Deloitte.

On the board agenda 2021

November 2020

Contents

Foreword

Dear Board Member,

I am so much looking forward to 2021, as I am sure you are. But this is not with naïve relief and hope, for one thing is certain - if Covid and our response to it have accelerated underlying industry trends, there is no return to before.

We need to be clear about what will be different, understand it, engage with it, and react to it. Some of this is real change now, some will be expectation of change tomorrow. There will be lots of it for sure – and we have to embrace it, own it and shape it.

Tangible changes will be pervasive: at our customers, in our products or services, at our competitors, our suppliers, within our processes, in our communities, at our workplace; perhaps most importantly in our people, in their expectations – yes, just about everything is changing! The digital technologies we are deploying everywhere are not themselves the challenge; but rather the challenge lies in the pace required - the sequencing, the communications, in the company's capacity to handle change, and the capabilities of the people to deliver it. For those who do all this well, and manage to drive rapid adoption, the reward will be fast and sustainable.

While making these changes within, companies will also have to engage deeper with the ecosystem around them. And this ecosystem is itself changing rapidly; government, regulators, our communities, and investors are responding to a range of societal demands and also to the basic necessity to respect, nurture and, if we can, restore our planet. We have all witnessed how the planet itself is changing and increasingly making its displeasure felt, as though from the north to the south poles, from Siberia to the South Pacific and Australia, from California to Brazil, to Africa and the Himalayas our host is hurting and saying "come on now, that's enough". To nudge the laggards along, as we go about fixing things in the period ahead we can expect an increased volume of well-intentioned regulations.

On the Board Agenda 2021 discusses many of these themes in a series of short articles and provide links to source materials for further study. We review the resilient agile company, workforce strategies, the power of purpose driven brands; we examine the emerging components of corporate reporting, the proposed public interest statement, new climate reporting requirements and the demands for consistent ESG metrics; we interview Paul Stephenson, Deloitte's new managing partner for Audit and Assurance, and review reporting reminders for the year from the FRC; we challenge you to modernise your internal risk and assurance processes, and encourage you forward on internal controls; finally, we review the dynamics in the consideration of executive remuneration.

It is a very full agenda reflecting the times. However, the Deloitte Academy will continue to support you in your role as an executive or board member, with deep dives for specific roles, and with broader topics such as the climate crisis, biodiversity and future trading relationships. We hope you find this publication and the Deloitte Academy programme useful; with each article you will find contact details should you wish to explore more.

For now we send you, your families and colleagues our best wishes and look forward to welcoming you to the Deloitte Academy's programmes in 2021.

Yours truly,

William Touche
Vice-Chair

November 2020

Deloitte Academy Quick Reads

During the year the Deloitte Academy has held events which are very relevant to some of the topics covered in this publication. We prepare 'quick reads' to capture the key messages from the expert speakers at these events and, where relevant, we have included links to these throughout this publication.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

Deloitte opinion pieces

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

Resilience Reimagined

High impact events and economic shocks will continue to happen. To survive and thrive tomorrow, directors need to re-examine, and re-imagine, what 'being resilient' truly means.

COVID-19 has revealed where you have resilience and where there are vulnerabilities; now is the time to capture, and consider further, the changes necessary to enhance the resilience of your organisation and its new ways of operating. You may feel comforted that your organisation has demonstrated that it can move rapidly to find new ways of doing things, build new networks and keep services going - but relying on 'we'll find a way through' is not enough for boards of directors, the stewards of long term value creation and reputation.

In this article we describe what being resilient means, and we highlight areas to examine on the path to stronger resilience for the benefit of all. This is particularly relevant as we consider a new board statement on resilience, as recommended by Sir Donald Brydon. We touch on the three pillars of financial, operational and reputational resilience.

Becoming a more resilient organisation

The more resilient organisation adopts a mind-set of 'What if? What next?' - not just a mind-set for the next risk, but a mind-set also for the next opportunity. Resilience of an organisation is the ability to thrive during and after adversity.

The resilient organisation specifically addresses the three pillars of resilience – finance, operations and reputation – and, by doing so, is better placed to deal with future uncertainties. Furthermore, by instituting and monitoring resilience indicators, the resilient organisation is able both to measure and drive resilience for the long-term, improving transparency and governance over those factors that keep it so.

The more resilient organisation has a broad view of resilience: It has an embedded understanding of what it means for the organisation; what it means for customers, suppliers, employees and wider society. It finds the right balance between the 'defensive posture', stopping bad things from happening, and being 'progressive', making good things happen.

Resilient organisations have a clear purpose; on this the inevitably difficult choices and decisions can be anchored. They have well-honed crisis leadership skills at all levels of the organisation, and the organisational capabilities to coordinate and communicate both quickly and effectively. These capabilities must be developed, trained and practiced.

Thriving before, during and after adversity

To thrive during adversity requires an organisation to have "resilience by design". This is more than having tried and tested plans in place. It requires diversity, and enough redundancy and resourcefulness not just designed-in, but built-in. These are fundamental principles for resilience.

The more resilient organisation uses these principles to create options, and to make the right strategic choices when responding and adapting. These organisations have both the mind-set and the capabilities, to identify and navigate the next obstacle, and to mobilise fast and seize the next opportunity.

Thriving before and after adversity requires the organisation to adapt rapidly to changing markets, new threats and disruptive competition, and to learn lessons. The more resilient organisation does not just respond positively to change – it seeks to be part of it, influence it; and has the confidence to take risks and learn from experience. It ensures resilience through change.

The three pillars of resilience

Resilience must achieve practical outcomes, reflecting the following three core pillars of resilience:

01. Financial resilience - the ability of an organisation to withstand events that impact its liquidity, income or assets. These events may include routine or severe but plausible shocks and stresses.

02. Operational resilience - the way an organisation uses its non-financial resources to withstand and absorb the impacts caused by shocks and stresses affecting its demand or supply, its people, technology or facilities.

03. Reputational resilience - the organisation being responsive to external perceptions; scrutinising self-limiting behaviours, building brand capital and reserves, and maintaining a foundation of trust and dependability.

When a shock or disruption happens, it will typically affect one of these pillars first, but it is the combined strength of all that will ultimately help the organisation thrive.

To achieve resilience for the long term, and to create value from it, the more resilient organisation constantly monitors its resilience, and applies stress tests using reasonable worse case scenarios. Since the global financial crisis, organisations have used financial resilience indicators, combined with stress testing, to help measure and achieve greater financial resilience. Resilience indicators provide the necessary transparency to win the confidence of regulators and investors seeking enhanced resilience in their portfolio; they help Boards make informed decisions and effective communications.

Similar practical indicators can be designed for operational resilience and reputational resilience; for example, we must have at least 25-days buffer stock, 15% spare operating capacity, AA grade independent ESG rating and 75% employee satisfaction.

The resilience dividend

The quest for efficiency has arguably pushed organisations too far. Resilience does cost, but as we have sadly witnessed, a lack of resilience costs a lot more. The costs are borne not just by investors, but by the organisation's eco-system of customers, suppliers and ultimately by people, families, society and government. The challenge for organisations is knowing how much to invest, and where; how do you balance 'just-in-time' efficiency with 'just-in-case' redundancy to create 'just enough' resilience?

There will be vulnerabilities, trade-offs and priorities to consider. Absolute resilience is not achievable. But there is a 'double dividend' from investments in resilience. The first is the more obvious avoidance of tangible and intangible damage during adversity. The second benefit arises before and after adversity, and includes greater service reliability, higher levels of financial stability, enhanced ability to make investments and take risks, and better connectedness with and reputation amongst all stakeholders.

Building stronger resilience

Resilience must be achieved by design; it is safeguarded through challenge and change, but is demonstrated in adversity. By specifically addressing the three pillars of resilience – finance, operations and reputation - you will make your organisation more resilient to future uncertainties and shocks.

Establishing resilience indicators will enable you to measure, drive and maintain resilience for the long-term, improving transparency, and governance, over what keeps you resilient. One thing is certain, another shock is never far away. How will you be placed?

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Workforce strategies, ethics and the Future of Work

Human capital is fundamental to creating value, and an effective workforce strategy is therefore a critical enabler for an effective business strategy. This is not just about attracting and retaining the right people; workforce strategy makes sure that people are able to carry out their work as effectively as possible.

The people imperative is at the top of the board agenda, and the employment structure in the UK is going to change with the expected rise in unemployment. However, the labour market is not just vocal, it is strong in terms of what it wants from employers. The workforce of today has a real sense of purpose, and this means people will be looking for organisations to deliver in multiple dimensions.

Despite this recognition that the workforce needs to be a real priority, our 2020 Human Capital Trends report found that just over half of companies said that they have made moderate or significant progress in the last ten years. While it is a big priority, there is still quite a way to go.

In this article we discuss workforce strategies which boards could review within their own organisations, from real-time data and productivity, to ethical decision making and the contingent workforce.

Real-time data

The ability to track a person's attributes such as location, health or tiredness in real-time is now significant, compelling even; this has enabled organisations to improve the health, safety and wellbeing of their workforce. However, real-time data analysis is currently only deployed for some specific use cases, and HR functions within organisations as a whole are being held back by their understanding of what real-time data can really inform.

We now see examples of smart buildings that can inform bespoke or personalised styles for employees, right down to being able to set the room temperature in meeting rooms based on preferences. And, in the same vein, wearables can produce really helpful data too, but from a data protection perspective, careful examination is required to be able to unleash greater value here, for organisations and individuals alike.

Productivity metrics

During the COVID-19 pandemic, where significant proportions of the UK's workforce are working from home, employers' thoughts naturally orient towards not only wellbeing, but productivity, and how productivity can be measured effectively. At the moment, data sources available for productivity are generally softer sources around employee experience i.e. sentiment data to understand experiences, feelings coupled with environment data covering where your workforce is positioned, and what they are doing.

To create a productivity index, or to be able to create a maturity index, organisations should start by thinking – where do we want insight, and what is it that we are trying to change in our environment? Building a framework, and getting a sense of how to answer these questions, and thinking about which types of data to use all informs the right starting point.

Balancing the contingent workforce with ethical challenges

The rise of the gig economy workforce model was driven out of the need for flexibility. From the perspective of a labour market demanding flexibility in jobs, organisations needing perhaps peak demand skills, or flexibility in skills access - such as project management or creative design – and employees being able to move from one job to another with those skills. The contingent workforce has some very strong and attractive benefits for both employees and employers. However, good practice in managing and deploying a contingent workforce falls within the ambit of an organisation's ethical values posture and risk appetite, as this is an area where legislation needs to catch up and where governance is not standardised across organisations.

Even at a nuts and bolts level, organisations need to determine the job title of a contingent worker, and this should be properly tracked in HR systems. The system should be capable of tracking the work that the contingent worker is doing, together with the compensation and benefits that that worker will get. The contingent worker is often underserved when it comes to having the same policies, processes and mechanisms to track and support career development that exist for the traditional permanent/semi-permanent workforce. And don't forget the recent changes in tax legislation regarding the self-employed.

The shifting workforce and ethics within organisations

As the future of work rapidly evolves, and organisations are integrating people, technology, alternative workforces with new ways of working, leaders are wrestling with an increasing range of resulting ethical challenges. These challenges are especially pronounced at the intersection between humans and technology, where new questions have risen to the top of the ethics agenda about the impact of emerging technologies on workers and society.

How organisations combine people and machines, govern new human-machine work combinations, and operationalise the working relationship between humans, teams, and machines will be at the centre of how ethical concerns can be managed for the broadest range of benefits. Organisations that tackle these issues head-on—changing their perspective to consider not only "could we" but also "how should we"—will be well positioned to make the bold choices that help to build trust among all stakeholders.

The future of work in light of COVID-19

As we think about the future of work, organisations need to become sophisticated in developing their understanding of exactly what the job roles are going to be in the future, and how they might be changing now. Workforce planning methods can be used to analyse the data that tells us what the demand is for certain job roles, and the people involved in those job roles. This informs how the design of work that will be performed in the future will change; and then using this data, organisations begin to understand what this means for the size and the structure of the workforce. Organisations can fast-track some of this insight by using existing technologies and processes to get real visibility of how work has changed already.

Contact for workforce strategies

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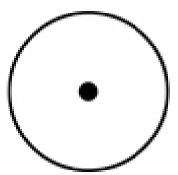
2021 Global Marketing Trends

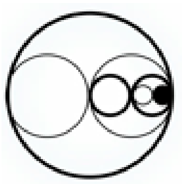
Customers have made it clear they have high expectations for brands. These include solutions they can trust, a brand purpose that aligns to their values, and experiences that enable them to act as co-creators rather than recipients of someone else's vision. In the current environment, those expectations have been heightened. Companies that succeed, particularly when confronted with global disruption of business, work modes, and service delivery, act with intention and clarity in fundamental ways.

Unprecedented change has shifted seven distinct global marketing trends for 2021: Purpose, Agility, Human Experience, Trust, Participation, Fusion, and Talent. The Deloitte report '2021 Global Marketing Trends' shares clarifying insights and real-world examples to help global brands to navigate these trends and to thrive. In this article we summarise the key observations from this report which can help your organisation to navigate the path forward.

For the '2021 Global Marketing Trends' report, Deloitte surveyed 2,447 global consumers and 405 executives from global companies to understand how each is navigating current conditions. Even during this time of unprecedented technological innovation - there is one constant: the human. Our report suggests that by putting the human at the forefront of your digital and physical environments, brands can successfully navigate the increasingly digitised business, economic and social environment to make an impact. This is reflected in the following seven trends which board members could consider in relation to their company's brand to inform the way you interact with your current, and prospective, customers and consumers:

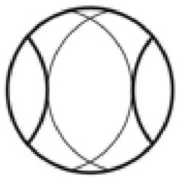


Purpose
Demystifying purpose. Customers know what their values are, but do you? As customers align with businesses that share their values, companies that act with purpose are better positioned for success; they are able to respond more quickly in times of uncertainty; they can turn tough decisions into simpler choices - because they know how to invest, how to engage their employees and how to meet the needs of their stakeholders.

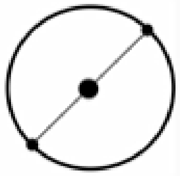


Agility
Changing the playbook. The current environment has tested business models in unprecedented ways, and demonstrated that agility is a crucial cultural mind-set for organisations. Agility has digital technologies at its core, as digital technologies empower organisations to respond nimbly when rapid changes in customer expectations and market necessity collide. It is now more important than ever to accelerate investment - not ease off on - in empowering digital technologies.

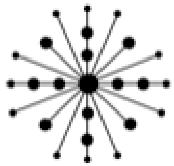
Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration



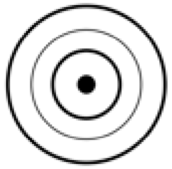
Participation
A two-way street. Customers are interacting with brands more than ever before, from providing a simple product review to collaborating and co-creating content. With engagement now a two-way street, companies are thinking about customers strategically in their engagement strategies – customers are brand ambassadors, influencers, collaborators, and innovators. Companies are tapping into this passion to broaden their focus for more collaborative engagement with customers.



Human experience
Know thyself. As our world becomes more enabled by technology, people are too easily reduced to an email address, a social media interaction, even just an order shipped in a box. By deepening their understanding of their customers, their employees and their other stakeholders, companies can create tools, solutions and devices to "make people's lives better", not just "always on".



Fusion
The new ecosystem. Organisations can better help the people they serve by creating innovative experiences through cross-industry partnerships. Fusion represents the art of bringing together new business partnerships, customer insights, and digital platforms to create ecosystems that more holistically address human customer needs.



Trust
The promises we keep—or don't. Trust takes years to build, yet only seconds to destroy. Trust is built on a brand's promise, and on the delivery of its product or service. Even in the most turbulent of times – or perhaps especially so - when delivery meets expectations, brands build trust. When the gap between messaging and delivery widens, trust breaks down and reputation suffers.

Talent
Marketers disrupted. As the pandemic shifted ways of working and impacted budgets and even headcount, marketing organisations have focused on ways to make their most valuable asset, their talent, a strategic force. Technologies like AI liberate marketers from mundane, tactical execution, freeing them to innovate and generate the big, creative ideas.

2021 Global Marketing Trends is thought provoking - revealing the importance of embedding purpose and values, of combining digital technologies with agility and trust, with broader alliances, and with creativity, to design meaningful customer experiences and loyalties.

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State of the state

This year's State of the State report by Deloitte and Reform finds government and public services across the UK leading radical, exhaustive and dynamic responses to the coronavirus pandemic. While this remains the public sector's highest priority, the UK government has lost none of its ambition for commitments - including a successful departure from the EU and levelling up. At the same time, the policies and politics of Northern Ireland, Scotland and Wales continue to diverge from Westminster and Whitehall as well as each other.

In this article we highlight the key findings from surveying members of the public as these provide an indication of what consumers are both concerned about and focusing on.

This year, Ipsos MORI surveyed more than 5,000 members of the public on attitudes to the government, public services and local economies. The survey shows how people feel about tax, spending and public service priorities amid the COVID-19 pandemic.

Key findings

- Local job opportunities are the public's biggest cause of dissatisfaction
- The public is worried about young people after COVID-19, but is more hopeful for community spirit and business innovation
- Nearly half the public believes that pursuing a green recovery will boost the economy
- The question of what people would like to see "levelled up" varies by region based on the local economies, services and facilities where they live
- Public priorities for more investment are health, social care, crime, jobs and housing

The full report also explores attitudes towards data sharing with - and across - government, which remains a central part of the public sector's response to the pandemic as well as one of its ongoing aspirations for future reform.

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Year-end reporting update

Should you embrace the Public Interest Statement this year?

There is ever increasing focus on company reporting in relation to stakeholders and other ESG matters. The reporting landscape is fragmented, frustrating investors and companies alike, but companies also often fail to integrate disclosures into core business reporting.

In the first part of this article we examine the current ESG reporting landscape, and we provide some tips for boards to consider when reviewing annual reports over the coming months.

We then consider the way in which ESG reporting could develop going forward. The FCA has confirmed that it will be introducing a requirement on all commercial premium listed companies to report on the impacts of climate change in accordance with the TCFD framework for periods commencing on or after 1 January 2021. We are also seeing significant effort from key players, including the IFRS Foundation, towards a set of global standards for ESG reporting.

Finally, we consider the suggested Public Interest Statement recommended by Sir Donald Brydon, echoed by the FRC in their call for a Public Interest Report in their recent discussion paper on the future of corporate reporting. In our view, this of all years is when boards should embrace the concept. This will provide clarity to stakeholders on how the board views their company's contribution to wider society, and provide clear context for the landscape of developing ESG disclosures within the annual report.

The current ESG reporting landscape

The diagram below provides an overview of the current ESG reporting landscape in the UK:

Statutory requirements	
Strategic Report	• Section 172 statement • Non-financial information statement
Directors' Report	• Streamlined Energy & Carbon Reporting
Outside the annual report	• Modern Slavery Statement • Gender Pay Gap Reporting • Payment practices & performance reporting

UK Corporate Governance Code	
Strategic Report	• Company purpose • Monitoring & assessing corporate culture • Workforce engagement • Consideration of section 172 factors • Diversity & inclusion

In addition, where material, ESG matters should also be referenced in the following

- Description of strategy & business model
- Principal risks and uncertainties
- Key performance indicators

Reporting coherently across all these different areas is a challenge for many companies. As board members, when you are reviewing draft disclosures this reporting season, we recommend that you consider the following:

- Does the description of the business model make clear what are the key resources and relationships driving value creation for the business?

- Are the disclosures telling a consistent story across the different elements of reporting (including those outside the annual report)? For example, is the description of engagement with employees in the Section 172 Statement consistent with that in the corporate governance statement on workforce engagement mechanisms? And is the description of engagement with suppliers in the annual report consistent with the company's statutory payment performance reporting?

- How does the range of ESG metrics being used compare to those recommended in the WEF's report 'Towards common metrics and consistent reporting of sustainable value creation' (see this article for further detail)?

- Are the metrics being used and reported focusing on the key resources and relationships, and how those are being managed? For example, where a company is saying that employees are their greatest asset, are there metrics to support the company's performance in managing this important asset?

Annual report insights 2020

This year we have structured the survey around four 'Ps': purpose, people, planet and profit. The survey provides insight and inspiration, accompanied by examples of better practice and regulatory hotspots as companies prepare for the next reporting season. Some findings are as follows:

- **78%** of companies surveyed gave a clear, prominent statement of their purpose beyond making profits for shareholders
- **76%** had a principal risk relating to staff turnover or attrition, but only 8% disclosed staff turnover or attrition as a KPI
- **22%** made fulsome disclosures in line with TCFD while 42% are working towards compliance

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

The future direction for ESG reporting and reporting on the public interest

In addition to the already complex reporting landscape outlined above, there are further developments in the pipeline:

Reporting on the impacts of climate change

A significant step change for ESG reporting will be the implementation of reporting against the Taskforce for Climate-related Financial Disclosures' framework for reporting for all commercial premium listed companies. We cover this topic in section on climate change.

Towards global standards for sustainability reporting

In the past few months, we have seen growing momentum towards the development of a global framework for sustainability reporting. The WEF's International Business Council came first with a set of common metrics developed in conjunction with the Big Four (see this article for further detail).

A further significant step forward took place when the five leading international sustainability standard setters and frameworks (CDP, the Climate Disclosure Standards Board, the Global Reporting Initiative, the International Integrated Reporting Council and the Sustainability Accounting Standards Board) issued a joint statement setting out a vision, and intent to work together, towards a comprehensive corporate reporting system. In addition, the IFRS Foundation is consulting on the role it can play in the development of global standards for sustainability reporting.

The Public Interest Statement

In his review of the quality and effectiveness of audit, Sir Donald Brydon recommended that the annual report should contain a Public Interest Statement. In this new statement boards would explain:

- how the directors view the company's legal, financial, social and environmental responsibilities to the public interest
- how the company has discharged its self-declared public interest obligations and responsibilities, what actions it has taken to mitigate any externalities it has caused during the period, and how effective these actions have been

In addition, in its recent discussion paper on the future of corporate reporting (see this section for more details on the FRC's paper), the FRC put forward a proposal for a combination, or "network", of corporate reports that would include a Public Interest Report focused on external outcomes from the business. The FRC considers that this report would be broader than Brydon's Public Interest Statement bringing together much of the reporting which currently sits outside the annual report. The objective of the Public Interest Report would be:

- to provide information which enables a user to understand how the company views its obligations in respect of the public interest; how it has measured its performance against those obligations; and to provide information on future prospects in this area; and
- at a minimum it should include identification of stakeholders, their relationship with the company and how the company interacts with them; metrics relating to external outcomes for each stakeholder relationship, together with policies and risks posed by the company's operations to that stakeholder, plus related mitigation.

Questions boards should be asking

- What does being a public interest entity mean to us as an organisation?
- How does this fit with our company purpose?
- Have we challenged ourselves to identify all stakeholder groups who are affected, or at risk of being affected, by our operations?
- Is the board getting the right information to oversee performance and outcomes in relation to stakeholders?

It seems clear that the annual report this year, of all years, will benefit from a summary, written from the board's perspective, which pulls together the board's conceptualisation of public interest, and summarise the key themes and messages. Bolder companies will call this a Public Interest Statement, but others who may be less advanced in their thinking will in all likelihood be discussing these matters in the introduction to their Section 172 Statement.

Deloitte Academy Quick Reads

Responding to the new business environment

Climate and ESG reporting

Telling your story

Click on the tile above for details

Areas of focus from the FRC's Corporate Reporting Review

This year has been enormously challenging for many companies, and of course this has been recognised in the corporate reporting arena. The FRC has published many guidance papers to reinforce high standards and to provide guidance to companies; it has also recently released its 'Annual Review of Corporate Reporting 2019/20' and its year-end letter to CFOs and Audit Committee Chairs which, this year, is also addressed to CEOs.

The FCA has confirmed recently that the extension to the reporting deadline for listed companies (from four to six months) will continue until April 2021; early discussion and communication of the reporting process and timetable amongst all key constituents is encouraged. The year-end process will inevitably take longer on a remote-working basis and the ongoing movement between levels of lockdown creates further uncertainties and challenges for forecasting and going concern considerations. This also comes at the time when the revised auditing standard on going concern becomes effective, which calls on auditors to do more testing around the adequacy of management's going concern assessment and to provide a positive statement that the going concern basis is appropriate.

In this article we distil these developments to assist directors in their review of their company's annual report. The consistent drumbeat from the FRC is for companies to provide tailored and sufficient disclosure to explain judgements made and decisions taken.

We also introduce some future considerations as you plan the year ahead; the Financial Conduct Authority (FCA) has introduced a requirement to report on climate change for years commencing on or after 1 January 2021, using the Task force for Climate-related Financial Disclosures model (TCFD), and the FRC is considering the future of corporate reporting.

Reviewing the 2020 annual report

Reporting in times of uncertainty

In On the board agenda – half year 2020, we summarised the FRC's guidance for reporting on COVID-19 and reporting in times of uncertainty, focusing on the helpful material published by the Financial Reporting Lab. It remains relevant and is not repeated here.

During July, the FRC published the key findings of a thematic review of the financial reporting effects of COVID-19 for a sample of interim and annual reports and accounts with a March period end. Companies are encouraged to ensure not only that mandatory disclosure requirements have been met, but also to ensure that sufficient explanations have been included within the financial statements to enable a user to understand how COVID-19 has affected both the amounts presented and the company's future prospects. The FRC encourages companies that in the light of continuing uncertainty they should seek to provide tailored and specific disclosures explaining their financial and non-financial position and performance.

Whilst most of the 17 companies reviewed had provided sufficient information to enable users to understand the impact that COVID-19 had on the company's performance, position and prospects, the FRC indicated that there was room for improvement. These areas form a helpful set of consider points for directors planning their review of their 2020 annual report.

Going concern disclosures	Clearly explain the key assumptions and judgements taken in determining whether a company is able to operate as a going concern. In particular, any significant judgements in determining whether or not there is a material uncertainty in respect of going concern must be clearly explained.
Assumptions	Assumptions used in determining whether the company is a going concern should be compatible with assumptions used in other areas of the financial statements.
Estimation uncertainty	Sensitivity analysis or details of a range of possible outcomes should be provided for areas subject to significant estimation uncertainty.
Presentation of exceptional items	Arbitrary splitting of items such as impairment charges between COVID-19 and non COVID-19 financial statement captions is discouraged, as such allocations are likely to be subjective and unreliable. Existing accounting policies for exceptional and other similar items to COVID-19 related income and expenditure are expected to be applied consistently. Companies should be especially cautious about identifying impacts as exceptional if they are expected to arise in more than one accounting period. Where the impacts of COVID-19 are so pervasive that they are difficult to quantify, additional narrative disclosures should be provided

For more detailed current information on the accounting considerations for COVID-19, Deloitte's accounting roundup for October 2020 summarises and provides links to current material.

In relation to the UK Exit from the European Union, the FRC's year-end letter to CEOs, CFOs and Audit Committee Chairs strongly encourages companies to assess carefully the nature of information about the likely impacts of the UK's exit that would be most relevant to users. Reports are expected to explain company-specific risks and uncertainties, including the potential impacts on different parts of the business and any effects on the financial statements (including major sources of estimation uncertainty, amounts at risk and ranges of potential outcomes).

Other topical areas of reporting

The table below summarises key findings on other areas identified during the FRC's annual corporate reporting review published in October 2020.

Area of focus	Description
Strategic Report	This year the FRC has highlighted a few points that companies should seek to address: • improving section 172 disclosures by describing outcomes of the engagement process, linking identified stakeholders, relates risks and impact on business model; and finally providing examples of decisions. For more details, please see 'Making Section 172 statements more useful'. • considering the impact of climate change on the organisation; • comprehensiveness of the strategic report, e.g. reflecting key changes in the income statement, the balance sheet and in cash flows in financial reviews; • providing thoughtful and accurate references for non-financial information matters, making sure those resources actually meet the legislation requirement; • describing not only positives, but also difficulties or downturns.
Statement of Cash Flows	The FRC continues to observe issues with the cash flow statement and strongly encourages companies to pay particular attention to the correct classification of cash flows, avoiding inappropriate netting of gross cash flows and the disclosure of non-cash changes in financing liabilities.
Judgements and Estimates	More companies are tailoring their disclosures on judgements and estimates. However, companies should ensure that they: • explain critical judgements around the accounting for difficult, subjective or complex transactions; • explain key assumptions and illustrate the impact of reasonably possible changes on reported results; • quantify estimation uncertainties, e.g. through sensitivity analyses or by disclosing the range of reasonably possible outcomes; • quantify the values given to key inputs and assumptions; and • provide an explanation of judgements and estimates on matters where there is no guidance within IFRS, e.g IFRS 15 does not provide guidance on accounting for claims from third parties such as sub-contractors, or no material going concern uncertainties identified.

Area of focus	Description
Impairment of Assets	Companies are expected to consider carefully the requirements for disclosures under IAS 36, e.g. quantify the value assigned to key inputs and assumptions impacting the headroom; describe impairment testing method; disclose impairment losses; specify the nature of CGUs.
Revenue	All companies are expected to tailor their disclosures to provide sufficient qualitative and quantitative information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers. In particular they should consider: • disclosures about performance obligations, e.g. significant judgements made in determining whether a contract contains multi-element arrangements; performance obligations delivered over time; • accounting policies and disclosures around determining transaction price in business combinations (including the variable consideration constraint); • clarifying any contract modifications that have occurred during the period; and • setting out clearly whether the entity is acting as an agent or a principal.
Financial Instruments	Companies are reminded that supply chain financing arrangements, including reverse factoring transactions, are currently an area of focus for the FRC. Companies are expected to disclose sufficient details on expected credit losses, e.g. methodology used to assess recoverability; factors in considering the credit risk.
Alternative Performance Measures (“APMs”)	All companies that report APMs should apply the Guidelines produced by ESMA. In particular, companies should: • explain the rationale and consistency of adjustments made; and • provide a reconciliation to the closest equivalent IFRS line item.
Provisions and Contingencies	In relation to provisions and contingencies, companies should ensure that they provide sufficient details in disclosures, e.g. timing of third-party claims and high-level information about legal provisions, and clarify the measurement method, e.g. discount rates applied.
Fair Value Measurement	Companies are expected to provide a description of valuation techniques used, even when the valuation is performed by a third party.
Business Combinations	Companies should provide information about discount rates applied and commodity assumptions, methodology and assumptions applied to estimating fair value of deferred income.
EPS and unlawful distributions	Companies are expected to carefully consider the calculation of EPS and be mindful about rules of distributions.

New requirement for TCFD disclosures for periods commencing on or after 1 January 2021

The FCA consulted earlier this year on a new rule for commercial companies with a UK premium listing requiring them to state whether they comply with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and to explain any non-compliance. This will come into effect for periods commencing on or after 1 January 2021 and will meet the Government's commitment under the Green Finance Strategy issued in July 2019.

The final rule is due to be issued by the end of the year but the consultation said that the new Listing Rule would require companies to disclose whether they have made disclosures consistent with the TCFD requirement, or why they have not, where the disclosures can be found in the annual report, and if they have included disclosures outside the annual report, why they have done so.

TCFD disclosure recommendations – many companies already include these

Increasingly, boards recognise the high level of focus around climate-related activity and disclosure, with major investment houses largely united in their call for decision-useful information around climate. Where companies do not include these disclosures at present, we believe the board should consider this year's annual report a journey to full TCFD disclosure next year, once the FCA's rule is in place.

To facilitate that assessment, here is a reminder of the four areas and eleven disclosure recommendations:

Governance

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

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

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

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

Risk Management

Disclose how the organisation identifies, assesses and manages climate-related risks

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

Metrics and Targets

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

01. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process
02. Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks
03. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

Climate change is covered in more detail in a separate section.

The future of corporate reporting

The FRC has issued a thought leadership paper exploring ideas for changes to the system of corporate reporting with a view to making it more effective and engaging for all those with an interest in a company. The objective of the paper is to challenge the status quo and to set out proposals for a new corporate reporting model.

The FRC is running a series of events to engage stakeholders in the discussion and is asking for comments by 5 February 2021.

The paper proposes that there should be a 'reporting network' centred around a stakeholder-neutral Business Report designed to enable users to understand how the company creates long-term value in accordance with its stated purpose. In addition, the 'reporting network' would include two other core reports – the full Financial Statements and a new Public Interest Report. The objective of each report should drive its content and the report should create an active dialogue between a company and its stakeholders about issues that matter to them.

Under the proposals, each of the reports would be founded on common principles for corporate reporting to:

- maintain cohesiveness across different disclosures (system level attributes);
- establish information adequacy (report level attributes); and
- promote effective communication (content communication principles).

The paper posits that clearly identified objectives for each report will help direct regulatory decisions on required content and corporate decisions on the information to include when meeting regulatory requirements.

Questions audit committees should be asking

- What is the story our annual report is telling our stakeholders? Is it consistent between the strategic report and the financial statements?
- Is there clarity about the company's going concern position and the factors that support that decision, such as the cash position, support from others (including government schemes), current level of business operations?
- Is there enough information provided about areas of uncertainty, in terms of going concern and viability and also where sensitivities may be required to illustrate areas of estimation uncertainty?
- Are items identified as exceptional in the annual report validly described in that way and are additional narrative disclosures required?
- Have we articulated our plans to meet demands for climate-related disclosure and a roadmap to achieve those plans?

Making Section 172 statements more useful

In the current environment, decisions are being made at pace to respond and recover from the impact of the pandemic and at the end of the year boards will be reporting the factors they have considered in their Section 172(1) Statement.

In addition, the FRC's Financial Reporting Lab has issued a short publication 'Section 172 statements – how to make them more useful'. This article sets out tips for improvement using the structure of the Lab report, but also draws on our own year one review of Section 172 statements. As a reminder, the section 172 statement is a record of how you as directors have fulfilled your statutory duty. In this year of all years, this statement should receive proper focus and attention and so we hope these tips will assist you when reviewing the statement this reporting season.

There should be plenty to discuss in this year's statement:

- Engagement with employees around new working arrangements, health and well-being
- Adapting routes to market to meet new patterns of demand from customers
- Working with the supply chain
- Keeping investors informed
- Community outreach
- Maintaining high standards of business conduct during very challenging times
- Environmental considerations such as building back greener

The FRC Lab's paper covers three areas: content, presentation and process. Remember, the detailed narrative may well be in different parts of the annual report, and the Section 172 statement does not need to repeat, but can cross refer to explanations which sit more naturally elsewhere.

Content

- ***Be specific and genuine, avoiding box-ticking*** – is the statement an authentic reflection of what happened and what is material to the company, referencing specific events and decisions?
- ***Explain the "why"*** – is it clear why particular stakeholders are key and why chosen engagement activities are effective? Does the disclosure bring alive how the activities have adapted and evolved during the year?
- ***Link to strategy*** – is it clear how the stakeholders and other section 172 factors affect the development and implementation of strategy?
- ***Include difficulties, not just the positives*** – has the statement explained where trade-offs and decisions have been made in the short-term to benefit the long-term, and to the benefit of one stakeholder group over another, to bring alive board decisions?
- ***Reflect the board's oversight*** - how does the board challenge and oversee management's engagement with stakeholders, how is the stakeholder voice heard in the boardroom? How does the board oversee the formulation of strategy?
- ***Include material KPIs on key stakeholders*** – is there information on the key performance indicators on key stakeholders which are monitored by the board – how have those changed in the year, what do they say?

- ***Address future consequences and planned actions*** – have you explained the implications of stakeholder feedback received and what actions have been taken or are planned as a result?
- ***Be consistent*** – is the statement consistent with the rest of the annual report and considered in the context of the company's story, as a whole?

Presentation

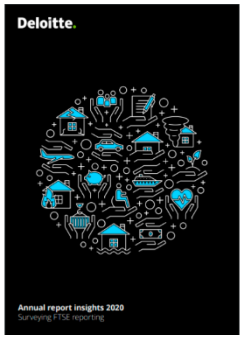
- ***Think of the flow and context*** –how does the statement fit within the context of stakeholder engagement, and how does the statement provide context to other areas?
- ***Make it visible*** - is the statement clearly labelled and referred to in the contents page of the annual report?
- ***Use cross-referencing to enhance understanding*** – is the statement providing a coherent message by itself? Cross-referencing should not be used to make the statement a contents page or list of links, but detail and illustrations can be provided elsewhere as long as appropriate context and signposting is provided.
- ***Include case studies*** – have current year case studies been provided to explain how stakeholders and the other section 172 factors were taken into account in significant strategic decisions during the year?

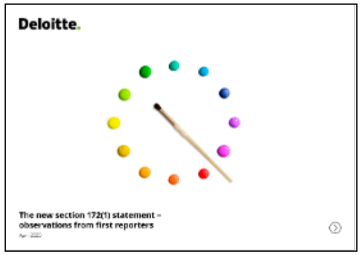
The paper also includes some important reminders about the statement:

- It is **not** about stating compliance with the section 172 requirements, but about reflecting the board's consideration of the section 172 factors in pursuit of the success of the company
- It is **not** just about stakeholder engagement, the statement should consider all the requirements of section 172
- It needs to reflect what is relevant to the company even where decisions or engagement may have been carried out centrally by the group in the case of some subsidiaries
- Section 172 should be embedded in the directors' strategic decision-making and supported by the company's culture

The FRC tips are part of a broader Lab project on reporting on stakeholders. Interested parties are still welcome to share their views and experience. More information can be found here, and you can contact the Lab team at: financialreportinglab@frc.org.uk

Two further sources of guidance for preparing your Section 172 statement are available here:





Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

Lessons from year one of the 2018 UK Corporate Governance Code

You will recall that the 2018 UK Corporate Governance Code was a substantial re-write, and companies were encouraged to take a fresh approach rather than build on their prior period reporting. In its recently published 'Review of Corporate Governance Reporting', based on an assessment of 100 companies across the whole premium listed market, the FRC has revealed its findings and its expectations for the future application of the Code and reporting. The word disappointing is used frequently.

In addition, the FCA recently announced that, going forward, it will be considering governance disclosures to inform decisions about the deployment of future surveillance and monitoring efforts.

The FRC review highlights that there is much for companies to work on and in this article we draw out the headline expectations which the FRC and FCA have now set for governance reporting. This year of all years is the time to make a meaningful advance.

The FRC's 'Review of Corporate Governance Reporting'

This hard hitting report does not paint a pretty picture of the state of governance reporting. In the foreword Sir Jon Thompson states "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 goes on to make clear that as the FRC transitions to becoming a new regulator, it expects to receive further powers to engage with companies about the quality of their governance reporting. The intention is to do this constructively by working together with companies to develop the quality of reporting and high standard for which the UK is known. However, companies should be in no doubt that, where appropriate, the FRC intends to call out poor behaviour.

The headline expectations are as follows:

Governance standards

- Companies should maintain the high standards of the Code by taking the good practice demonstrated within it, applying it to the company and reporting by use of clear and meaningful explanations

Leadership

- Companies to have a well-defined purpose and to show clearly the progress made towards achieving it
- Better assessment and monitoring of culture, including consideration of methods and metrics used
- Demonstrating commitment to diversity and inclusion through actions, such as improved succession planning, recruitment from diverse talent pools and responsiveness to findings from board evaluations

Stakeholder engagement

- Companies should report on how the company has engaged with its key stakeholders, and the steps it has taken to understand the views of stakeholders. In particular, there should be discussion of the issues raised, topics considered, and feedback received during engagement with shareholders and employees.
- It should be clear how the board oversees decisions relating to stakeholder matters, including how, and on what basis, stakeholder information is passed to the board, as well as on how the board has reached key decisions and the likely impact of those decisions.
- Reporting should make clear what the impact of engagement with stakeholders, including shareholders, has been on decision-making, strategy and long-term success. The FRC would like companies to provide more detail on their approach to measuring the performance of their engagement strategies.

Remuneration

- Describe the impact of engagement with shareholders on remuneration policy and outcomes
- Clearly show the impact of the engagement with the workforce on executive remuneration policy

In conclusion the report provides the following message for boards to consider:

"The strongest and most insightful reporting came from companies that described not only the initiatives that were introduced and processes that were followed, but also discussed their outcomes and what impact they had on the business. From risk review, through board evaluation to stakeholder engagement, measuring and reporting on impact means moving away from the boilerplate statements towards meaningful reporting. Giving more emphasis to the impact, while not disregarding thorough process, will also help companies better assess the effectiveness of their governance and generate better company performance and outcomes for shareholders and stakeholders."

You can access the full report here.

FCA Primary Market Bulletin 31: Corporate Governance Disclosures by listed issuers

The FCA has also undertaken a review of corporate governance disclosures by listed issuers and has confirmed that it will be working together with the FRC to consider areas for improvement and will use the results of their review of corporate governance disclosures to inform decisions about the deployment of future surveillance and monitoring efforts in this area. Issuers are encouraged to consider their compliance with the relevant rules and to make improvements where appropriate. Two areas in particular were identified for improvement by the FCA:

Description of how the Code Principles have been applied – the FCA's review suggested that many of these disclosures appeared to be boilerplate.

Quality of Board Diversity Reporting – The FCA has called for the description of the work of the nomination committee in this area to be enhanced.

Most boards are thoughtful and sensitive in their decision making which is not conveyed in many of the formulaic disclosures seen. The range and depth of engagement undertaken and the thinking behind the decisions taken by the board could be further brought alive. There are clear recommendations in the FRC review for boards to consider and embrace in this most important of reporting years.

Responsible business

Climate change - governance and reporting

Investors, regulators, government and consumers are increasingly focused on the health of our planet. Some business leaders are also amongst the leading advocates for change. Despite the disruption arising from COVID-19, it is climate change and the destruction of biodiversity in the natural world that are the defining themes of our time. Hopes are pinned on a post pandemic "green recovery" - as the economy re-opens, governments, businesses and individuals make different, greener choices.

In this article we focus on governance and reporting, rather than the detailed operation of a company's decarbonisation plan. We discuss practical steps boards can take to become climate competent for evaluating their own opportunity for a "green recovery", including targets under the UN's Goal 13 on climate action. We also explore the FRC's thematic review on climate change and in particular their observations on the role of the board.

Finally, we touch upon current disclosures by companies and areas for improvement.

Setting up for success

Boards understand their business strategy, their stakeholders and the competition they face in the market. Climate change is likely to affect all of these over the next 10-20 years, making certain assets and types of business too expensive or risky to pursue, affecting the choices and priorities of stakeholders and the nature of the competition.

Those companies that prepare for transition to a lower carbon economy are likely to be those that succeed over the next few decades. There is already a proliferation of successful ESG funds that choose not to invest in certain market participants.

We have identified three key areas where the board can evaluate its position now and act to make change.

Get informed	Join the dots	Be authentic
Big change needs to happen in the next decade; too few businesses currently understand the speed or scale of the change required.	Organisations that are getting ahead on climate risk and strategy have a named individual who is accountable for driving change across the organisation.	Investors and regulators are calling for informative and fulsome disclosure. For many companies TCFD disclosure will involve both a mindset change and the need to generate new and reliable data. In some cases this will be challenging to produce and may need to be managed over the course of a year or more. The most critical element is that the information is reliable and appropriately describes the position of the company.

Get informed	Join the dots	Be authentic
Make sure your board is "climate competent". This means being able to access the expertise you need, when you need it, to input to board discussions about strategy, business change, risk and controls. Ask questions: how often is climate on the agenda? Should it be discussed more regularly? Are targets for executive management driving the behaviours that the board wants to see?	While this person is often based in the Finance function, they'll need to lead and co-ordinate activity and action from all functions – working together to understand and respond to climate risks and opportunities.	Planning for clear goals that describe what new information you'll need to produce and when, will help your business to keep its focus.
All board members should seek to upskill in the area of climate. A good first step could be the Deloitte Academy resources below, exploring the links in this article and browsing the resources on our Deloitte climate change website www.deloitte.co.uk/climatechange. Non-executive directors can also access resources via Chapter Zero.	They are also likely to be useful in certain board and committee meetings and must have a mandate from the board in order to drive change.	Planning disclosures over time can enable you to build up your shared climate capability, and increase confidence in your disclosures as you do so

The Goal 13 Impact Platform

To support business in the UK, a partnership of organisations including the CBI, Deloitte, Dell, Chapter Zero, The Prince's Accounting for Sustainability Project and the Met Office have launched the Goal 13 Impact Platform. It aims to accelerate the climate transition, in order to reduce emissions and enhance resilience. It will achieve this by publishing company insights from across the UK and beyond, showing examples of what has worked to inspire further climate commitments and action, and facilitate collaboration between companies.

The first output of the initiative is an emerging insights report, which highlights a number of key themes:

- consumers are increasing pressure for climate-friendly products and services;
- business customers are looking to decarbonise their own supply chains due to regulation or pressure from stakeholders;
- early attention has been on reducing operational impact but 40% of initiatives are now customer-facing (including products and services);
- because system change is required throughout the value chain, small and medium-sized entities (SMEs) need to be engaged, to ensure that both large companies themselves and their supply chains are part of the conversation;
- progress inside the organisation can be slowed down by internal silos, so leadership from the top is important. Externally, unclear policy roadmaps are seen as a significant challenge; and
- industry collaboration can increase progress

The FRC's thematic review on climate change

During November, the FRC published a review of climate-related issues as they affect governance, reporting and audit, and the roles of a range of market participants. The review highlights the important roles that boards, companies, audit firms, professional associations and investors have to play in delivering society's climate ambitions. We summarised the key messages in a newsflash.

While the FRC's review highlights some examples of better practice, the overall message is that more needs to be done - by everyone. The section on governance, "How are boards taking account of climate-related challenges?" is informative reading.

The FRC's headline finding on board governance, based on a review of annual reports and discussion with investors, is that *"It is the board's responsibility to consider climate-related issues, but there is little evidence that business models and company strategy are influenced by integrating climate considerations into governance frameworks."*

Areas where the FRC identified better practice for reporting – which must of course be backed up by the underlying governance structures – were:

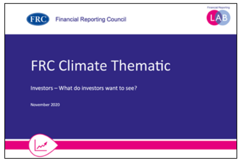
- Better reporting on climate governance includes a clear explanation of the company's governance structure and oversight. The more developed reporters link these insights to the TCFD framework.
- Better reporting on committee structure includes:
  - – the selection process for the climate expert or body;
  - – any relevant training members had received; and
  - – explanations of the process by which the board received climate-related information.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

- Better reporting on board and committee monitoring of climate-related risks and opportunities includes:

  – reporting on examples of specific climate-related issues discussed by relevant company bodies, how those issues could impact the business and the reasoning behind any related decisions; and
  – where relevant, reporting on remuneration linked to the achievement of sustainability and climate change targets as key part of governance.

The FRC is concerned that there is little evidence from annual reports of companies below the FTSE 350 of climate-related issues being a regular feature on board or committee agendas, even for resource-intensive industries where climate change is likely to have a larger impact, and where the companies themselves have a larger environmental impact.



The FRC also highlighted that investors want companies to explain "how the board considers and assesses climate change. Governance, and an understanding of the role of the board in relation to climate-related issues, is considered a key part of [investors'] understanding the company's approach." The FRC's Financial Reporting Lab published a report in 2019 covering investor views, questions and examples of good reporting, which is available here.

The move towards an integrated framework

One question we are asked regularly is whether now is the right time to start work on climate change disclosure given the likely changes in standards and reporting over the next few years, with announcements such as the recent intent to merge of the IIRC and the SASB, to become the Value Reporting Foundation. The choice has been taken out of the hands of most UK companies by the announcement from the Treasury that TCFD disclosure will be required by all large businesses across the economy over the next few years, starting with December 2021 year ends onwards for commercial premium listed companies.

The roadmap published by Treasury and supported by the ICAEW, BEIS, FRC, DWP and The Pensions Regulator makes it clear that improvements in disclosure standards will be contemplated over the five-year period of the roadmap. There are some key areas for consideration: Investors are focused in particular on how climate factors are incorporated into financial statements judgements and decision-making. Some companies have spoken about governance, risk and strategy in the front half alone without following through in the financial statements and this is no longer enough. Recently the Principles for Responsible Investment (PRI) letter and the report from the Institutional Investors Group on Climate Change (IIGCC) have already called for climate change and associated costs to be in the financial statements and referenced an IASB article explaining that this should be the case. There is now an additional resource for preparers to use in the form of an educational document from IASB: "Effects of climate-related matters on financial statements".

Investors see climate change as material for almost all companies, as outlined in many recent materials from major investment houses. This position is in line with the TCFD's position that climate change is an undiversifiable risk that, therefore, needs board involvement – in particular in relation to governance and risk management.

So, how best to prepare? The TCFD has recently published its 2020 status report. This has good examples of disclosure, and supporting guidance about the disclosures that expert users such as investors find most helpful, as well as case studies with key takeaways that boards will find useful.

For more updates on developments in purpose-driven business practices that are impacting corporate reporting, including progress towards sustainability standards, we publish regular newsletters, Purpose-driven Business Reporting in Focus.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

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Deloitte Academy Quick Reads

Nature on the board | Transition to net zero | Audit & Risk Committee Climate | Future of energy

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Diversity & inclusion

At the time of writing, for the first time women represent more than a third of board members across the FTSE 350, with only one all-male board remaining. Yet calls from investors, stakeholders and society at large for improved diversity and inclusion in boards and throughout businesses are only increasing. Since we published our last annual review "On the Board Agenda 2020", the Black Lives Matter movement has been a potent catalyst for calls for improved ethnic diversity; and there is widespread commentary that the pandemic has also set back the diversity agenda at many companies. This article examines these current calls for board attention and the key reporting obligations in the annual report.

Speed of travel

LGIM lists actions it sees as some emerging best practices:

- Disclosure of ethnic representation at board level, at executive level, at management level (as defined by the company), and throughout the full workforce
- Disclosure of the ethnic pay gap
- Aspirational goals for ethnic diversity and pay equality, and strategies for reaching them with regular updates towards these goals
- Participation in the 'race at work' charter or other relevant industry initiatives
- Disclosure of an anti-discrimination policy, including specificity on the process for investigating and sanctioning discriminatory or harassing behaviour
- Inclusive hiring policies
- A focus on inclusive culture to harness the value of a diverse workforce

The social demand for information on how businesses deal with diversity and inclusion is outpacing the introduction of laws and regulation to respond to it. Investors and many businesses are taking action in advance of regulation.

This year, LGIM released its ethnic diversity stewardship plan. It explains that diverse leadership is linked to outperforming value creation and that, rather than looking for more consistent and reliable disclosure, it plans to engage more forcefully regarding action and reporting alike.

> *"Our expectation is that companies set ambitions related to the ethnic composition of their organisation, throughout the workforce, with a particular emphasis at the board level, which generally sets the tone from the top. For companies that fail to meet our transparent and rules-based minimum expectations, there will be voting and investment consequences."*

Gender diversity

In September 2020, the Government reported that women make up more than a third of all board members across the FTSE 350 for the first time. This is an average across 250 companies that have met the target and 100 that have not yet done so. Below the FTSE 350, there continue to be large numbers of companies that have not responded to the call for greater board diversity.

In response to COVID-19 the government sought to alleviate various reporting burdens on business, and companies were permitted not to report on their gender pay gap in 2019/20. Although many companies had already prepared the information to report before the requirement was lifted - only two weeks before the deadline – over 4,000 employers from an estimated 10,000 chose not to submit the information. The Financial Times reports that the data that was submitted shows an increase in the average gender pay gap from 11.9% to 12.8%.

Change the Race Ratio
Companies are also taking action. The CBI, together with leading companies including Deloitte, has launched a campaign, Change the Race Ratio, to increase racial and ethnic participation in British businesses. The campaign calls for businesses to set clear targets for greater racial and ethnic diversity at board and senior leadership levels.

This complements and builds upon the initial Parker Review target of FTSE 100 companies having one board member from an ethnic minority by the end of 2021, which was reported in February 2020 as having shown only "slow progress" – 37% of FTSE 100 boards still had no such board member.

The CBI commitments are:

- Increase racial and ethnic diversity among board members (FTSE 100: 1 by end 2021, FTSE 350: 1 by end 2024)
- Increase racial and ethnic diversity among senior leadership – set and publish clear and stretching targets for executive committees and their direct reports
- Be transparent on actions – publish a clear action plan and share progress; disclose ethnicity pay gaps by 2022
- Create an inclusive culture in which talent from all diversities can thrive

Diversity must have inclusion to succeed

Diversity in itself is not the whole answer – to succeed, inclusion is fundamental. This is not a new concept – Deloitte's Global Human Capital Trends survey has explored the value of inclusion to a diverse business in several ways over the past decade. In order to perform effectively, people need to feel comfortable at work and be their authentic selves.

Deloitte's 2020 Human Capital Trends survey went one step further to encourage organisations to build a culture of belonging, with three mutually reinforcing attributes:

- Comfortable – people should feel comfortable at work, and that they are treated fairly and respected by their colleagues.
- Connected – they should feel connected to the people they work with, and the teams they are part of.
- Contribute – they should feel that their strengths contribute to achieving meaningful work outcomes.

93% of responders to the survey agreed that having a sense of belonging drives performance of the organisation.

The diversity and inclusion reporting landscape

The diagram below provides an overview of the current diversity and inclusion reporting landscape in the UK:

Statutory requirements	
Strategic Report	• Section 172 statement • Non-financial information statement • Employee gender diversity table • Relevant KPIs
DTR	• Board diversity ploicy, objectives and outcomes
Outside the annual report	• Gender pay gap reporting
On the horizon	• Ethnicity pay gap reporting

Companies are expected to provide voluntary data submissions to the Hampton Alexander and Parker reviews. Several voluntarily disclose an ethnicity pay gap. Some voluntarily provide information in line with recommendations from the McGregor-Smith report.

UK Corporate Governance Code	
Corporate governance statement	• How the appointment process and succession planning support developing a diverse pipeline • How board evaluation has or will influence board composition • Policy or diversity and inclusion objectives and linkage to company strategy • How the policy has been implemented • Progress on achieving policy objectives • Gender balance of senior management and their direct reports

Our ongoing reading of annual reports in this area suggest there are some key areas that companies find challenging:

- Explaining the policy on diversity and inclusion, and identifying and disclosing those areas where the policy for the organisation as a whole differs from that at board level.
- Clearly tying the policies to targets or objectives that are formulated in such a way that progress against those goals can be measured and disclosed. It is helpful to explain the different targets at different levels of the organisation, and for different aspects of diversity where they exist.
- Articulating how the board perceives diversity and inclusion as linked to the company's strategy – highlighted by the FRC in 2018, and where companies continue to struggle – boards should explain how a diverse workforce and focus on inclusivity will be helpful in delivering the company's strategy.
- Explaining how the policy has been implemented - drawing out specific actions and how they support the delivery of the objectives.
- Identifying, disclosing and evaluating performance against relevant KPIs, consistently applied.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

New study reveals stark barriers to LGBTQ+ progression

The report, commissioned by the FRC, found that too often corporate culture has not been a welcoming environment for LGBTQ+ people to be themselves. In progressing to the highest ranks of corporate leadership, the leaders interviewed for the report often faced discrimination and had to make personal sacrifices. As a result, many chose not to disclose their LGBTQ+ identity until late into their careers.

While many companies are making progress, the report concludes that:

- many need to go much further to foster inclusivity;
- to achieve lasting change, companies must systematically embed inclusive practices and ways of working; and
- without transparency and evidencing of progress, corporate commitment to equality risks remaining aspirational rather than being truly attainable.

The full report can be accessed here.

Questions boards should be asking

- What is the story our board composition is telling our stakeholders?
- Have we articulated at board level and throughout the organisation why diversity and inclusion is important to achieving our strategy as a business?
- Has the organisation set clear diversity and inclusion policies that go beyond positive words? Is there a recognition that targets are important both to achieve change and to hold executive management to account?
- Does the board get the right information to understand the planned activities and timelines to achieve challenging diversity and inclusion targets?
- Has the board received information about progress on the gender pay gap and ethnicity pay gap and considered whether this should be made available internally or externally?

Deloitte Academy Quick Reads

Ethnic Diversity in the Boardroom

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Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

AGMs: Time for a re-examination?

COVID-19 presented substantial obstacles to the organisation and holding of Annual General Meetings in 2020. In March the FRC supported guidance issued by the Chartered Governance Institute which set out how companies could hold a legal AGM during the pandemic; and in June the Corporate Insolvency and Governance Act 2020 gave companies legislative certainty on how AGMs could be held.

Notwithstanding this guidance, in a recent review the FRC observed that companies took very different approaches to AGMs during the 2020 season. Many held meetings with only one or two members present, while others embraced technology to ensure that shareholders were able to participate effectively. The FRC believes that of 202 AGMs held between March and August, 30 did not enable any shareholder engagement through Q&A either before or during the AGM.

Recognising that the current environment presents challenges to the purpose of the AGM, the FRC has suggested a number of ways that boards can consider to improve engagement.

As a reminder the AGM is an opportunity for:

- The board - to present the company strategy and performance, and other matters to investors.
- Shareholders - to hold the board to account through Q&A and discussion.
- Shareholders - to exercise their voting rights.

To uphold good governance and to enable all shareholders to hold the board to account in line with good practice set out in the UK Corporate Governance Code, the FRC wants all companies to avoid the situation where insufficient engagement is able to take place on the actual day of the AGM. The FRC is to convene a stakeholder group to include government, companies, and investors and their representatives to consider whether there is a need for legislative change to allow alternative means to achieve some additional flexibilities whilst maintaining the overall integrity and objective of the AGM.

The FRC's report includes best practice guidance that companies should consider when planning and conducting future AGMs. At a high level boards could consider the following:

Prepare Now – consider the ways in which technology can be used more effectively

Prior to the meeting – provide clear information to shareholders on how to submit their questions

Questions at the AGM - questions should be facilitated in real-time, both for those shareholders who attend in person and for those who choose to attend remotely. This should include the opportunity for shareholders to follow up on the given answer to ensure that matters raised at the AGM have been properly addressed

Voting by Proxy - best efforts should be made to ensure that those who wish to vote following Board presentations and Q&A are able to do so.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

Towards common metrics and consistent reporting of sustainable value creation

As businesses are increasingly expected to play a positive role in society, and as investors demand more consistency in ESG metrics, common standards are essential. For boards, metrics not only demonstrate commitment, but enable tracking and measurement of performance. In this article we highlight the work done by the International Business Council of the World Economic Forum as a step towards global standards and to provide a comprehensive set of metrics for companies to reflect in their thinking and reporting when measuring value creation. We set out the core metrics and disclosures recommended in WEF's report 'Towards common metrics and consistent reporting of sustainable value creation'.

The metrics, using recognised existing standards and metrics where possible, are organised under four pillars that are aligned with the UN's Sustainable Development Goals and with principal ESG reporting frameworks (for example SASB, the Global Reporting Initiative and TCFD): Principles of Governance, Planet, People and Prosperity. The report suggests metrics across these four pillars as a more systematic way of measuring and communicating sustainable value creation for those companies wishing to report their impact in a more tangible and consistent manner.

Whilst much of this will be familiar, boards may wish to consider whether the range of ESG metrics currently being reported to them do in fact focus on the key resources and relationships for the business, and how those are being managed. Boards might want to consider the quality and depth of the information they are being presented.

Principles of Governance

Governing purpose	***Setting purpose*** The company's stated purpose, as the expression of the means by which a business proposes solutions to economic, environmental and social issues. Corporate purpose should create value for all stakeholders, including shareholders.
Quality of governing body	***Governance body composition*** Composition of the highest governance body and its committees by: • competencies relating to economic, environmental and social topics; • executive or non-executive; • independence; • tenure on the governance body;

Quality of governing body	• number of each individual's other significant positions and commitments, and the nature of the commitments; • gender; • membership of under-represented social groups; and • stakeholder representation.
Stakeholder engagement	***Material issues impacting stakeholders*** • The topics that are material to key stakeholders and the company, • How the topics were identified and • How the stakeholders were engaged.
Ethical behaviour	***Anti-corruption*** • Total percentage of governance body members, employees and business partners who have received training on the organisation's anti-corruption policies and procedures, broken down by region. • Total number and nature of incidents of corruption confirmed during the current year, but related to previous years. • Total number and nature of incidents of corruption confirmed during the current year, related to this year. • Discussion of initiatives and stakeholder engagement to improve the broader operating environment and culture, in order to combat corruption. ***Protected ethics advice and reporting mechanisms*** • A description of internal and external mechanisms for: • Seeking advice about ethical and lawful behaviour and organisational integrity; and • Reporting concerns about unethical or unlawful behaviour and lack of organisational integrity.
Risk and opportunity oversight	***Integrating risk and opportunity into business process*** Company risk factor and opportunity disclosures that clearly identify the principal material risks and opportunities facing the company specifically (as opposed to generic sector risks), the company appetite in respect of these risks, how these risks and opportunities have moved over time and the response to those changes. These opportunities and risks should integrate material economic, environmental and social issues, including climate change and data stewardship.

Planet

Climate change	***Greenhouse gas (GHG) emissions*** • For all relevant greenhouse gases (e.g. carbon dioxide, methane, nitrous oxide, F-gases etc.), report in metric tonnes of carbon dioxide equivalent (tCO2e) GHG Protocol Scope 1 and Scope 2 emissions. • Estimate and report material upstream and downstream (GHG Protocol Scope 3) emissions where appropriate. ***TCFD implementation*** Fully implement the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). If necessary, disclose a timeline of at most three years for full implementation. Disclose whether you have set, or have committed to set, GHG emissions targets that are in line with the goals of the Paris Agreement – to limit global warming to well below 2°C above preindustrial levels and pursue efforts to limit warming to 1.5°C – and to achieve net-zero emissions before 2050.
Nature loss	***Land use and ecological sensitivity*** Report the number and area (in hectares) of sites owned, leased or managed in or adjacent to protected areas and/or key biodiversity areas (KBA).
Freshwater availability	***Water consumption and withdrawal in water-stressed areas*** • Report for operations where material: mega-litres of water withdrawn, mega-litres of water consumed and the percentage of each in regions with high or extremely high baseline water stress, according to WRI Aqueduct water risk atlas tool. • Estimate and report the same information for the full value chain (upstream and downstream) where appropriate.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

People

Dignity and equality	***Diversity and inclusion*** Percentage of employees per employee category, by age group, gender and other indicators of diversity (e.g. ethnicity). ***Pay equality*** Ratio of the basic salary and remuneration for each employee category by significant locations of operation for priority areas of equality: women to men, minor to major ethnic groups, and other relevant equality areas. ***Wage level*** • Ratios of standard entry level wage by gender compared to local minimum wage. • Ratio of the annual total compensation of the CEO to the median of the annual total compensation of all its employees, except the CEO. ***Risk for incidents of child, forced or compulsory labour*** An explanation of the operations and suppliers considered to have significant risk for incidents of child labour, forced or compulsory labour. Such risks could emerge in relation to: • type of operation (such as manufacturing plant) and type of supplier; • countries or geographic areas with operations and suppliers considered at risk.
Health and well-being	***Health and safety*** • The number and rate of fatalities as a result of work-related injury; high-consequence work-related injuries (excluding fatalities); recordable work-related injuries; main types of work-related injury; and the number of hours worked. • An explanation of how the organisation facilitates workers' access to non-occupational medical and healthcare services, and the scope of access provided for employees and workers.
Skills for the future	***Training provided*** • Average hours of training per person that the organisation's employees have undertaken during the reporting period, by gender and employee category (total number of hours of training provided to employees divided by the number of employees). • Average training and development expenditure per full time employee (total cost of training provided to employees divided by the number of employees).

Prosperity

Employment and wealth generation	***Absolute number and rate of employment*** • Total number and rate of new employee hires during the reporting period, by age group, gender, other indicators of diversity and region. • Total number and rate of employee turnover during the reporting period, by age group, gender, other indicators of diversity and region. ***Economic contribution*** • Direct economic value generated and distributed (EVG&D), on an accruals basis, covering the basic components for the organisation's global operations, ideally split out by: – Revenues – Operating costs – Employee wages and benefits – Payments to providers of capital – Payments to government – Community investment • Financial assistance received from the government: total monetary value of financial assistance received by the organisation from any government during the reporting period. ***Financial investment contribution*** • Total capital expenditures (CapEx) minus depreciation, supported by narrative to describe the company's investment strategy. • Share buybacks plus dividend payments, supported by narrative to describe the company's strategy for returns of capital to shareholders.
Innovation of better products and services	***Total R&D expenses*** Total costs related to research and development.
Community and social vitality	***Total tax paid*** The total global tax borne by the company, including corporate income taxes, property taxes, non-creditable VAT and other sales taxes, employer-paid payroll taxes, and other taxes that constitute costs to the company, by category of taxes.

Audit & assurance

Focus on audit quality

We asked Paul Stephenson, Deloitte's new Managing Partner, UK Audit & Assurance, to consider the changing audit landscape and let us know some of the areas he considers important for audit committees this year end.

Paul, in your view, how has COVID-19 impacted the audit landscape?

Most businesses have experienced increased pressures as a result of COVID-19. The nature of those pressures depends on the nature of the business and how robustly the business model could respond. As we approach 2021, the effects continue to place a greater onus on directors to enhance resilience across their company, and that includes ensuring that controls and processes are robust.

Regulators around the world have underscored the importance of high quality reporting by companies and high quality audits. From an auditor's point of view, we have seen a number of audit opinions delayed because we insisted on high quality evidence to support our sign-off. The challenges of auditing during the pandemic have also underlined for me both the importance of access to a range of experts, and the importance of resilience of the firm, both delivered through our multi-disciplinary partnership model

I would expect the audit committee to ask about how we are planning our audit in this changed environment: the scope of our work, changes to materiality resulting from changes to the underlying business, an increased risk of fraud in some cases, the increased uncertainty inherent in forecasting which underpin so many judgments, and an increase in quality review processes to reflect the strains of working in a COVID-19 environment. As auditors, we need to assess how far work can and should be undertaken remotely, and also ensure we maintain a culture of collaboration, consultation, professional scepticism and robust challenge.

I would also expect the audit committee to ensure there are high quality management papers on critical judgments and to encourage management and auditors to address issues early, given the challenges.

Going concern and longer term viability have been a focus area for some time. Should the auditor be prepared for a discussion with the audit committee given the intensive focus in this area?

Absolutely. I'm acutely aware that assurance provided as auditors is critical to effective functioning of capital markets. When businesses fail and audit is called into question, trust in the profession is undermined. The profession is under more intense scrutiny than ever before.

With the many financial pressures arising from the ongoing pandemic, going concern and the viability statement will again be high on the agenda of most audit committees, and I'd expect the audit committee to be kicking the tyres hard on this.

There should be a robust dialogue between the audit committee, management and the auditor focusing on viability in the shorter term and business model resilience in the longer term. We shouldn't be afraid to talk about some of those emerging risks of technology disruption and climate change that could affect the business model, as well of course as financing and the potentially volatile effects of the current pandemic. Audit committees should understand what is new in the revised going concern standard and be asking how company processes need to be enhanced.

Paul, you have already mentioned the importance of internal controls. In some cases the audit committee might consider internal controls effective, even where the auditor has chosen not to rely on internal controls. Do you have any observations in this area?

I like to work with companies and boards that put a great deal of emphasis in areas such as high quality, effective corporate reporting and a robust control environment. Where audit quality is called into question there is often a correlation with poor corporate controls. Well-governed companies also tend to have a greater ability to cope with disruption.

So I'd always prefer our audit teams to be in a position to test internal controls. It gives me more comfort in the quality of management and in the systems in place, plus it's definitely interesting and relevant work for my audit teams.

Companies need to have robust internal processes and documentation, including a financial risk assessment, a fraud risk assessment, up to date documentation of material internal controls and how they are assured. There should be detailed papers supporting the board's annual review of the effectiveness of internal controls required by the UK Corporate Governance Code – remembering some of these will likely have changed in responding to the pandemic.

I think this year is critical, as we are expecting government to build on the already extensive requirements set out in the UK Corporate Governance Code to review the effectiveness of controls every year, which by the way some companies do well but many companies do poorly, and we expect the government to propose some form of attestation by management on financial controls. This will put a greater onus on businesses to make sure controls and processes are robust. Going into this, audit committees will want to be clear about their level of confidence in internal controls and what might need attention when these proposals come into play.

Internal control and the board: What's all the fuss about? provides a good summary of how to start improving the approach to internal controls.

What about assurance over the front half of the annual report?

Corporate reporting is richer and much more informative than it used to be. The FRC has indicated that it may well look at the whole of the front half this year if they review a company's annual report, so audit committees need to take this into account. For example, do key performance indicators have any vulnerabilities, or are they robust and verifiable?

Thinking more broadly about assurance and considering the recommendation of Sir Donald Brydon for audit committees to publish an Audit and Assurance Policy, I believe that effective audit committees will not wait until the introduction of an Audit and Assurance Policy becomes mandatory, as they will recognise that developing such a policy will be worthwhile in itself. It would help to provide clarity for stakeholders in two areas: first, a company's approach to obtaining assurance over the range of important information reported in the public domain; and second, assurance processes around the handling of risk.

Deloitte has recently issued guidance for those audit committees considering the development of an Audit and Assurance Policy.

Do you have any further observations about upcoming audit reforms?

There is a lot of work going on behind the scenes in the audit firms to implement the FRC's principles of operational separation. We have embraced this as we believe operational separation will enhance transparency and reinforce audit quality, but critically will also allow continued access to specialists from other parts of the firm. Also, staying as part of a multi-disciplinary firm continues to support resilience.

But it is also important that this is seen as just one part of a much broader picture, alongside a wider package of reforms, including in areas such as corporate reporting, the role of directors and the regulatory environment in which we operate. We expect more from Government on these elements soon. It is critical that the reform delivers change that embraces audit quality, improves choice and restores trust – in the ecosystem as a whole. We also need to remember that we do actually have very high standards in the UK and this is widely recognised abroad; we also host some of the world's largest companies here and auditors do very good work across a range of assignments.

We have a lot to be proud of, but there is also a lot to do - I'm committed to us playing a leading role in reforming audit in the public interest. It's our top priority to deliver independent high quality audits and to do this our auditors need to continue to develop their technical proficiency, behave with integrity and, of course develop their professional scepticism; it's not easy being an auditor these days!

Paul, what do you expect from the new Audit, Reporting and Governance Authority (ARGA)?
The regulator will be recruiting many more people and using those people on their mission to improve the overall quality of corporate reporting. This will mean more letters received by companies asking for explanations and additional information; it will mean comments being received also on the front half of annual reports, not just the financial statements. This is particularly important now that climate, public interest and other ESG factors are so important to investors. Directors and auditors alike will have to get used to justifying what is reported in the front half much more – we are all used to this in relation to the financial statements, but everyone will now be held to a higher standard for the whole annual report.

Finally, Paul what about prospects for the profession?
I am excited to be taking on the leadership of Deloitte's audit and assurance practice at this time. There is a lot of change, but there also seems to be a growing consensus around the reforms that are needed. Audit and company reporting are recognised as hugely important, which is why both are receiving so much attention. This is all the more so as the indicators that society and investors seek to measure are changing - and quickly too. The profession presents exciting and interesting opportunities for young people with enquiring minds, strong ethics and a sense of public duty and societal mission.

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Modernising risk and assurance

COVID-19 has both challenged organisations and put their budgets under pressure to do more with less. This is possible, but requires new thinking.

Organisations are on the brink of a new age of capabilities; the acceleration of digital technologies is challenging basic assumptions and operating models of entire industries. For companies to stay relevant competitive and thrive, they must both harness these new capabilities, and navigate the risks of disruption. However, in a rapidly changing digital world, many existing organisational defence mechanisms are no longer sufficient, and this limits abilities to predict, manage and respond to risk.

In this article we look at how organisations can connect, modernise and digitise their approach to assurance, compliance and risk, how they can embrace digital technologies and new ways of working across the lines of defence to achieve multiple objectives: optimise performance, increase productivity, grow profitability, improve risk management and lower the cost of compliance.

As organisations increase their focus on taking strategic decisions, moving beyond COVID-19 'Respond' actions into developing 'Recover' and 'Thrive' strategies, where we leave COVID-19 behind us, many are taking the opportunity to reimagine risk and assurance. This looks across the three lines of defence to drive both efficiencies ('more for less'), and better management and oversight of risk ('better insight'). The cost and accessibility of cognitive, analytical and automation technologies are no longer limiting factors. By incorporating 'assurance by design' into business processes, leveraging automation for control functions, and innovating assurance activities, organisations are able to gain greater visibility into risk and faster response to remediation.

We all know that a traditional three lines of defence model brings with it persistent challenges, including burdensome compliance programs and often misaligned assurance activities; these can limit the ability of organisations to optimise efforts, and require constant reinforcement to win hearts and minds. Issues can be compounded by disconnected site-specific tools and siloed solutions resulting in lapses and errors, and, often, very public management failures. Together, these conditions perpetuate the image of traditional three line of defence functions as intrusive, of limited value, even sclerotic.

Traditional control activities can be expensive and time intensive. Worse, they can provide organisations with a false sense of security as they do not keep pace with digitization and regulatory change. For example, many SOX compliance programs have become too big and too costly. Companies invest too much for too little return. As a result, organisations are undertaking assurance activities in the most expensive way.

Failure to address these issues generates a number of common problems:

- First line functions in the business can lack ownership for risk and believe it is being managed in the second line and third lines.
- Duplicative compliance and assurance efforts in the second line disrupt the business, generate excessive costs, and provide fragmented perspectives on risks, and how they are being addressed.
- Internal audit—the "last line" of defence—is often seen as the primary source of assurance or, in some cases, as a policing function, which undermines its brand, stakeholder trust, and, potentially, the organisation's risk management behaviours.

At a time when the UK is thinking about introducing internal control certification, now is the time to look at a programme to connect, modernise and digitise risk and assurance activities which:

- Assess people, processes, and technologies, and automates and connects those that will, if automated and connected, benefit users and the organisation; in contrast, purely technology-focused efforts overlook such considerations.
- Goes beyond automation to foster connection and efforts of the three lines of defence as appropriate to stakeholder needs, organisational culture, and regulatory mandates.
- Transforms and reinforces a sound operating model of risk management, such that risk owners are informed and empowered, and assurance providers, such as Internal Audit (IA), focus on the areas of greatest risk.

A connected, modern and digital organisation can generate the following benefits:

- Align key activities across the lines of defence to reduce overlap, close gaps, and enhance control.
- Provide transparency into process and control performance to help people identify, monitor, and mitigate risk events earlier and more effectively.
- Automate activities to provide assurance in real-time or close to real-time.
- Initiate a time/value shift to move talent from manual activities to advising stakeholders and addressing threats and opportunities.
- Provide people with risk-related responsibilities data-driven insights and a digital workspace, which they embrace as they exercise higher levels of observation, analysis, and expertise.

Leaders who see the opportunities and harness these technologies—and reallocate their talent accordingly—are generating results far superior to those of legacy compliance and assurance methods. These leaders are realising the promise of intelligent assurance.

In addition to efficiency gains, productive collaboration and real-time insights, these technologies in risk and assurance help keep pace with the whole organisation's digital transformation programmes. They also help upskill the risk and assurance functions enabling the whole organisation to better understand and address the risks in digital. Time to reimagine and modernise risk and assurance.

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Are you really getting assurance over the effectiveness of your internal controls?

At the time of writing, we await the Government's consultation paper on its proposals in response to the Kingman Review and the Brydon Review. The consensus is that this is likely to include proposals for attestation on internal controls over financial reporting.

Of course, the continued absence of a specific requirement to attest to the effectiveness of internal controls (over financial reporting or more broadly) does not mean that boards and audit committees of listed companies should be taking a lighter approach on their monitoring and review of the company's system of internal control as currently required.

The combination of the UK Corporate Governance Code and the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting set a clear expectation for the activities boards should currently be undertaking. This article lays out the steps which companies should be taking to meet current requirements, but these will also make any future attestation less challenging.

First, here is a reminder of the requirements set out in the UK Corporate Governance Code:

UK Corporate Governance Code Principle C
The board should establish a framework of prudent and effective controls, which enable risk to be assessed and managed.

UK Corporate Governance 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.

UK Corporate Governance 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.

UK Corporate Governance Code Provision 25

The audit committee's roles and responsibilities include:

- 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
- Monitoring and reviewing the effectiveness of the company's internal audit function or, where there is not one, considering annually whether there is a need for one and making a recommendation to the board

To obtain assurance over the effectiveness of internal controls over financial reporting, boards should consider whether the following activities are in place:

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 ***monitoring*** the design and operating effectiveness of material controls

Define and evidence a robust process for the ***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

The Audit and Assurance Policy

In our recent publication "Developing your company's Audit and Assurance Policy" we explore how companies might wish to take forward Sir Donald Brydon's recommendation to inject clarity and provide greater transparency on how boards are approaching assurance around both the handling of risk and internal controls, and over the range of reporting for which they have responsibility.

As you approach year end, you can examine the steps described above with several objectives in mind – your current responsibilities under the UK Corporate Governance Code, the development of an Audit and Assurance Policy for your company, and laying the groundwork for attestation on internal controls over financial reporting.

The audit of going concern – how should the board prepare?

One of the most significant judgements that boards make each time they report to the market or sign financial statements is that their company continues to be a going concern. UK listed companies also report on the "longer term" viability, which in practice most directors choose to assess over a 3-5 year medium term time horizon. Both these assessments normally encompass an understanding of strategy, the wider competitive landscape, risk management, internal control, forecasting reliability, working capital availability together with forecast banking covenant compliance, and will often extend to a number of other judgement areas specific to the company.

The Financial Reporting Council has issued a revised going concern standard for auditors that took effect for periods commencing on or after 15 December 2019. This means that your auditors are following this new standard for 31 December 2020 year end audits.

This article examines the areas of change, what your auditor is likely to ask of you and how the board can help the company prepare.

The new going concern standard

Following recent well-publicised corporate failures where the auditor's report did not highlight concerns about the prospects of businesses which collapsed shortly afterwards, the FRC revisited the work that auditors need to perform. Inevitably, this has a knock-on effect on the preparatory work that businesses will need to undertake, although the FRC points out that most companies with a well-controlled and well-defined process should see little difference.

Published in September 2019 ISA (UK) 570 "Going concern" takes effect for periods commencing on or after 15 December 2019. For most businesses, this will be December 2020 year ends and later. The changes permeate the audit, from initial risk assessment activities through to concluding and reporting, and, as explained by the FRC in its press release, these changes mean that the requirements in the UK "will follow significantly stronger requirements than those required by current international standards."

The following table summarises the changes and the areas where boards can prepare for the year-end audit.

Area of audit change	Areas for board focus
Planning – risk assessment and related activities The auditor will consider the business model, operations and financing in more detail at the planning stage of the audit, including: • the company and its environment; • the applicable financial reporting framework; • the company's risk assessment process; • the system of internal control; and • the IT system and related business processes.	Consider the quality of the company's processes and controls over the going concern assessment and whether they are documented in enough detail, including the role of the board. The assessment and documentation should cover the group as a whole and subsidiaries. The auditor is likely to raise more questions about the detail of the going concern assessment process.
Evaluation of management's assessment There are new and detailed procedures for the auditor to perform in this area, that are required for all audits, including an evaluation of the method used to assess going concern and any changes to the method during the year. The auditor should evaluate the underlying data, the assumptions used and how consistent they are with other related assumptions underpinning the financial statements, including plans for future actions. Under the new ISA, the auditor will always request representations regarding the "plans for future actions and the feasibility of these plans."	Even for companies in a strong cash position with clear prospects, a detailed articulation of the assessment, method and future plans will be critical. Boards will need to be confident in and challenge management where necessary around plans for future actions and their feasibility, as the auditor must now request a representation in this area. The board's challenge will be particularly important in areas where management intends to pursue a line of business that is underperforming or unprofitable.
Enhanced professional scepticism requirements and evaluation of sufficiency and appropriateness of audit evidence The auditor will further consider the risk of management bias. There is also a new stand-back requirement to consider all relevant audit evidence obtained, whether corroborative or contradictory, and any indicators of possible management bias.	Management teams tend to be confident in their own abilities and in their ability to effect change. This new requirement to challenge management bias will lead to more challenge of management and perhaps also of the board regarding the evidence provided in support of the going concern assessment and the board's confidence in that evidence.

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

Area of audit change	Areas for board focus
Considering the appropriateness of disclosures The auditor is now required not just to consider whether disclosures are adequate, but whether they are appropriate.	Many boards will already be spending much more time and effort reviewing the appropriateness of going concern disclosures this year, given the changes brought about by COVID-19. However, even for those that are not facing significant change, there will be more likelihood of challenge from the auditor over the extent and content of disclosure. Early discussion and review of the planned disclosures on going concern and viability will help meet the new requirement of "appropriate".
Principal risks and viability statements Additional audit procedures to identify any material inconsistencies between the viability statement and the knowledge obtained by the auditor during the audit include: • understanding the method used by the company to assess viability; • considering the supporting documentation; • considering the appropriateness of the period used by the board; • performing consistency checks over cash flow forecasts; • considering the appropriateness of alternative outcomes (where applicable); and • considering compliance with the UK Corporate Governance Code.	The board will need to consider whether the detail it sees on the viability statement gives sufficient confidence that management will be able to respond to these requirements. In many cases the board has a formal, documented process with robust controls to evaluate supporting documentation for the viability statement together with the judgements made in sensitivity analysis and scenario planning. However, this has not historically been the case across the whole listed market and some boards may need to encourage better management process and documentation in order to prepare fully for the audit process.
Enhanced audit reports An explanation should now be included of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern. Where relevant, key observations should be included. In practice, this means that the audit report's discussion of going concern will be in line with what would be required if going concern was a key audit matter. In other words there will be tailored narrative disclosure in the audit report.	Boards and audit committees should consider whether they should include more detailed disclosure of both the judgement on going concern and the processes for evaluating going concern and viability, including the level and nature of audit committee and board scrutiny. This will assist the company in "owning the narrative".

Resilience Reimagined
Workforce strategies
Marketing trends
State of the state
Public interest reporting
Corporate reporting
Section 172 statement
Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

FRC review of audits of going concern assessments

On 24 November the FRC published a review of audits of going concern assessments in the current economic climate, considering whether the policies and procedures responding to COVID-19 related risks had been put into practice effectively. The FRC highlights areas for improvement covering in audit testing, documentation and disclosure. Some of these are also areas where audit committees should consider discussion with management and the auditor:

- **Disclosure improvements** – where the auditor recommends disclosure improvements these should be followed through to ensure disclosure is appropriate and provides the information needed by users. The audit committee has a role to play in supporting better disclosure and introducing its own oversight challenge.

- **Integrity of forecast models** – the audit committee should consider discussing with the auditor how testing of the forecast model has been followed through and whether specialists or computer-assisted techniques have been used.

Remuneration

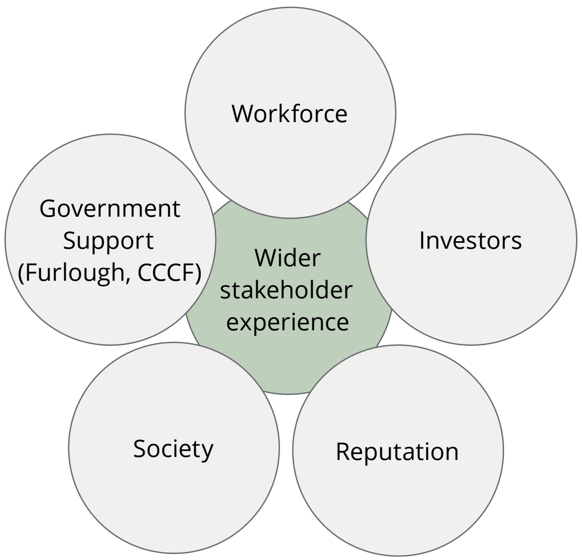
On the Remuneration Committee Agenda

Investors, regulators and government continue to focus on executive remuneration. They expect remuneration decisions to be fair, in line with results for the workforce, and above all transparent. This article examines areas of focus for remuneration committees in the year ahead, providing key insights on areas of investor focus for 2021 and into the latest market practice around how remuneration committees are responding to the new challenge of COVID-19.

As the majority of companies have December year ends, most remuneration committees will now be contemplating decisions on senior executive pay. These will be made in the context of ongoing scrutiny around executives 'sharing the pain' of COVID-19 with wider stakeholders, and a growing debate around building back a fairer society. While the impact of the pandemic will differ by company, many remuneration committees are faced with the challenge of incentivising executives to deliver innovative leadership and resilience at a time of significant business uncertainty, while balancing investor expectations and potential reputational risks in this area.

Key areas of focus for remuneration committees in the year ahead are set out below.

1. Recognising the stakeholder experience



Investors and proxy agencies have been clear that the primary focus in the year ahead will be how the impact of COVID-19 is reflected in executive pay; this should take into account the experience of employees and shareholders, as well as the company's overall performance, in particular where government support (CCFF / furlough) has been used.

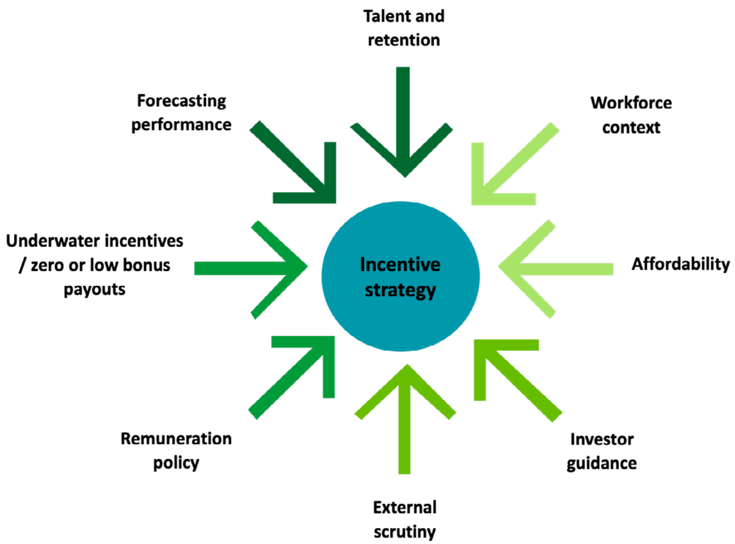
LGIM's Principles of Executive Pay (October 2020) state that 'the payment of a bonus may result in a vote against the remuneration report' where support from government or shareholders (via additional capital or suspended dividend) and staff redundancies were necessary.

Shareholders do not generally expect remuneration committees to adjust performance conditions for in-flight annual bonuses or for long-term incentive awards to account for the impact of COVID-19, and discretion and judgment should be used to ensure that pay outcomes reflect the wider stakeholder experience. Remuneration committees are expected to provide detailed narratives in their year-end reporting around why they believe their decisions are appropriate.

2. Executive pensions – continued investor focus

While the 2020 AGM season was the quietest in recent years, the majority of 'low votes' linked back to executive pensions of 25% of salary or more, where insufficient action was taken to reduce pension levels to that of the wider workforce. Over 85% of FTSE 100 companies with executives on pension rates higher than the workforce committed to make a reduction, and this will remain an area of focus for investors in the coming year. It is likely that the IA's Red Top threshold of 25% of salary or more will be reduced next year, to focus on executives at the next level down.

3. Incentive design – greater innovation, more bespoke solutions?

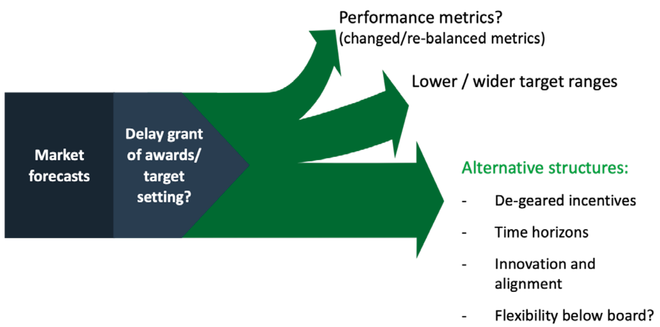


During the 2020 AGM season we saw examples of high support for alternative incentive structures, in particular the use of restricted share plans where supported by a strong strategic rationale. As remuneration committees look afresh at incentive frameworks to ensure they remain appropriate in a more uncertain and challenging business environment, a greater diversity of approaches is expected in the coming year.

In recent months a number of companies have come forward with changes to incentives such as annual bonus with performance conditions set for two halves of the financial year, and 'de-geared' arrangements with lower bonus opportunities linked to strategic metrics, where the setting of financial targets is particularly challenging.

4. Long-term incentives and target setting

LTIPs - considering your approach



While nearly one half of FTSE 350 March to June year ends delayed setting LTIP targets in line with Investment Association guidance, there are also examples of companies granting awards with wider and lower target ranges, reflecting business uncertainty in the medium. These have been generally supported by investors, who emphasised that the key focus will be on out-turns to ensure they reflect the overall performance and experience of stakeholders during the performance period. Remuneration committees should ensure that sufficient flexibility exists in plan documentation to enable the expected use of discretion at vesting.

5. Windfall gains

A potential windfall gain for executives has been identified as the most common issue raised by investors in recent discussions, and shareholders have indicated that they expect grant levels to be reduced in the event of a 'significant' share price fall. While most have been careful not to define how this will be considered, calling on remuneration committees to look carefully at all relevant factors, some have identified a share price fall of 20% or more from prior year as an area of focus.

Where a reduction at grant is not implemented, there will be scrutiny around the use of discretion to reduce any outcomes at vesting where share prices have recovered. Remuneration committees have been urged to set out how they plan to address this in the directors' remuneration report.

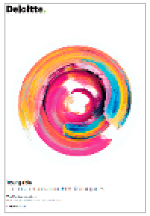
6. Fair pay and wider workforce

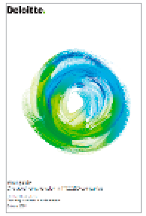
We are seeing a growing focus on how remuneration committees are fulfilling their expanded remit under the UK Corporate Governance Code to review workforce pay and conditions, accelerated by the continuing debate around social inequality. Committees can do more to understand and support low paid workers in their organisation, including offering free shares and commitments to pay a real living wage in the UK and in operations elsewhere. Where pay freezes have been implemented, we have seen some companies 'ring-fence' their lowest paid workers from a firm-wide policy approach. A number of companies are leading the way with improved disclosures in this area.

7. Diversity and inclusion

Remuneration committees should identify which elements of their diversity, inclusion and wider ESG strategy are pertinent to pay and reward and closely monitor progress. Getting 'under the bonnet' of pay demographics across the workforce will enable committees to better address pay gaps across the organisation. Understanding the voice of the workforce is also key to raising the game of remuneration committees in this area.

You also might like to read:





Your Guide – Directors' remuneration in FTSE 100 companies (October 2020)

Your Guide – Directors' remuneration in FTSE 250 companies (October 2020)

Questions boards should be asking:

- How do we plan to balance the expectations of key stakeholders in the challenging year ahead?
- Are there innovative solutions to remuneration issues that we could be considering?
- Have we sufficiently built diversity into our remuneration considerations?
- Are we confident that we are getting enough insight into the wider workforce experience and supporting the fair pay agenda, in line with investor expectations?

Contact for remuneration

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Governance disclosures
Climate change
Diversity & inclusion
AGMs
Towards common ESG metrics
Focus on audit quality
Modernising risk and assurance
Internal controls
Going concern
Remuneration

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