposed structure.

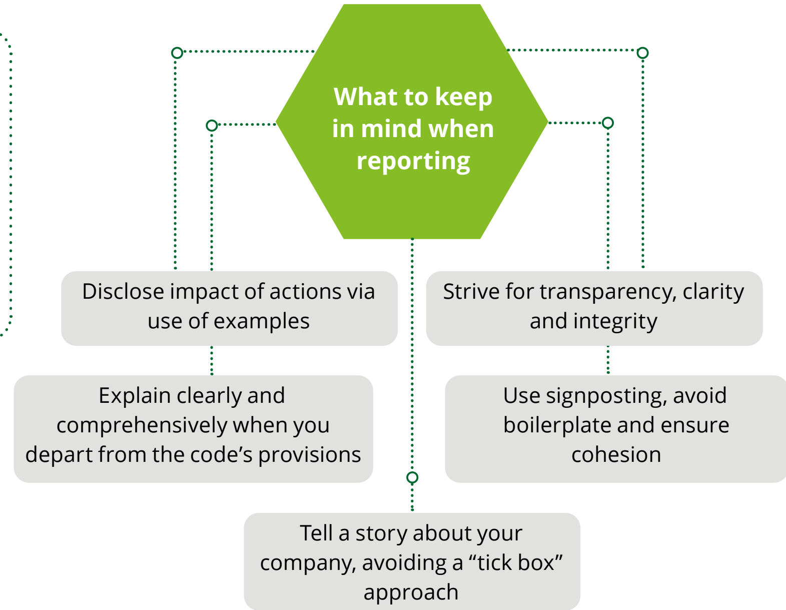
Other key expectations for governance disclosures

"Much of what we have analysed is formulaic. Too often the objective of reporting appears to be to claim strict compliance with the Code concentrating on achieving box-ticking compliance, at the expense of effective governance and reporting. This approach is a disservice to the interests of shareholders and wider stakeholders, and ultimately is not in the public interest; it undermines trust." Sir Jon Thompson, "Review of Corporate Governance Reporting"

In November 2020, the FRC published its 'Review of Corporate Governance Reporting' which was based on a review of 100 companies across the whole premium listed market. The report presents the findings from the review and sets out the FRC's expectations for the future application of the Code and reporting.

In his foreword, Sir Jon Thompson looks forward to new powers to review the whole annual report, including corporate governance and remuneration reporting.

The FRC sets out five guidelines to consider when putting together corporate governance reporting:



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It highlights seven areas where companies can improve reporting and where boards can consider the adequacy of the reporting that is presented to them.

Area for reporting focus	Some considerations set out by the FRC
Companies to have a well-defined purpose and to clearly show the progress towards achieving it	"Our view is that a purpose must be simple to understand and act as a reference point for decision making." "FRC expects companies to demonstrate further improvements in the quality of disclosures of how purpose, values, and strategy are connected." "Company purpose should act as a driver for decisions and actions. It is therefore critical that the board agrees the purpose and oversees the alignment between values."
Discussion of the issues raised, topics considered, and feedback received during engagement with shareholders and employees	"The FRC expects companies to report on their engagement efforts with their stakeholders, which should be conducted in an open manner. Reporting should also include a discussion on how any received feedback has informed company decisions and strategy."
Clearly show the impact of engagement with stakeholders, including shareholders, on decision-making, strategy and long-term success	"With growing focus on the social issues, we will review how directors are discharging their s.172 duty, in particular the quality of stakeholder engagements, the extent to which they have informed board decisions and how effectively companies are responding to concerns raised." "We were disappointed that more companies did not report on channels of engagement with suppliers and their importance as a source of risk. Failures and concerns within the supply chain will impact the success of the company, even if only in the short term."
Increased focus on assessing and monitoring culture, including consideration of methods and metrics used	"FRC expects more companies to take a more rigorous approach to culture and set up effective ways of monitoring and assessing both the culture and its alignment with purpose, values and strategy, including setting out any actions taken in this area in line with Provision 2." "Staff surveys can offer insight into culture but have significant limitations, especially when considered in isolation." "We also have concerns about the reliance on site visits to gauge culture. Such visits can be helpful for directors and non-executive directors (NEDs) to improve understanding of the business and its operations. However, whether an escorted visit to a 'site' offers valuable insight into company culture is questionable."

Increased attention and better reporting of succession planning, diversity and board evaluation	"FRC expects to see an improvement in reporting on succession planning. This is particularly the case for companies which highlight succession planning as an outcome of a board evaluation as an area to improve. We would also like to see improved cohesion between diversity commitments, board evaluations and succession plans." "FRC expects to see all companies promoting and recruiting on merit. Those who use it as a justification for not actively pursuing diversity policies should demonstrate how their approach brings about diversity in the boardroom and workforce." "Reporting on board evaluations should not be approached as a compliance exercise. Instead, a clear set of recommendations, actions, and a time period for review of progress against agreed outcomes should be made."
Clearly show the impact of engagement with shareholders on remuneration policy and outcomes	"FRC expects all companies to move to the full alignment of pension contributions as soon as possible. We also expect, along with investors, those companies which still have not addressed this issue to provide a clear and specific rationale and to define a timeline by when this will be rectified. Until then, those companies must disclose this non-compliance in the governance statement."
Clearly show the impact of the engagement within the workforce in relation to executive remuneration policy	"The [remuneration committee] should also engage with their workforce meaningfully, ensuring there is a two-way dialogue. Good practice would be to separate engagement on executive remuneration policy from other workforce engagements to ensure a focused discussion." "FRC expects to see an improvement in companies reporting the steps that they have taken to engage their employees on their remuneration policies."

Workforce engagement and the UK Corporate Governance Code

The FRC published research in May 2021 which indicates that companies could do more to explain and to take credit for workforce engagement in their annual reports. Through interviews and reviews of published material, the researchers Royal Holloway London and the Involvement and Participation Association elaborate on a series of key observations and suggest that boards should ask themselves an underlying question: what purpose should workforce engagement serve for this organisation?

Questions for the board based on the report's key observations:

- What purpose should workforce engagement serve for our organisation – a sounding board, ensuring diversity of views, driving organisational change?
- Is our employee voice representative and does it reflect the geography and demographic of our workforce?
- Does our workforce engagement integrate our different engagement and voice channels, including collective forms of employee representation, to ensure depth of coverage?
- Do we obtain regular and structured input from the workforce, especially during periods of rapid change?
- Have workforce representatives on a panel or as directors been chosen with input from the workforce?
- Is enough focus placed on the substance of workforce engagement and is the agenda well-balanced between topics of management and workforce interest?
- Is the dialogue with the workforce meaningful – is enough information provided for the workforce to have insight into the topics raised for discussion with them, and has an effective feedback loop been established?
- Is the effectiveness of workforce engagement kept under regular review?
- Are there helpful changes that can be made – either reflecting and learning from existing practice (which could include consulting the workforce) or looking outside to learn lessons from other organisations?

Reporting on remuneration practices

During May 2021, the FRC published research by the University of Portsmouth, "Changes in remuneration reporting following the UK Corporate Governance Code 2018". The research examines the remuneration policy disclosures of a sample of 80 FTSE 350 companies during the reporting periods before and after the introduction of the 2018 Code. It also examines shareholders votes on revised directors' remuneration policies during AGMs.

The research concluded that there is more disclosure of remuneration policies since the introduction of the 2018 Code, together with an improvement of the clarity of reporting, particularly in the FTSE 100. There was also more disclosure regarding engagement with shareholders on remuneration, although not much on engagement with the workforce.

On shareholder votes, the report observes that dissent on changes to directors' remuneration policy appeared not only to be about maximum pay, but also about other issues surrounding those pay packages, for example changes within the company or external factors such as the level of directors' pay relative to income and pay of other employees in difficult times due to Covid-19. Companies' comments on shareholder dissent were mixed, although most companies appeared genuinely concerned, wishing to find out the reasons for shareholder dissatisfaction, and to seek remedies.

Questions for the board:

- Does our report provide transparent, company-specific details of how the Code's Principles have been applied and detailed information regarding how the company has complied with the Provisions related to remuneration?
- Are we confident that our dialogue with the workforce is effective and enables us to seek their views on how executive remuneration aligns with wider company pay policy?
- Have we clearly explained why particular non-financial KPIs have been selected as drivers for remuneration and how they are formulated?
- In case of significant shareholder dissent, have we published an update statement on the shareholders' reasons and the actions we have taken as a result?

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In this article we explore the board's existing responsibility under the UK Corporate Governance Code to establish a framework of prudent and effective controls alongside the UK proposals for a US-style internal control attestation. In addition, we provide questions for boards to consider in deciding whether to take action on internal control in advance of further announcements from Government or regulators on an enhancement to the UK regime together with insights from a poll of Deloitte Academy members on where they see some of the challenges.

A reminder of the current UK Corporate Governance Code requirements

Overarching board responsibility from Code Principle C:
The board should establish a framework of **prudent** and **effective** controls, which enable risk to be assessed and managed.

Secondary board responsibility from Code Principle O:
The board should establish procedures to manage risk, **oversee the internal control framework**, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

Board activity prescribed by Code Provision 29:
The board should **monitor** the company's risk management and internal control systems and, at least annually, carry out a **review of their effectiveness** and report on that review in the annual report. The monitoring and review should cover **all material controls**, including financial, operational and compliance controls.

Audit committee responsibilities prescribed by Code Provision 25: Reviewing the company's internal financial controls and internal control and risk management systems, unless expressly addressed by a separate board risk committee composed of independent non-executive directors, or by the board itself.

So what does this mean in practice?
The FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting states that "effective and on-going monitoring and review are essential components of sound systems of risk management and internal control". It recommends the following disclosure:

The board should summarise the process it has applied in reviewing the effectiveness of the system of risk management and internal control. The board should explain what actions have been or are being taken to remedy any significant failings or weaknesses.

So in putting together a robust process, the Guidance recommends that, on an ongoing basis, the board should consider:

- how effectively the risks have been assessed and the principal risks determined;
- how the principal risks have been managed or mitigated;
- whether necessary actions are being taken promptly to remedy any significant failings or weaknesses; and

whether the causes of the failing or weakness indicate poor decision-taking, a need for more extensive monitoring or a reassessment of the effectiveness of management's on-going processes.

To obtain assurance over the effectiveness of internal controls over financial reporting, boards should consider whether there is clear evidence from management that the following steps have been undertaken:

STEP 1 – initial assessments and entity level controls

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

STEP 2 – confirmation of in scope systems and identification of material controls

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

STEP 3 – establish robust monitoring and review processes

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

STEP 4 – establish clear reporting protocols and accountability for action

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

Areas some more sophisticated organisations are addressing also include consideration of the appropriate mix of controls – for example, over-reliance on management review controls can lead to lack of precision, and controls really should be embedded in and supporting business processes.

In addition, organisations need to consider what information is used in operating a control, to ensure that information is appropriate. The classic example is the debtor ageing report – is this aged from invoice date or due date – and how free from "re-aging" is it? Another common area is outsourced services - where organisations need to ensure that the controls around these are operating effectively.

Boards that believe they have a way to go on this journey may wish to start with the following questions in relation to each of the steps outlined earlier:

STEP 1 - initial assessments and entity level controls

- Are the risk management and internal control systems appropriate for the company's business model?
- How are authority, responsibility and accountability for risk management and internal control defined, co-ordinated and documented throughout the organisation?
- Has a financial risk assessment been undertaken? What does it tell us?
- Has management undertaken a fraud risk analysis, including the risk of fraud in financial reporting?
- What are the channels of communication that enable individuals, including third parties, to report concerns, suspected breaches of law or regulations, other improprieties or challenging perspectives?

STEP 2 - confirmation of in scope systems and identification of material controls

- Have "material controls" been defined for the business? Where are material risks apparent and where are material decisions taken?
- Can management provide an analysis of material controls by process and central function and provide details around how they are assured?
- Is the company clear about which IT systems are material to financial reporting, operating or compliance controls and have the IT controls been tested?
- At an entity level, has the board considered how the company's culture, code of conduct, human resource policies and performance reward systems support the business objectives and risk management and internal control systems?

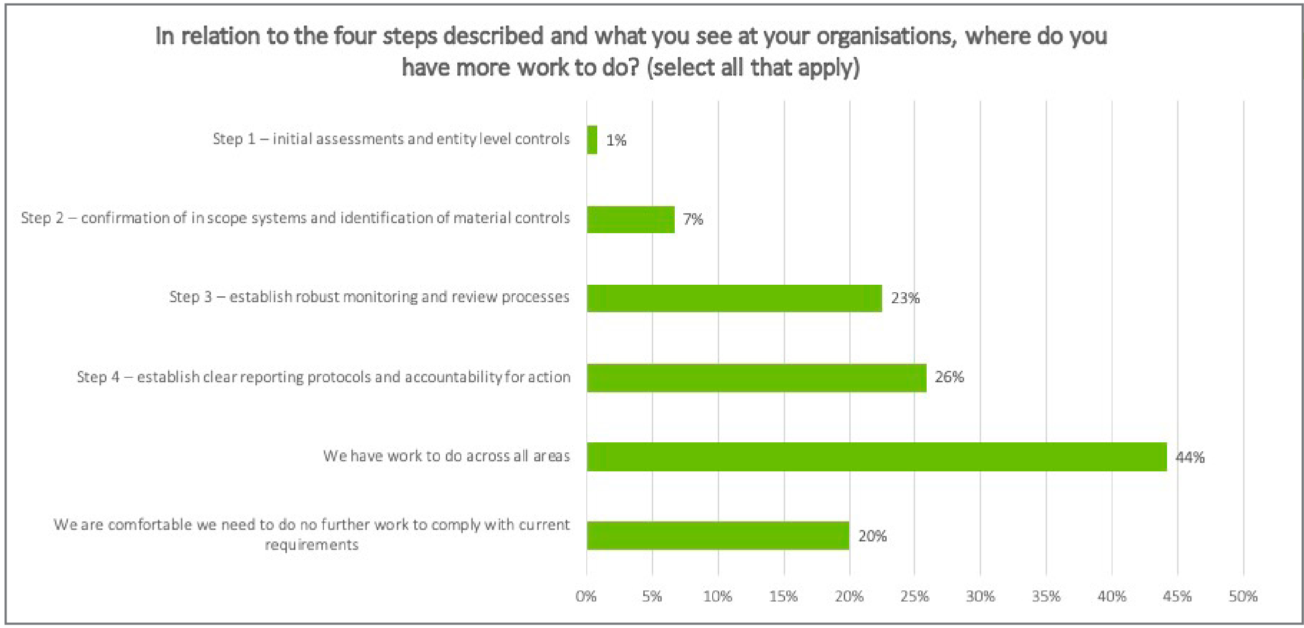
STEP 3 - establish robust monitoring and review processes

- How does the board satisfy itself that the information it receives is timely, of good quality, reflects numerous information sources and is fit for purpose?
- Are the papers supporting the board's annual review of effectiveness of internal controls sufficiently comprehensive to support the conclusions, or are the papers more of an "exception report"?

STEP 4 - establish clear reporting protocols and accountability for action

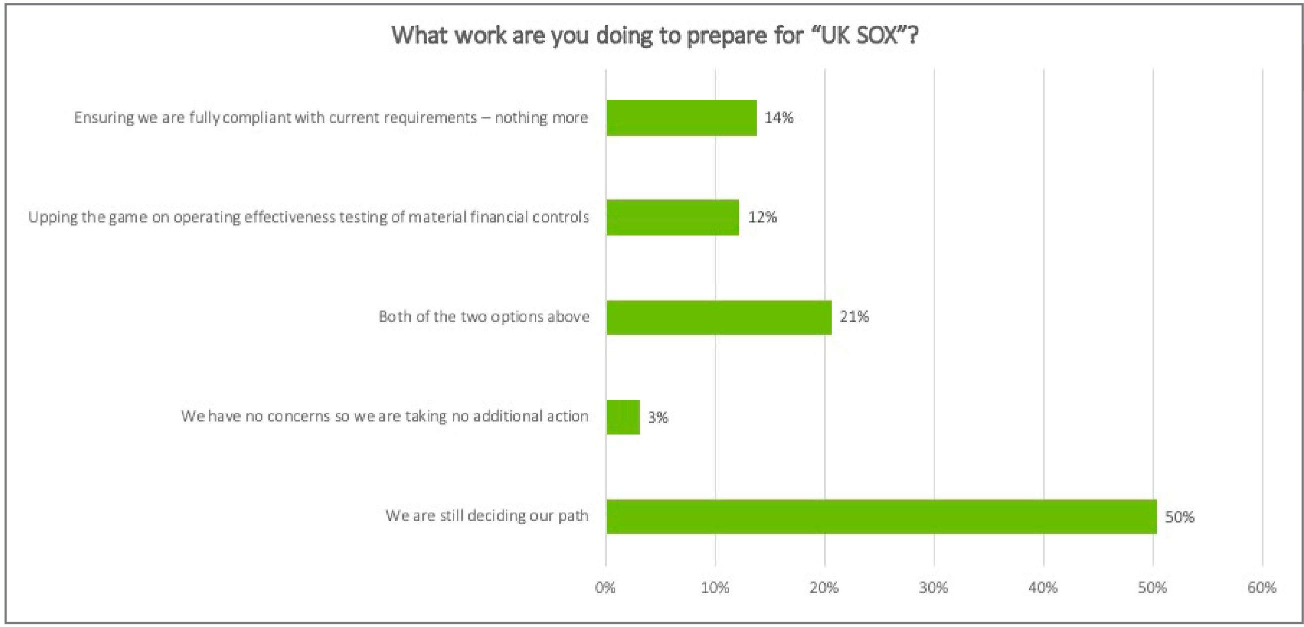
- If the annual review of effectiveness has revealed areas where more needs to be done to enhance material operational, financial or compliance controls, is there a clearly defined action plan and are these areas of weakness appropriately disclosed in the annual report?

At a Deloitte Academy event for Audit Committees at the start of June, we put a series of questions to the audience of around 200 directors – the polling indicates more time should be invested meeting current requirements:



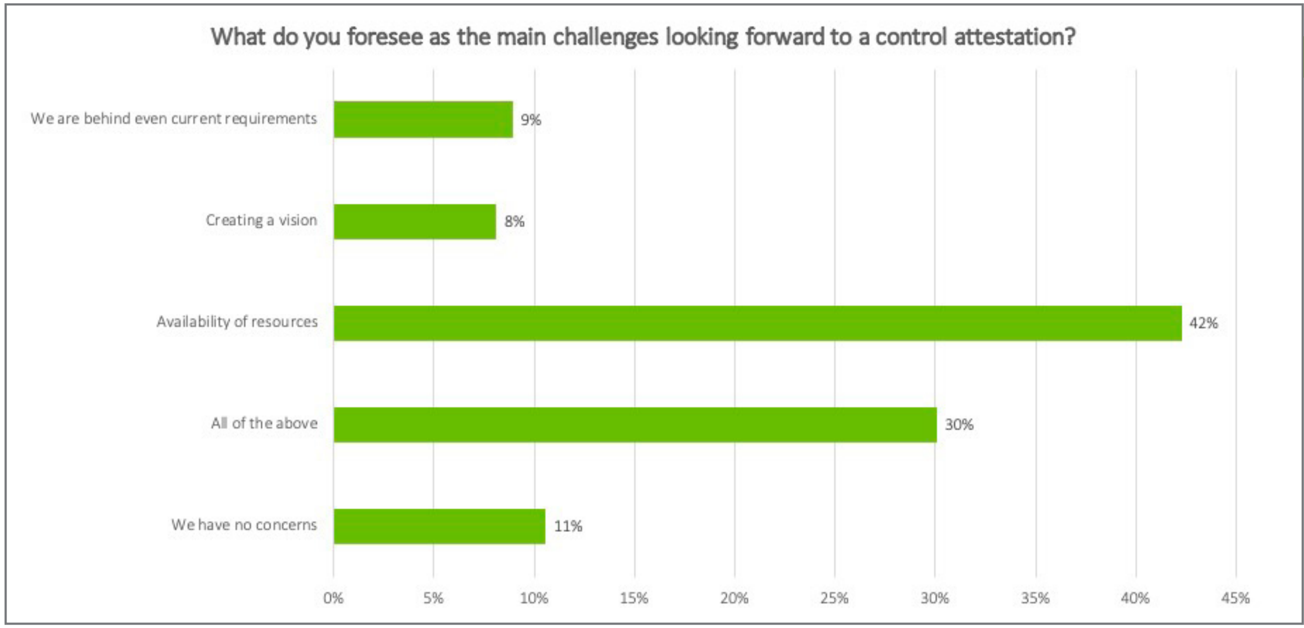
In relation to the four steps described and what you see at your organisations, where do you have more work to do? (select all that apply)
Step 1 – initial assessments and entity level controls
1%
Step 2 – confirmation of in scope systems and identification of material controls
7%
Step 3 – establish robust monitoring and review processes
23%
Step 4 – establish clear reporting protocols and accountability for action
26%
We have work to do across all areas
44%
We are comfortable we need to do no further work to comply with current requirements
20%
0%
5%
10%
15%
20%
25%
30%
35%
40%
45%
50%

1



What work are you doing to prepare for "UK SOX"?
Ensuring we are fully compliant with current requirements – nothing more
14%
Upping the game on operating effectiveness testing of material financial controls
12%
Both of the two options above
21%
3%
We have no concerns so we are taking no additional action
We are still deciding our path
50%
0%
10%
20%
30%
40%
50%
60%

2



3

'Internal control and the board: What's all the fuss about?' has been updated to reflect the BEIS White Paper proposals and provides further detail and considerations for you in relation to the Government's proposals to strengthen the UK internal controls regime.

What is the latest position on ESG and climate reporting?

In this article we provide an overview of the latest position on building credible climate commitments, on requirements for reporting against the TCFD framework in the UK, the move towards global common standards of ESG reporting, and proposals to update the EC's Non-Financial Reporting Directive. The overall message is that reporting of climate matters will take a leap forward in 2021.

Building credible climate commitments

As the focus on climate change intensifies, companies are increasing their public commitment to fighting it: In 2020, net zero pledges tripled over 2019[1]. This increasing commitment is driven not only by leaders who want to make a difference but by the growing demands of a wide range of stakeholder groups, from customers and employees to investors, policymakers, and NGOs and activists.

Building trust in company climate action with the universe of stakeholders is ultimately a journey toward embedding climate considerations into every facet of the organisation—in governance, strategy, risk management, and metrics and targets. This shift requires integrated thinking, in which the company's purpose and consideration for its impacts on the planet, people, and wider economic prosperity are embedded throughout the enterprise. Integrated thinking, in short, means infusing sustainability into the core of the business.

In other words, trust can be earned when commitments are authentic to the organisation's purpose and grounded in the organisation's business strategy over time.

The prize of doing it right is that credible climate commitments can inspire trust in a company and its plan for addressing its carbon footprint. By contrast, organisations that claim to be environmentally friendly but lack a credible plan to support their claims – or, worse, are shown to be hindering climate action – risk accusations of greenwashing, which can lead to multiple negative consequences, including the erosion of trust with stakeholders that may question (possibly rightfully) an organisation's capabilities or intent to reduce its climate impact.

Building credible climate commitments: A road map to earning stakeholder trust explores ways to close the trust gap and forge robust climate commitments.

Reporting against the TCFD (Taskforce for Climate-related Financial Disclosures) framework - premium listed entities

During December 2020 the Financial Conduct Authority (FCA) published a Policy Statement (PS20/17) and new listing rule LR 9.8.6R(8) to promote higher-quality climate-related financial disclosures. The new rule applies to commercial companies with a premium listing who must include a statement in their annual report setting out:

[1] Data-Driven EnviroLab and NewClimate Institute, Accelerating net zero: Exploring cities, regions, and companies' pledges to decarbonize , September 2020

» Whether they have made disclosures consistent with the TCFD recommendations and recommended disclosures in their annual report.

» Where they have not made disclosures consistent with all of the TCFD's recommendations and recommended disclosures, an explanation of why and a description of any steps they are taking or plan to take to be able to make these disclosures in the future – including the timeframes.

» Where they have included some, or all, of their disclosures in a document other than their annual report, an explanation of why.

» Where in their annual report (or other document) the various disclosures can be found.

The rule is effective for accounting periods beginning on or after 1 January 2021. The first annual reports subject to this rule will therefore be published in early 2022.

A reminder of the relevant TCFD recommendations

1. Governance
Disclose the organisation's governance around climate-related risks and opportunities

- Describe the board's oversight of climate-related risks and opportunities
- Describe management's role in assessing and managing climate-related risks and opportunities

2. Strategy
Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information of material

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

3. Risk Management
Disclose how the organisation identifies, assesses and manages climate-related risks

- Describe the organisation's processes for identifying and assessing climate-related risks
- Describe the organisation's processes for managing climate-related risks
- Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management

4. Metrics and Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material

- Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process
- Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks (TCFD guidance on when disclosure of Scope 3 emissions is appropriate is expected during 2021)
- Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

Questions for the board and audit committee to consider:

Executive ownership

- Is there a named individual responsible for driving change across the organisation? Is there a mandate from the board?
- Is there a board-level owner of climate change and is there sufficient focus at executive committee level?
- Are targets for executive management driving the right outcomes at the pace that the board wants to see?

Strategy

- Have the business impacts relevant to the sector been fully considered?
- Is climate change a consideration when evaluating strategic decisions and investment priorities?

Governance

- Where is climate change discussed – at the board or at a committee level? Is there a committee focused on ESG / sustainability matters?
- How often is the company's required climate response/ transformation on the agenda and is enough time dedicated to the discussion? Should it be discussed more regularly?
- Is there a process to identify and manage climate-related opportunities?

Risk and scenario analysis

– Has the company developed a rigorous climate-change scenario impact analysis?

– Is the audit committee satisfied that the scenarios are sufficiently challenging, diverse and relevant?

– Is the audit committee's risk monitoring activity appropriately addressing climate change risks for the company?

Information, reporting and assurance

– Is climate-related management information robust and fit for purpose?

– What external data, or external expertise, has the company relied upon and is it reliable and credible?

– Does the finance function take ownership of information and accounting around climate change - if not, are there sufficient checks and balances to give confidence in the information?

– Have the findings of reporting reviews such as the FRC's climate thematic review been considered? Have appropriate changes to annual report processes and reporting been implemented?

– To what level of internal or external oversight or assurance will the company's metrics be subjected?

BEIS consultation on mandatory climate-related financial disclosures for publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs)

Commercial companies with a premium listing that already follow the Listing Rule requirement described above will not need to take additional action to meet the proposed disclosure requirements.

The proposed changes would take effect for periods commencing on or after 6th April 2022 and would apply to:

- all UK companies currently required to produce a non-financial information statement (being UK companies that have more than 500 employees and have transferable securities admitted to trading on a UK regulated market, banking companies or insurance companies (Relevant Public Interest Entities (PIEs));
- UK registered companies with securities admitted to AIM with more than 500 employees;
- UK registered companies which are not included in the categories above, which have more than 500 employees and a turnover of more than £500m; and
- LLPs which have more than 500 employees and a turnover of more than £500m.

Unlike the new Listing Rule requirement noted above, companies in scope would not be required to make the eleven recommended disclosures as set out in the Recommendations of the Taskforce on Climate-related Financial Disclosures, they would be required to provide information in line with the four "pillars" of TCFD, being Governance; Strategy; Risk Management; and Metrics and Targets. It is proposed to require in scope companies and LLPs to provide disclosures relating to:

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- a description of the governance arrangements in place to identify and manage risks and opportunities arising from climate change;
- who has operational responsibility for climate change, including the experience of that executive or committee; and
- if the company has an audit committee, whether climate change is a matter considered by the company's audit committee

Strategy

- a brief description of the company's business model and strategy (to the extent that the company is not already required to report such information);
- a description of how the company's business model and strategy may change in response to effects relating to climate change, and the trends and factors that affect this change.

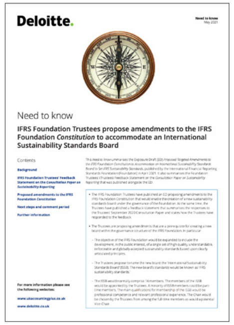
Risk Management

- a description of the principal risks and principal opportunities, including material financial risks and opportunities, relating to transition risk, physical risk and regulatory risk arising from climate change which may affect the business and a description of how the company manages those areas of risk and opportunity including:
    a. a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk
    b. a description of how it manages the principal risks; and
- a description of the risk management policies pursued by the company in relation to climate change, any due diligence processes implemented by the company in pursuance of those policies and a description of the outcome of those policies.

Metrics & Targets

- a description of the key performance indicators relevant to the entity's exposure to climate change risk and opportunity, and the targets set by the business for those key performance indicators.

The proposals would not require companies and LLPs to provide detail on scenario analysis but would encourage such disclosure where possible. The consultation closed on 5th May 2021.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Need to know

IFRS Foundation Trustees propose amendments to the IFRS Foundation Constitution to accommodate an International Sustainability Standards Board

IFRS Foundation Trustees move towards the development of an International Sustainability Standards Board

The IFRS Foundation Trustees have published an exposure draft proposing amendments to the IFRS Foundation Constitution that would enable the creation of a new sustainability standards board under the governance of the Foundation.

The exposure draft proposes to amend the Constitution to expand the Foundation's remit to create a new board that would set IFRS sustainability standards. In particular, the Trustees propose to expand the objectives of the Foundation to include the development, in the public interest, of a 'single set of high quality, understandable, enforceable and globally accepted sustainability standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in corporate reports to help investors and other participants in the world's capital markets in their decision-making and connect with multi-stakeholder sustainability reporting.'

After the comment letter deadline of 29 July 2021, the Trustees will review an analysis of the comments on the proposed constitutional amendments.

European Commission publishes proposed Corporate Sustainability Reporting Directive

The European Commission (EC) has published a proposed Corporate Sustainability Reporting Directive (CSRD). The objective of the proposed CSRD is to improve sustainability reporting and ensure it is brought into a company's management report to better leverage the potential of the European single market and to contribute to the transition to a fully sustainable and inclusive economic and financial system in line with the European Green Deal and the UN Sustainable Development Goals (SDGs).


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Purpose-driven Business Reporting in Focus

European Commission publishes proposed Corporate Sustainability Reporting Directive

The CSRD will update the NFRD, which was directly implemented into UK law in 2016 as part of the strategic report requirements in the Companies Act 2006. It is currently unclear if the proposed update will also be brought into UK law as the UK is no longer required to implement EU legislation. UK companies will be directly affected by the CSRD if they have securities listed on EU regulated markets and if they have EU subsidiaries. The proposed CSRD includes mandatory limited assurance of the sustainability information provided by companies. The next step is for the European Parliament and the Member States in the Council to negotiate a final legislative text on the basis of the EC's proposal.

IASB proposes a revised Practice Statement on Management Commentary

The International Accounting Standards Board (IASB) has published an exposure draft of a revised Practice Statement on Management Commentary. This reflects the IASB's decision to play a more active role in wider corporate reporting and provide a link between disclosure of financial and non-financial information. The IASB's research also indicated that management commentaries do not always provide investors and creditors with the information they need on sustainability and environmental, social and governance issues and the Practice Statement aims to address this concern.


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IFRS in Focus

IASB proposes a revised Practice Statement on Management Commentary

The exposure draft proposes that the revised Practice Statement would be effective for annual reporting periods beginning on or after the date that the final Practice Statement is issued. It will not be an IFRS Standard and its application will not be mandatory for IFRS reporters. The comment period closes on 23 November 2021.

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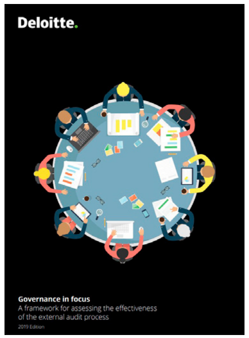
Further resources

This section pulls together some additional resources with a brief introduction to each of them, so they are easier to refer to when required. These publications offer a deeper dive on the governance topics of interest we touch upon in this publication, where we believe they can add insight to your role as a board member.

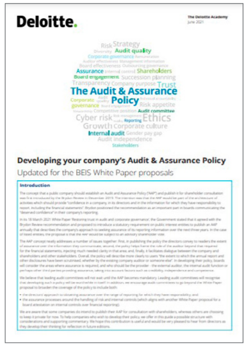
As always, do get in touch with your Deloitte partner or with us in the Deloitte governance team if you would like to discuss any areas in more detail. All our recent governance publications and newsflashes are available to read and download from www.deloitte.co.uk/governancelibrary.

Governance in focus

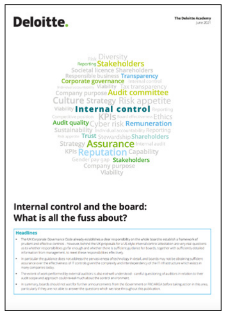
Audit Committee effectiveness framework is a practical self-assessment guide which covers all aspects of the audit committee's remit for companies outside the financial sector. The framework does not anticipate the results of consultations on changes to the board or audit committee remit, auditor responsibilities or corporate reporting, but does take into account areas where expansion of role can be expected. We have also included a number of qualitative considerations in the form of 'good practice statements' which help to differentiate an effective audit committee from one which is just ticking the boxes.



A framework for assessing the effectiveness of the external audit process presents a set of questions for audit committees and for material component management to consider. This publication can help audit committees determine how to assess the effectiveness of the external audit process with greater confidence, as part of fulfilling their key role to scrutinise the quality of the external audit on behalf of investors.



Developing your company's Audit and Assurance Policy offers a possible structure for the Audit and Assurance Policy with accompanying considerations and commentary. Leading audit committees will recognise that developing such a policy stimulates thinking in two areas: the directors' approach to obtaining assurance over the range of reporting for which they have responsibility; and the assurance processes around the handling of risk and internal controls.



Internal control and the board: What is all the fuss about? is a guide to the internal control framework and the associated responsibilities of the board and audit committee. The document includes a summary of the Code requirements and a summary of key steps of the control assurance process. This publication also provides a set of questions for the Board to consider within the internal control framework preparation and attestation.

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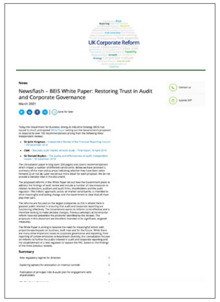
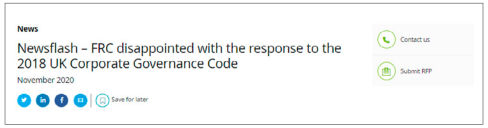
Newsflash

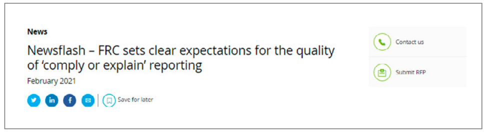


BEIS White Paper: Restoring Trust in Audit and Corporate Governance summarises the recommendations taken forward from three independent reviews, being Sir John Kingman, CMA and Sir Donald Brydon

FRC disappointed with the response to the 2018 UK Corporate Governance Code explains the main areas of reporting where room for enhancement was identified by the regulator and sets out the FRC's expectations for the future application of the Code and reporting.


News
Newsflash – FRC disappointed with the response to the 2018 UK Corporate Governance Code
November 2020
Save for later
Contact us
Submit RFP

FRC sets clear expectations for the quality of 'comply or explain' reporting describes key areas of the FRC review and relevant recommendations. This article is aimed at companies that report on their compliance with the UK Corporate Governance Code and provides details about the FRC's expectations regarding the quality and transparency of reporting of the degree of compliance with the Provisions of the Code.


News
Newsflash – FRC sets clear expectations for the quality of 'comply or explain' reporting
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The Deloitte Academy

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

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

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

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