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Governance in focus

Audit committees in 2016 – refocusing the agenda

Contents

Refocusing the agenda

Foreword from William Touche

Dear Audit Committee Member,

Another reporting and AGM season is over but as we approve interim results, inevitably we look at agendas for the rest of the year. At our Centre for Corporate Governance we want to help you set your agenda, which is why, this year, we have decided to provide you with a half year round-up of areas your audit committee will need to consider during the remainder of your meetings in 2016 and into 2017.

The repercussions from the vote to leave continue to develop. For corporates, this is the beginning of a period of both heightened uncertainty and opportunity. While most of the major implications will only become clear with time, businesses need to be considering how they might be affected by Brexit and the uncertainties and opportunities in the period leading up to it, however long that might be. For audit committees there will be a number of matters to consider arising from the vote which impact their areas of responsibility.

As we consider these and the matters raised by investors during the 2016 reporting season, we focus on a number of areas likely to become principal risks for more companies in the near future – cyber security, data protection, transparency in tax reporting and of course the uncertainties arising as a result of the vote to leave.

Looking ahead to 2017, we set out here the key features of the revised UK Corporate Governance Code and Guidance on audit committees which apply for periods commencing on or after 17 June 2016 and raise some interesting challenges for audit committee composition, activities and reporting. Many companies will seek to adopt these early in their 2016 reporting.

We also provide an update on the lessons learned from the 2014 risk management and internal control changes and some next steps you may wish to consider to further embed risk management, plus hot topics in corporate, remuneration and taxation reporting.

Do get in touch with your Deloitte partner or our Deloitte governance team if you would like to discuss any matters arising. And don't forget you can join us at the Deloitte Academy where we host live updates which allow you the opportunity to air current issues and swap notes with your peers – even more useful at a time of great change and uncertainty. The Deloitte Academy website also has all of our publications and useful checklists.

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The vote to leave – what do you need to disclose?

The immediate business impacts of the vote to leave

At Deloitte, we recently engaged our leadership team to consider the implications of the EU referendum on our clients. We focused on the likely impacts in the run up to the referendum vote and in the immediate aftermath if there was a vote to leave. Participants identified five major channels through which organisations could be affected:

01. Reduced availability and higher cost of capital: Short term market liquidity fears have prompted HM Treasury and the Bank of England to make available more than £250 bn of additional liquidity. However, it would be wise to review your financing needs over the short and medium term, review the terms of facilities and consider the impact on any plans to raise or refinance debt. Considerations should include whether your facilities include Brexit clauses and, if so, what contingency plans are in place.

02. Sterling depreciation: Whilst the costs of hedging have risen, if you are dependent on imports, you will likely now be reviewing your hedging strategy in light of the depreciation in the value of sterling on costs. If you are a significant exporter, you will be considering how you might quickly exploit this boost to competitiveness? It is also worth considering any impacts on dividend flows to the holding company that might influence the group's ability to pay a dividend.

03. A sell-off in equities and capital outflows: Higher uncertainty would tend to fuel capital outflows and depress the value of UK denominated assets; this may create a gap in funding for some projects and weaken demand for some asset classes. Have you reviewed major projects and M&A activity? A reduction in sterling combined with low interest rates may also make UK assets attractive to opportunistic foreign buyers.

04. Fall in business confidence: Over the last 8 years our CFO survey has shown that sharply lower business confidence and risk appetite is associated with weaker capital spending, M&A and hiring. Whilst economists will be reviewing their forecasts, it would be wise to consider how you would react to a more risk averse business environment and potentially reduced spending by other corporates? In other words, have you a defined set of contingency plans?

05. A premium on communications: Organisations which are likely to be, or perceived to be most impacted by the leave vote will need to communicate in a timely and effective fashion with investors, employees and customers. Other organisations may wish to reassure stakeholders that the effect on them is limited. After the initial wave, all stakeholders will wish to have regular updates as the situation evolves and effective communicators will normally be admired. Do you have a clear communication plan?

Given the numerous uncertainties we believe that the focus in terms of contingency planning should be on minimising short-term risks at minimal cost.

For more information, please go to our EU Referendum website at www.deloitte.co.uk/eu-referendum.

Navigating uncertainty – key considerations for audit committees

For corporates, this is the beginning of a period of heightened uncertainty. While most of the major implications will only become clear with time, businesses need to be considering how they might be affected by Brexit and the uncertainties in the period leading up to it, however long that might be. For audit committees there will be a number of matters to consider arising from the vote which impact their areas of responsibility.

Corporate reporting – implications for half yearly and annual reports

The half year reporting season is shortly to be upon us, and this half year will be scrutinised for messages about the possible impact on UK listed companies. In addition, for those companies with a June, July or August year end, these considerations will apply equally for your annual reports.

Directors should be considering the following:

- Principal risks and uncertainties – what is the impact on the company's principal risks and how they are being managed? As you will be aware, only a handful of companies included Brexit as a risk in their annual report and now we would expect virtually all companies to do so. Such disclosure could include new risks that need to be disclosed or changes to the potential impact or likelihood and mitigating activity for existing risks. For the half-yearly report, disclosure may need to include more detail than the usual approach of summarising and referring to the last annual report.

- Critical accounting judgments and areas of estimation uncertainty – should the discussion of the judgments and estimates to be disclosed under IAS 1 change, or should new items be added to that discussion? For the half yearly report, consider the requirements to provide an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Sterling depreciation will likely affect many end of June balance sheets.

- Volatility – is short term or longer term volatility likely to impact the key assumptions used when developing forecasts, and which judgments and disclosures could this affect? In particular, it is worth considering asset valuations, pension assumptions, financial instruments and foreign exchange impacts, especially for valuations as at 30 June 2016. Are valuations impacted by market liquidity issues?

- Impairment reviews – directors will have to form a view as to whether they believe the market reaction to Brexit is a trigger event for impairment reviews.

- Longer term viability – will any effect on principal risks or volatility considerations lead to an impact on the company's longer term viability statement? In the second half of the year most companies will now be embarking on their three year planning cycle prior to budget approvals in Q4. Do directors wish to give special guidance to management at this stage? Do directors believe that they should be refreshing the analysis underlying that statement at this stage?

- Disclosure – we expect extensive disclosures about the considerations and management action arising from Brexit in half year and annual reports, largely in the front half commentary, to provide investors and other stakeholders with a view on the potential impact and what management action is being undertaken.

External audit considerations for audit committees

The trend has been for external audit plans to be presented earlier in the year than previously. We would expect the July audit committee to include a discussion of the audit risks arising from Brexit and the impact on both the external and internal audit plans:

- Internal audit scope – should the scope of internal audit now include any contingency planning, or testing the robustness of key risk indicators which provide early warning/horizon scanning intelligence?

- Significant risks – is the audit committee satisfied that the auditors have identified all the significant risks in light of this event, and have they considered whether the changes to the political and economic environment impact risk classifications and are the planned responses to risks still appropriate?

- Specialists – where the audit involves the use of specialists, in particular financial instrument, pension and valuation specialists, is there a need to discuss with them and/or revisit the scope or timing of their work?

Status of EU reporting and audit requirements

Any changes to reporting requirements will become clear in due course depending on the timescales set for agreeing the terms of leaving the EU – however, in the short term:

- EU regulations and EU-inspired UK laws, including in relation to direct and indirect tax, will continue to apply for at least two years – meaning consideration of laws and regulations relevant to the short term will be unchanged;

- there will be no impact on implementation of EU audit reform changes, which came into effect for periods commencing on or after 17 June this year as these are enshrined in UK law; and

- for the foreseeable future, the requirements for use of IFRSs as endorsed for use in the European Union (including the need for endorsement of new standards before they can be applied) will not change.

Deloitte view

Businesses now need to ensure that they are set up to navigate the immediate risks and impacts of an exit, and have the processes and people in place to manage a period of uncertainty.

The half year reporting season is upon us and management will wish to present boards with analysis of the potential impact on their business and actions being undertaken to underpin statements to the market.

For many businesses, the results of the vote could also bring opportunities, and planning should also focus on identifying and exploiting these.

Key areas of focus in corporate reporting

Identifying and reporting principal risks

Stephen Haddrill, CEO of the FRC, wrote an advice letter to audit committee chairs in March 2016 regarding **reporting in times of uncertainty or volatility**.

The letter pointed out some of these areas that are occupying the minds of many boards and audit committees at present: "For example, asset prices have been volatile, oil prices have moved further... interest rates have fallen and the UK's referendum on EU membership has been announced." In the light of the EU Referendum results, the FRC's advice continues to be particularly apposite.

The letter echoes the concerns raised in 2015 by the Corporate Reporting Review team and calls out five main areas where audit committees should consider whether there is any impact to the annual report:

01. The strategic report provides an opportunity to provide the most current view of prospects.

02. Key to an understanding of a company's prospects will be disclosure of the directors' judgements as to the **principal risks** and their potential impact.

03. Accounts should be drawn up on the basis of conditions existing at the balance sheet date.

04. Financial reporting standards require companies to disclose material post balance sheet events.

05. Consider whether the events have a material effect on the preparation of the accounts on a going concern basis.

Underlying all of these is the board's assessment of the areas of uncertainty or volatility that impact the business, the timing of that impact and the extent of that impact. One of the critical areas is identification of the principal risks. For all such principal risks, it is also important to disclose the actions taken to manage or mitigate the risks.

Four key risks that should be on your agenda

EU referendum – the ramifications of a vote to leave
Following the results of the UK's EU referendum, many companies will need to revisit the information previously provided in their annual reports and we expect there to be a great deal of interest in whether there are new principal risks and uncertainties disclosed in 30 June half yearly reports.

As the media widely reported earlier in the year, only a few companies included the risk of a Leave vote and its repercussions as a principal risk in their annual report. For the half-yearly report, disclosure may need to include more detail than the usual approach of summarising and referring to the last annual report.

Our previous section, **The vote to leave – what do you need to disclose?** provides a run-down of the main considerations for companies, including deciding whether there is any need to change the company's conclusion on whether there is an effect on principal risks and uncertainties.

Data protection – a changing landscape
Customers are more sensitive to privacy issues than ever before. Rules governing the processing of customer data are complex, ever changing and vary across the globe. The EU has overhauled and now introduced the General Data Protection Regulation (GDPR). The requirements concentrate on improving consumer protection and harmonising existing EU privacy laws, but also introduce extra burdens and restrictions for organisations that collect, store or use personal data relating to EU citizens. This will come into force from 25 May 2018, along with the threat of very large fines for significant non-compliance.


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Governance in brief
EU Privacy Legislation

At the same time, data protection and privacy has been in the news for a number of reasons including the European courts invalidating the 'Safe Harbor' concept which allowed data to be transferred freely between Europe and the US for organisations that participated. The courts ruled that US protocols meant that security agencies could be able to access this data in circumstances where the EU would not permit such access. The new EU-US 'Privacy Shield' has been named as the solution, however there is still a lack of clarity over some aspects and whether the US will be able to implement them in a way that stands up to EU requirements.

Boards should consider whether either the changes or the uncertainties could result in a principal risk for their business.

The Global Tax Reset
A global tax reset is underway: In 2013 the G20 engaged the OECD to address perceived inequities and inconsistencies in the global tax landscape; in particular, the perception that existing rules give businesses too much opportunity for arbitrage of tax rates and regimes. The OECD recommendations have become known as the Base Erosion and Profit Shifting (BEPS) Action Plan.

The UK Government has already brought out both consultations and some legislation on the UK plans for implementing the rules, which include:

- introducing a diverted profits tax of 25% to counter the use of aggressive tax planning techniques aimed at shifting profits to lower tax rate jurisdictions –profits arising on or after 1 April 2015;
- requiring UK multinational corporations with a turnover of £586m or more to provide HM Revenue & Customs (HMRC) with country by country reporting with detail for each country in which they do business – accounting periods commencing on or after 1 January 2016; and
- neutralising hybrid mismatch arrangements (arrangements which exploit differences between countries' tax rules to avoid paying tax or to claim excessive tax relief) – payments made from 1 January 2017.

Companies that believe they may be affected by these measures other than administratively will need to consider how best to flag to investors that there will be a change in taxation affecting the company.

We include more detail on the Global Tax Reset, tax transparency (including disclosure of your UK tax strategy) and the recent legislation on country by country reporting in the later section on Taxation.

Cyber risk – everything that depends on cyberspace is potentially at risk
Cyber crime is growing more rapidly than cyber security.


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Governance in brief
Is your organisation prepared for a cyber-attack?

In many cases, audit committees will need to act as catalysts to ensure that their companies are well informed about the cyber threats they face, the most important information assets and systems to monitor and protect, and how they would respond to a successful attack. For most companies, cyber attacks are now not a matter of whether they will happen, but when, how regularly and with what degree of expertise they are attacked.

We consider that boards should carefully consider how they describe and report upon cyber threats. This area is rapidly evolving and boards are well advised not to give the impression of total resilience or comprehensive controls.

Key areas for consideration

Robust assessment of the risk

- Who is likely to want to launch a cyber attack on us, and why? How is this likely to evolve in the future?
- What are the most critical assets we need to protect from a cyber attack? How did we assess this?
- Do we understand what the impact of a successful attack on these assets might be?
- Have we defined a cyber risk appetite? How?

Monitoring of internal controls effectiveness

- Who is responsible for managing our risks associated with cyber?
- Are our controls to prevent cyber attacks effective and in line with our risk appetite?
- Do we have the right intelligence mechanisms in place to understand rapidly how the cyber risk is changing? Can we rapidly alter our controls as a result of this intelligence when needed?
- Are we confident we would detect a successful attack? Have we developed and rehearsed how we would respond to a successful attack?

Management and mitigation activity

- How do we ensure that our people, including the Board, are trained appropriately regarding cyber threats and their responsibilities ?
- How do we compare to our competitors, other industries and relevant cyber security standards?
- What is risk, internal audit and external audit's role in assurance around cyber?

The FRC's Corporate Reporting Review – recurring themes

In October 2015, the FRC published the 2015 Corporate Reporting Review (CRR) and set out areas of focus for the coming reporting season. The corporate reporting environment is mature, with few new standards being introduced and boards are largely familiar with IFRS requirements and application.

The CRR team has indicated that for June 2016 and for December 2016 annual reports, the areas of focus will be driven by macro-economic factors, which are now likely to be particularly volatile given the recent UK vote to leave the EU. These include:

- Volatility in commodity prices and in equity and bond markets which may affect **asset valuations**, including appropriate disclosures of measurement sensitivity and impact on goodwill impairments in certain industries.

- Global and national focus on taxation could increase **tax uncertainties**, leading to an increasing focus on disclosure of accounting policies, tax risks and tax estimates.

The FRC will issue the 2016 Corporate Reporting Review in October 2016 but in the meantime we wanted to highlight a number of areas which we have seen as recurring themes which are likely to be included in the 2016 report.

Commercial income/supplier rebate arrangements

There have been a number of CRR enquiries into the disclosure of commercial income/supplier rebate arrangements including whether amounts included within the balance sheet should be separately disclosed in the notes as amounts relating to such arrangements rather than being described as general prepayments or accruals. Where these amounts have been material, agreement has been reached as part of the enquiry process that in subsequent financial statements the amounts will be presented separately.

It is important for the audit committee to consider the nature and types of these arrangements and the materiality of such balances and whether sufficient and appropriate disclosures have been made in the financial statements, including in the critical accounting judgements note.

Tax rate reconciliation

We are aware of a number of enquiries in CRR letters relating to apparent inconsistencies or omissions in the tax notes. When reviewing the financial statements have you considered whether the amounts disclosed in the tax rate reconciliation and note are consistent with the rest of the financial statements and in particular whether the deferred tax charge or credit reconciles to the balance sheet position? Audit committees should challenge whether the tax effect of any exceptional items should be disclosed. Also the audit committee should consider whether, if there are any adjustments to the prior period tax charge, any explanation is required in relation to such adjustments, particularly where they may relate to one off transactions. Where the presentation of items in the tax note includes offsetting, it is important to ask whether this is appropriate and whether disclosure to explain the offset is required.

Income statement presentation

Are you presenting one off or exceptional items in the income statement? We have seen increased challenge from the CRR as to whether the disclosures in the financial statement really demonstrate that these items are one off or exceptional in nature. Is the term exceptional/one off defined in the accounting policies and is it clear whether such items really are one off or non-recurring in nature? In particular, where appropriate, the audit committee should ask management to demonstrate that the treatment of non-recurring tax charges or credits are consistent with the definition of exceptional or one off items.

"The areas of focus will be driven by macro-economic factors, which are now likely to be particularly volatile"

Other hot topics in corporate reporting, including non-financial reporting

Bulletin board – IFRS and other financial statement disclosures

Use of non-GAAP measures

The European Securities and Markets Authority (ESMA) has published its finalised Guidelines on Alternative Performance Measures (APMs). APMs are also an FRC focus area and very similar guidelines have been produced by the International Organisation of Securities Commissions (IOSCO).

These guidelines apply to financial APMs (other than those included in the financial statements themselves) such as EBITDA or 'profit before exceptional items' disclosed in 'regulated information' that is made available to the market in accordance with the requirements of the Transparency Directive and the Market Abuse Regulation and prospectuses published on or after 3 July 2016 and will require:

- that APMs not be displayed with more prominence, emphasis or authority than, or distract from, measures directly stemming from financial statements;
- that each APM has a meaningful, well-defined label;
- that each APM is reconciled to the most directly reconcilable item in the financial statements;
- that an explanation be provided as to why an APM is considered to provide useful information; and
- that APMs be presented consistently from period to period with comparative information provided.

It is possible to provide this information via cross-reference to another easily accessible document.

The inclusion of documents other than annual reports in the scope of ESMA's guidance should not be overlooked as it will require care to be applied in the preparation of a variety of documents (for example, analyst presentations) including the addition of reconciliations between APMs and financial statement items.

The FRC has isused some FAQs on the ESMA Guidelines – these are available from www.frc.org.uk.

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15, *Revenue from Contracts with Customers*, was issued in May 2014 and has been the subject of much debate and significant amounts of work in certain industry sectors. The standard provides a single, principles-based, five-step model to be applied to all contracts with customers in order to recognise revenue, as well as mandating more informative and relevant disclosures.

Some elements of the standard were clarified by the IASB in April 2016. Details of these clarifications are included in our **Need to Know** newsletter.

This standard is a significant one for many companies. Preparing for it may require not only changes in thinking and business process, but may also require changes in systems, financing agreements, remuneration and other areas.

There is increasing pressure from the FRC to disclose the anticipated impact of the change in revenue standard in 2016 year end reporting – this makes it ever more important to ensure your accounting conversion project is well under way.

IFRS 16 *Leasing*

Subject to EU endorsement, IFRS 16 will be effective for annual periods beginning on or after 1 January 2019, with earlier application permitted for entities that have also adopted IFRS 15 *Revenue from Contracts* with Customers. It supersedes IAS 17 *Leases* and its associated interpretative guidance. The length of time given for adoption reflects the work the IASB considers some entities will need to undertake in order to apply the new Standard.

Some key points are:

- IFRS 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer.
- Significant changes to lessee accounting are introduced, with the distinction between operating and finance leases removed and assets and liabilities recognised in respect of all leases (subject to limited exceptions for short-term leases and leases of low value assets).
- The Standard does not include significant changes to the requirements for accounting by lessors.
- The Standard significantly expands the disclosure requirements for leases, including amongst other requirements a requirement to disclose a maturity analysis for lease liabilities, separately from other financial liabilities.
- Companies will need to consider the impact of the changes introduced by this Standard on, for example, IT systems and internal controls.

Questions to consider:

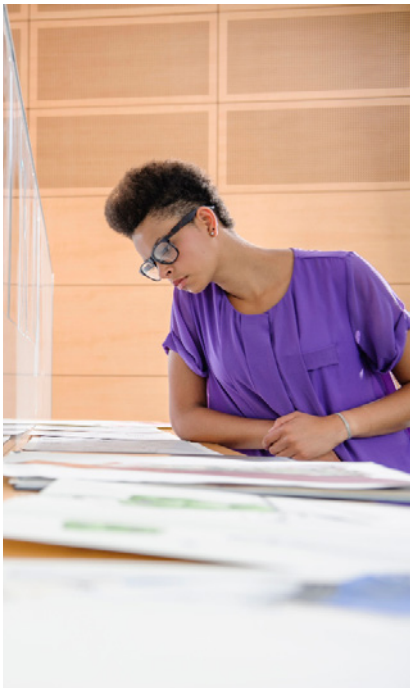
- What changes will be required to your company's systems and processes, for example to track leases individually or at portfolio level and to perform calculations ?
- What judgements need to be taken in respect of the definition of a lease and the assessment of the lease term?
- Are there any potential tax impacts associated with any changes in treatment of the lease?
- What impacts need to be considered on key metrics and debt covenants?
- Does the remuneration committee need to consider any impact on management compensation?
- What additional information needs to be gathered in order to meet the expanded disclosure requirements and is this readily available, or does management have a plan to have the information available in good time?

Consultation: realised and distributable profits

Following the report on the importance of distributable profit disclosures to investors from the FRC's Financial Reporting Lab, which we commented upon in our **November audit committee round-up**, the ICAEW and ICAS have jointly issued TECH 05/16 BL, an exposure draft of revised guidance on realised and distributable profits to assist companies in determining whether profits made are realised and can be paid out as dividends.

Substantive changes have been made to the guidance on accounting for intragroup off-market loans and on retirement benefit schemes. Other changes update references to the revised standards and remove obsolete material.

Investors are demanding greater disclosure around distributable reserves. Whilst not proposing changes to disclosure, the guidance will assist companies to meet investor expectations in this respect. It will also help to avoid the potentially serious consequences for companies and their directors of making an unlawful distribution.



Consultation: EU Non-Financial Reporting Directive

Non-financial reporting requirements in the UK have developed substantially in recent years, and the UK is now considered to be a world-leader in reporting and governance. Non-financial reporting information, including information about a company's growth strategy and how it responds to risks and opportunities to deliver returns, enables businesses to communicate the contribution they have made to society, thereby strengthening trust with all stakeholders.

The EU Non-Financial Reporting Directive requires large public-interest entities (PIEs) with more than 500 employees to include a non-financial statement disclosing, as a minimum:

- environmental, social and employee matters;
- respect for human rights; and
- anti-corruption and bribery matters.

This information is required only to the extent necessary for an understanding of the undertaking's development, performance and position and the impact of its activity.

Those large PIEs that have 'traded shares' will also be required to provide information on their board diversity policy, covering age, gender, geographical diversity, and educational and professional background. Disclosures should set out the objectives of the policy, how it has been implemented, and results.

How does this differ to existing UK requirements?

The key areas of difference between the EU NFR Directive and the existing UK requirements for the strategic report as applicable to quoted companies relate to:

- the scope of companies required to disclose the non-financial information;
- the matters which are required to be reported on;
- principal risks specifically related to those matters (including anti-corruption and bribery); and
- diversity information disclosures.

Our observations

The implementation of the Directive should also encourage companies to review and refresh their principal risks in respect of environmental, social and employee matters, human rights and anti-bribery and corruption. This may result in companies identifying amendments to their principal risks or including additional disclosure in respect of non-financial information. We encourage companies to start this process as soon as they can to minimise any impact.

The current UK requirements for the strategic report already require companies to provide numerical disclosures on gender diversity. However, the NFR Directive goes further than the existing requirement and also requires companies to include the information in their corporate governance statement specifically.

Wider reporting

BIS has also used the consultation to "take a wider, strategic look at reporting in the UK", particularly focusing on the scope for deregulation. The main topics for consultation are:

- whether non-financial information could be published solely in electronic format on a company's website and wider considerations in respect of electronic publication;
- amending the definition of the term 'senior manager' for the purposes of numerical disclosures on gender diversity, which as currently defined in the Companies Act 2006 explicitly requires the inclusion of all directors of subsidiaries who may not be seen as 'senior managers' in the context of the group;
- whether any existing UK or EU reporting requirements could be repealed in order to remove any unnecessary reporting; and
- the cost of preparing an annual report, as well as the expected costs and benefits of adopting the EU NFR Directive.

The consultation period closed on 15 April 2016.

Remuneration committee reporting – the return of the Shareholder Spring?

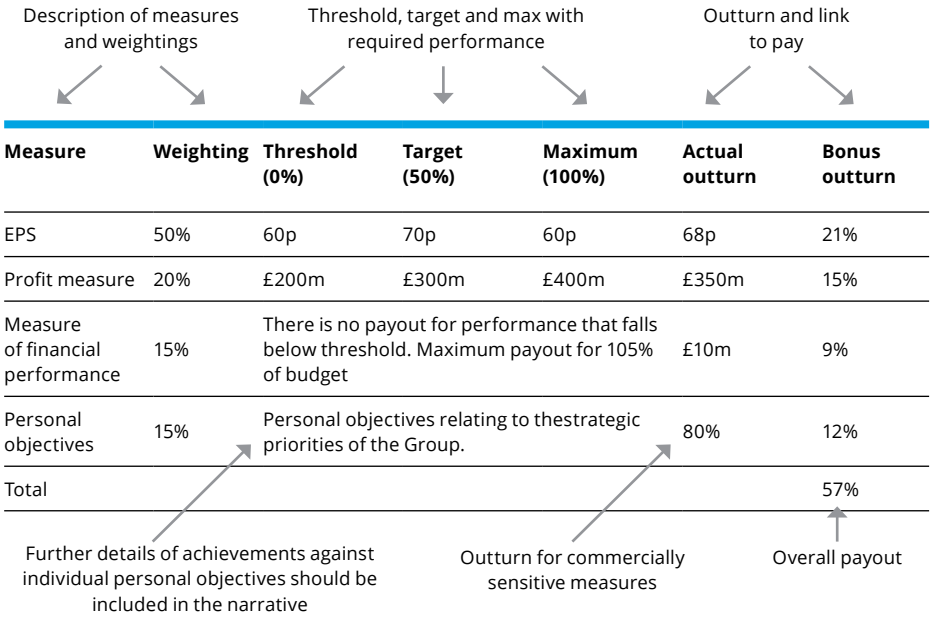
The 2016 AGM season
During the 2016 AGM season, the main areas of investor focus have been recruitment arrangements and the disclosure of bonus targets.

Recruitment arrangements
In respect of recruitment arrangements the issues have mainly been in companies where a director, most often the CEO, has been appointed from outside. Concerns have primarily been over buy-out arrangements but also over the overall size of the potential package. This is despite companies having approved recruitment policies in place which means that having an approved policy does not mean that investors will necessarily be happy with the way in which the policy has been implemented.

Retrospective disclosure of bonus targets
The issue with bonus target disclosure is the lack of quality retrospective disclosure of the targets and how this relates to the payout. Investors and corporate governance bodies have been increasingly vocal in their desire to see evidence of a link between pay and performance. While there is less pressure for disclosure of non-financial targets, often called 'personal objectives', which may include a number of softer or more strategic goals, investors still expect some explanation of how the outcome links to performance. In response to this, we have seen a shift in market practice towards more detailed disclosure around the performance targets used to determine bonus outcomes.

Preparing for the second round of remuneration policy voting
We have already seen the first instance where a binding policy vote has failed to gain shareholder approval, leaving the company with no option but to continue with the existing policy.

We believe that the following diagram demonstrates high-quality retrospective bonus disclosure.



Measure	Weighting	Threshold (0%)	Target (50%)	Maximum (100%)	Actual outturn	Bonus outturn
EPS	50%	60p	70p	60p	68p	21%
Profit measure	20%	£200m	£300m	£400m	£350m	15%
Measure of financial performance	15%	There is no payout for performance that falls below threshold. Maximum payout for 105% of budget			£10m	9%
Personal objectives	15%	Personal objectives relating to thestrategic priorities of the Group.			80%	12%
Total						57%

Based on the 2016 AGM season, we anticipate investor focus on the following areas:

- Increases in quantum – e.g. significant increases in variable incentive opportunity, substantial salary increases, which have a knock-on effect on the size of the total package and granting exceptional awards.
- The link between pay and performance – companies have faced a negative reaction for: exercising discretion which results in higher payouts for executives when original targets have been missed, adjusted targets resulting in larger payouts and failure to adjust large incentive awards and outcomes in the context of poor company performance.
- Pro-rating of incentives for leavers – managing the remuneration arrangements of executive directors when they join and leave the company continues to be a highly sensitive area, a key issue is a lack of pro-rating of incentive awards for outgoing executives.

Deloitte view

The three year renewal of the remuneration policy is the perfect opportunity to make sure the remuneration arrangements effectively support the delivery of the business strategy and the creation of shareholder value.

It is worth spending time getting this right and ensuring that the key messages are disclosed in a clear and unambiguous way.

UK Corporate Governance Code 2016 and Guidance on Audit Committees

The FRC has completed its 2016 updates to the UK Corporate Governance Code and to standards for auditors, which finalises its implementation of the EU Audit Regulation and Directive. It has also issued updated Guidance on Audit Committees. These take effect for financial years commencing on or after 17 June 2016.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May 2016

Governance in brief

FRC issues 2016 UK Corporate Governance Code, Guidance on audit committees and changes to auditor independence rules – Part One

For more detailed analysis, see Governance *in brief*: FRC issues 2016 UK Corporate Governance Code, Guidance on audit committees and changes to auditor independence rules – Part One

2016 UK Corporate Governance Code – changes for audit committees

The FRC has issued an updated version of the UK Corporate Governance Code, applicable to companies reporting on their compliance with the Code either under the Listing Rules requirements or voluntarily. The changes are driven by the Competition & Markets Authority's final Order as well as the EU Audit Regulation and Directive.

This is a 'light touch' update with changes only to section C.3 (Audit Committee and Auditors):

- The audit committee as a whole will need competence relevant to the sector in which the company operates. This is likely to affect induction processes and future recruitment policies.
- The FTSE 350 audit tendering provision has been removed as this is superseded by the CMA and EU requirements for mandatory tendering and rotation of the audit firm.
- The audit committee report within the annual report is now required to provide advance notice of any plans to retender the external audit.

2016 Guidance on Audit Committees – changes to recommended activities and reporting

In addition to changes which bring the Guidance in line with the proposed changes to the Code, there are the following amendments to audit committee activities and to audit committee reporting.

Activities

Area	Guidance
Key judgements	The audit committee should consider key matters of its own initiative rather than relying solely on the work of the external auditor. It must satisfy itself that the sources of assurance and information it has used to carry out its roles to review, monitor and provide assurance or recommendations to the board are sufficient and objective.
Responsibility for risk management and internal control systems – clarification	The board has ultimate responsibility for an organisation's risk management and internal control systems, but the board may delegate to the audit committee some functions to assist the board in meeting this responsibility.
Internal audit process	This section has been updated to reflect existing good practice, including that the internal audit plan is aligned to the key risks of the business. The audit committee should ensure the internal auditor has a reporting line that enables it to be independent of the executive and so be able to exercise independent judgement. The audit committee should ensure that the internal audit function has unrestricted scope and evaluates the effectiveness of the risk, compliance and finance functions as part of its internal audit plan. The audit committee may also wish to consider whether an independent, third party review of internal audit effectiveness and processes is appropriate.
External auditor	The audit committee should have primary responsibility for negotiating the fee and scope of the audit, initiating a tender process, influencing the appointment of an engagement partner and making formal recommendations to the board on the appointment, reappointment and removal of the auditors (reflecting the CMA Order). More emphasis is placed on interactions with the external auditor around the areas of significant judgement and risks to audit quality.
Non-audit services	Set and apply a formal policy specifying the types of non-audit service for which use of the external auditor is pre-approved. The guidance reaffirms that such approval should only be in place for matters that are clearly trivial.
Protecting shareholder interests	The audit committee has a role in ensuring that shareholder interests are properly protected in relation to financial reporting and internal control. The committee should consider the clarity of its reporting and be prepared to meet investors.
Remuneration of audit committees	Remuneration should reflect the responsibility members bear and that a significant extra amount of time needs to be committed.

Additional disclosure in audit committee reports

The Guidance on Audit Committees has introduced a number of new disclosures which reflect the changes to the Code and the new activities described above. Some of the disclosure changes are also designed to meet the needs of investors more directly and reflect the findings of the FRC's Financial Reporting Lab's project on **Reporting of Audit Committees**.

- How the audit committee composition requirements have been addressed.
- How the performance evaluation of the audit committee has been conducted.
- The current external audit partner's name and for how long the partner has held the role.
- Advance notice of any plans for retendering of the external audit.
- The committee's policy for approval of non-audit services.
- The audit fees for the statutory audit of the company's consolidated financial statements and the fees paid to the auditor and its network firms for audit related services and other non-audit services, including the ratio of audit to non-audit work.
- For each significant engagement, or category of engagements, an explanation of the services provided and why the audit committee concluded that it was in the interests of the company to purchase them from the external auditor.
- An explanation of how the committee has assessed the effectiveness of internal audit and satisfied itself that the quality, experience and expertise of the function is appropriate for the business.
- The nature and extent of interaction (if any) with the FRC's Corporate Reporting Review team.
- When a company's audit has been reviewed by the FRC's Audit Quality Review team, disclosures about significant findings and the resulting actions they and the auditors plan to take. This disclosure should not include the audit quality category awarded.

These disclosures are expected to be included in the audit committee report within the annual report and unfortunately there is no indication in the Guidance that it is acceptable to provide any of the disclosures on a website. However, the Guidance does say that the section need not repeat information disclosed elsewhere in the annual report, as long as 'signposts' are provided to the information. This will be helpful for boards seeking to keep information on matters such as the annual performance evaluation of the board and its committees in the same place.

A challenge for drafting audit committee reports will be ensuring that all of the new disclosures remain fresh each year and do not introduce too much repetitive material.

Deloitte view

Nomination committees and boards will need to determine whether the audit committee is constituted appropriately for the new requirements. Succession planning should be carried out where necessary to ensure there is sufficient depth of sector competence in the non-executive director population and succession matrices may need updating.

Audit committees should assess whether their terms of reference need to be amended for these changes. Some companies will already have updated their terms of reference earlier in 2016 and will now need to consider repeating the exercise.

Given the number of new reporting requirements, audit committees and the group company secretary need to plan ahead on meeting agendas to ensure all matters are covered and plan the new content requirements for the annual report.

It is a pity that website cross–referencing has not been encouraged for "standing data" items.

An ever increasing focus on risk, internal control and longer term viability – lessons for Year Two

Risk and the longer term viability statement – lessons for year 2


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Governance in brief
Risk, internal control and longer term viability – unlocking the value

In our governance and risk advisory practices, we have worked closely with companies implementing new risk management protocols in order to meet the requirements of the Year 1 changes. We have also held a forum for risk officers to discuss together their insights on risk appetite and the longer term viability statement following their completion of the first year of analysis and reporting.

The first year of reporting under the new regime saw a step change in the quality of discussion of risk and resilience both at the board and at management levels. Many businesses have also upgraded their risk management and analysis capabilities as they found weaknesses during the year.

There is scope for improvement for many companies coming into the second year of the 2014 Code changes. Key amongst them include:

Risk appetite:


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Risk appetite
Is your exposure where you want it?

- Do you have a consensus around the boardroom table and are you having sufficiently robust conversations?
- Is the discussion driven by the board or by management?
- Does the discussion link in to principal risks and is the risk appetite then clearly communicated to the business?
- Are you using a framework for analysing risk appetite which allows you to combine your understanding and analysis of different risks?

Modelling:

- Are you using the right forecasting model for the analysis leading to the longer term viability statement?
- Is it sufficiently flexible to be sensitised for complex scenarios or risks occuring in combination?
- If your company did not analyse risk impacts in combination last year, is that something that could be an improvement in your process for this year?
- If there were any problems, is this something that could be fixed during the year to save time at the critical points of the year?

Assurance over principal risks:

- Is internal audit fully involved in determining, monitoring and testing controls over the principal risks – and if not, why not?

Risk monitoring:

- Does the board get the information it needs, on a timely basis, in a clear and functional dashboard that allows the board to focus on the right areas and ask the right questions?
- Are there regular deep dives on principal risks of particular concern to the board?

Risk quantification:

- Was this sufficiently sophisticated in Year 1?
- Have you performed an analysis of how much risk you are able to take on, without mitigating actions?
- Is the business operating up to its risk tolerance levels or are there areas where the business takes on too much risk (or indeed where more risk could be accepted)?

Deloitte view

The work many organisations have undertaken to support the new viability statement reporting requirements has led to significant value being unlocked above and beyond being compliant with the requirements. However, many organisations got past the post with minimal efforts and so did not access value.

There remains significant further opportunity to unlock value in Year Two – boards, audit committees and risk committees should think about this carefully and schedule agendas to examine what was good and what can be improved in Year Two. For the first reporters we are already much of the way through Year Two.

The trick is to make risk and control monitoring substantive and embedded in business process, not a year end bureaucratic compliance exercise.

Responding to calls for increasing transparency of tax arrangements


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Governance in brief
The Global Tax Reset and the reporting of tax in annual accounts

Corporate taxation will see seismic change in the relatively near future. Most boards have been reviewing tax strategy in the light of public perceptions and recent changes in the law. However, the OECD changes being adopted in the UK in 2016 will change the tax landscape in a meaningful manner and will require action by many companies.

In this section we discuss:

- Transparency in reporting of taxation
- Recent changes introduced in the UK for country-by-country reporting

Transparency in reporting of taxation

Following a sustained period of public scrutiny of the taxation of large corporates, governments are acting to reframe the tax rulebook and companies are beginning to respond.

The OECD/G20's Base Erosion and Profit Shifting (BEPS) project has brought together over 60 countries over the last two years to review and refresh international tax standards. The European Union has sought to address perceived issues, such as the area of state aid, and some countries have moved unilaterally.

Companies have been adapting to this evolving environment: most will have reflected on how they manage taxes; some have been prompted to make specific changes, for example, by eliminating redundant group entities; and many are making greater disclosures in relation to their tax affairs. On this last element, our latest data indicates that 60 of the FTSE100 voluntarily disclose a reasonable level of detail regarding tax governance, with just over half doing the same for tax contribution information.

Public transparency demands

Research[1] indicates that the importance of transparency was a key area of common ground between industry and public bodies when reflecting on the responsible tax debate. This perspective appears to be reflected in a growing raft of public tax transparency requirements and expectations being imposed on companies, just at a time when they may have significant risks arising from BEPS to disclose.


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Governance in brief
Publication of your UK tax strategy

In the UK, the government has published legislation which will require all multinational businesses with UK operations and turnover in excess of €750 million, or UK registered companies, partnerships and permanent establishments with turnover in excess of £200 million or gross assets in excess of £2 billion to publish their board owned tax strategy in relation to UK taxation. Businesses are expected to follow the internal approval processes they would normally follow for public statements, including approval by the Board. Investor groups have also set out specific expectations regarding taxation disclosures.

In Europe, on 12 April 2016 the European Commission proposed measures to introduce requirements for public country by country reporting for the largest companies operating in the EU.

Broader corporate governance requirements are also contributing to the level of consideration given to tax, as discussed in our Principal risks section above.

On 1 December 2015 the FRC announced a thematic review of companies' tax reporting, aiming for its findings to help companies raise the quality of their tax reporting. The review will cover a number of FTSE 350 companies who will be notified in advance. Areas covered will include the transparency of tax reconciliation disclosures, how well the sustainability of the effective tax rate is conveyed and uncertainties relating to tax liabilities (and assets) where the value at risk in the short term is not identified. It will also go beyond the accounting disclosures to consider narrative reporting, including the disclosure of principal risks.

How are organisations responding?

Relatively little has been said publicly by UK headquartered companies in relation to BEPS. That said, one CFO of a high profile FTSE group did publicly state that the Group thought it would add "a few" basis points to their Effective Tax Rate. We anticipate that the current reporting season will see more companies reflecting on whether more needs to be said.

1 Henley Business School: What Stakeholders Expect from Corporations When It Comes to Paying Tax: Corporate Reputation and Optimal Tax Planning – March 2015

To help you gauge whether your organisation is on track we would recommend asking some or all of these questions:

Key questions boards should be asking

- What is the scale and timing of the impact of the Global Tax Reset on our Effective Tax Rate (ETR) and our Earnings Per Share (EPS)?
- Do we understand the needs/pressures of our stakeholders in respect of our EPS and other key measures?
- When do we think the impact will be sufficiently certain to trigger a requirement to communicate the impact to the markets?
- What opportunities do we have to mitigate the impact and what is our plan to act on these?
- Can we explain our position, and in such a way as to differentiate ourselves from our peers? Do we understand what high quality tax reporting looks like?
- Can our systems provide the information required by the new transparency reporting requirements?
- Do we have a documented tax strategy or policy and, if so, would we be happy to publish it today?

Update on BEPS actions – country-by-country reporting

On 26 February 2016, regulations came into force giving effect in UK law to the G20 / OECD's minimum standard for country-by-country reporting.

These rules came into force on 18 March and first apply for companies with year ends commencing on or after 1 January 2016. Companies have 12 months after their year end to finalise their reporting, so the first reports should be made available by 31 December 2017. Companies affected are large groups with turnover in excess of €750 million. The policy paper clarifies that this threshold should be translated into sterling at the average rate for the previous accounting period.

Key updates include:

- There is a new requirement for 'local filing' in the UK, affecting sub-groups headed by a UK entity. This is applicable where no Group reporting is otherwise available to HMRC – for instance, where the parent company of the Group is incorporated in a country that does not require country-by-country reporting, or where that country does not share information with HMRC.
- Groups are also able to voluntarily file a Group country-by-country report with HMRC where they would not otherwise have to do so. This could be helpful in particular for companies that have more than one UK-headed sub-group and would otherwise need to file several country-by-country reports.

Deloitte view

- There is increasing demand for better quality disclosure of uncertain tax positions and the judgements involved.
- Given the potential significance of the impact of the Global Tax Reset for multinational companies, additional disclosure of tax information is inevitable.

New reporting and codes designed to change behaviour

The Modern Slavery Act


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Governance *in brief*
Modern Slavery Act 2015

The Modern Slavery Act 2015 ("the Act") was published in March 2015, in response to heightened concern around slavery, human trafficking and forced labour in global supply chains and recognises the role that companies can play in tackling these crimes.

Relevant companies, which are commercial organisations supplying goods or services, in any sector, with a total turnover exceeding £36 million, conducting business anywhere in the UK, are required to prepare and publish a slavery and human trafficking statement for each full financial year, commencing with the year ending on or after 31 March 2016.

The Act does not specify the content and structure of the statement, the only strict requirements are that it must:

- detail all the steps taken during the financial year to ensure that slavery and human trafficking are not taking place in any of the company's supply chains or any part of the business (or make a negative statement that the organisation has taken no such steps);
- be approved by the board of directors and signed by a director (or equivalent); and
- be published on the organisation's website and include a link to the slavery and human trafficking statement in a prominent place on that website's homepage (and within 30 days to provide a copy of the slavery and human trafficking statement to anyone who makes a written request for one).

It is up to individual companies to determine the content and level of detail to disclose.

It is important to note that by making the statement the organisation is not required to guarantee that the entire supply chain and organisation is slavery free, but just to detail all the steps it has taken to ensure that no slavery or trafficking is taking place.

Although the risk resides in the supply chain, it will require central oversight given its nature and the reputational risk, and therefore we consider it should be added to the board's compliance or risk register so that the board receives appropriate regular updates.

Gender pay gap reporting


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Governance *in brief*
Gender pay gap information – draft regulations issued

Tackling the gender pay gap is a key priority for the current government. The Prime Minister has made clear the government's ambition to eliminate the gender pay gap in a generation, and the Government Equalities Office has now published draft regulations, along with its response to the 'Closing the Gap' consultation on gender pay disparity which closed in September 2015.

Employers with 250 or more relevant employees will fall within the scope of the regulations, which are expected to commence on 1 October 2016 with the first "snapshot" of information taken on 30 April 2017 for publication by April 2018. A relevant employee means someone who ordinarily works in Great Britain and whose contract is governed by UK legislation.

Employers are being asked to publish the following information for each financial year:

- the percentage difference in **mean** pay between male and female employees;
- the percentage difference in **median** pay between male and female employees;
- the percentage difference in the **average bonuses** received by male and female employees;
- the proportion of men and women who receive **bonuses**; and
- the number of men and women in each **quartile of pay** within the workforce.

The Government also expects that employers will want to provide additional narrative that provides context, explanation for pay gaps and sets out what actions will be taken. This will be strongly encouraged within the guidance accompanying the regulations.

The draft regulations and the behavioural change that the transparency will encourage are important steps in achieving greater gender parity, for pay and representation, at all levels within larger businesses. This new legislation will stimulate companies to review their reward strategies.

For many companies, this will be quite some work, and this will emphasise the importance of good data within HR and payroll systems.

The Prompt Payment Code

The Department for Business, Innovation & Skills launched the Prompt Payment Code in 2012. The over 1,700 signatories to the Code commit to pay their suppliers on time, give clear guidance to suppliers and encourage good payment practices more widely by encouraging their own supply chain to pay on time.

In March 2015, Code signatories were informed of a number of changes to strengthen the Code. In practice, the Prompt Payment Code will now promote 30 day payment terms as the norm and include a maximum 60 day payment term (defined as paying 95% of invoices within 60 days, unless there are exceptional circumstances). Signatories will also be asked to undertake to avoid any practices that are grossly unfair and adversely affect their suppliers.

In addition, the Government has passed the Small Business Enterprise and Employment Act 2015, section 3 of which allows the Secretary of State, through regulations, to impose a duty on all large companies (in effect, all quoted companies with more than 250 employees) to report on payment practices and policies. This will in due course be clarified through secondary legislation, including date of application, what disclosure will be required and any penalties for non-compliance.

Especially in times of economic uncertainty, it is important for good payment practices to be followed as slow payment hampers the cash flows of many small and medium-sized enterprises and, in the worst case, can threaten their survival. We encourage all companies to work towards compliance with the new, enhanced Code.

Audit reform

Audit reform

The relationship between audit committees and the external auditor has been subject to a great deal of regulatory focus in recent years, both nationally and internationally. Recent recommendations and changes driven by EU regulation and by perceptions of best practice in both the actions and the reporting of the audit committee will drive a further step change in the relationship, in particular when it comes to the audit committee's assessment of auditor independence and objectivity.

EU audit reform – the Revised Ethical Standard 2016

On 17 June 2016 the FRC issued the Revised Ethical Standard 2016, which applies to audits or reporting accountant engagements relating to financial years commencing on or after 17 June 2016. This gives additional clarity on the changes affecting auditor independence and which non-audit services are prohibited and restricted.

This is a principles-based standard, which nevertheless contains a lot of detailed rules. Auditors are required to consider the broad principles even if they think they have complied with all of the rules. In addition to changes relating to non-audit services detailed below, there are also changes for auditors relating to personal independence.

Most of the changes relate to EEA PIEs. A "PIE" is a public interest entity, defined in EU law as being an entity governed by Member State law with securities (debt or equity) admitted to trading on an EEA regulated market (including LSE Premium or Standard Listing, not AIM), a credit institution (bank or building society in UK terms) or insurance undertaking.

Non-audit services

The non-audit services changes introduce a number of significant changes for UK PIEs and UK groups which contain an EEA PIE, which audit committees will need to reflect in their non-audit services policies:


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Governance in brief
FRC consultation: Implementation of EU Audit Regulation and Directive, CMA Order and other changes relevant to audit committees

- The FRC has adopted the EU "blacklist" of banned non-audit services which cannot be provided to EEA PIEs by their auditors. Incorporated in the final FRC restrictions are pre-existing prohibitions under UK standards, reinforcing the UK's desire to be seen as having leading standards of independence but allowing Audit Committees a degree of flexibility within certain regulatory constraints. There are no changes to the table provided in the Appendix to our 2015 **Governance *in brief***: FRC consultation: Implementation of EU Audit Regulation and Directive, CMA Order and other changes relevant to audit committees.

- There is a "cooling in" period required in respect of designing or implementing internal control over financial information or systems and in respect of designing and implementing financial information technology systems. This applies for twelve months prior to the start of the financial year in which the auditor will provide its first audit and will require careful planning of tender processes.

- Certain tax and valuation services cannot now be provided by the auditor unless the service has no direct effect, separately or in the aggregate, on the audited financial statements, or if the effect would be inconsequential in the view of an objective, reasonable and informed third party.

There will be a challenge for groups with multiple EEA PIEs operating in different member states in applying non-audit services restrictions. This is likely to affect banking and insurance in particular. This is further complicated by member state options, which include the option to extend the definition of public interest entity, not all of which have been finalised.

70% cap

PIEs are required to apply the 70% cap on non-audit services fees, excluding non-audit services required by EU or national law, for the first financial period commencing on or after 17 June 2019 based on the 3 preceding years of audit fees.

The Ethical Standard includes two separate calculations that need to be performed, one an individual audit firm calculation, the other the audit firm network calculation.

Individual audit firm

The average of three consecutive years of audit fees paid to the individual audit firm for its audit of the EEA PIE and, where applicable, its parent and its subsidiaries, compared to fees for non-audit services paid to the individual audit firm in respect of the EEA PIE, its parent and its subsidiaries in the fourth year.

Audit firm network

The average of three consecutive years of audit fees paid to the audit firm and its entire network for audits of the EEA PIE and its subsidiaries, compared to fees for non-audit services paid to the audit firm and its entire network for non-audit services provided to the EEA PIE and its subsidiaries in the fourth year.

FRC thematic review

The FRC's Audit Quality Review team has issued four thematic reviews since December 2014. In the most recent of these, the FRC reviewed the quality control systems at nine audit firms and across 50 audits and published the results of its work in January 2016.

The thematic review acknowledges the role of the audit committee to "play an essential role in reviewing and monitoring the effectiveness of the audit process … an important contribution in building investor confidence in the quality of the external audit and ultimately the credibility of the financial statements."

Specific recommendations for audit committees relating to the audit process are:

- Audit committees may require more detail than contained in the audit firm's Transparency Report. They may consider requesting their audit firms to provide an overall annual report on their monitoring activities, providing a high level summary of areas for improvement identified and the actions they are planning to take, and discussing the matters reported with the firm.
- Audit committees may also wish to consider:
  - enquiring annually for the latest results of the firm's monitoring and whether their audit was reviewed, discussing the findings and remedial action taken to address them; and
  - asking about the scope of the review, including whether there were any UK components or whether the review was restricted to work at group level.
- Audit committees may wish to ask how the group auditor has assessed the competence of non-UK component auditors, and whether the audit team has received any feedback from the monitoring performed by network firms responsible for audit work on significant components.Where the company is undergoing a tender process, the FRC encourages audit committees to ask audit firms about their monitoring activities and discuss the matters arising with each firm.

The Competition and Markets Authority Order

There are two reporting requirements relating to The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 issued by the Competition and Markets Authority ("the CMA Order"), which should be included in the audit committee report for years commencing on or after 1 January 2015. Both apply to companies that are constituents of the FTSE 350 index at the reporting date and do not apply to smaller companies:

- The statement of compliance with the CMA Order should be made by all companies.
- For companies that have not conducted a competitive audit tender for five years, there is also a requirement to disclose the next year that a competitive audit tender will be conducted and the reasons that is in the best interests of the company's members. This reflects the CMA's view that companies would benefit by conducting a competitive audit tender every five years under normal circumstances.

In order to provide the compliance statement, it is worth remembering that the CMA Order is not only about a requirement to tender every ten years. The update to audit committee responsibilities is also relevant, notably the role of the audit committee in supervising and agreeing the scope of the audit. The Order also provides that audit committees must authorise provision of any non-audit services by the statutory auditor, although it allows for the pre-approval of permitted non-audit services with materiality thresholds set based on the value of the services.

The auditor can be used to monitor these requirements as under Article 7.2 of the CMA Order, if requested by the CMA they must provide details of these statements together with the financial year of the last competitive tender process within 15 days.

The reporting requirements have not been picked up by all companies. We examined 25 FTSE 350 companies with December 2015 year ends to assess their level of compliance. Only 15 of those companies make a statement that could be read as a statement of compliance with the CMA Order. Two companies also make a statement about their plans for a competitive audit tender, although without clear reasons why that is in the best interests of the company's members.

Deloitte view

Audit committees may need to refresh their non-audit services policy in light of these new requirements.

Audit committees should consider carefully which non-audit services are being provided by which audit firms in advance of planning a tender for the external audit. The prohibitions and the 12-month "cooling-in" period for certain non-audit services could otherwise lead to restrictions of choice or potential delay in changing external auditor.

With regard to the 70% cap, it is not always totally clear what services fall within the exemption for services required by EU or national law. It is worth bearing in mind that simply because work may be advised or required by an industry regulator does not mean it is pursuant to legislation – it will depend whether the industry regulator has statutory rights to require the work. Early discussion with the auditor is recommended for such services in order to avoid potential problems.

Although the compliance disclosure required by the CMA Order is largely boilerplate, it is a legal requirement and we encourage all FTSE 350 companies to include a short statement. The more challenging disclosure is where a competitive audit tender has not been conducted within five financial years. In those cases, the audit committee might need a robust discussion about why the year they have planned for the next tender is in the best interests of the company's members.

Audit committees and audit firms are on a journey together with the same goal: to improve audit quality. Audit partners should welcome additional interest from audit committees in their firm's quality monitoring process and we expect robust and transparent discussions to be initiated by the best audit committees.

Further resources

Throughout this publication we have mentioned some of our other publications where they offer a deeper dive on the governance topics of interest, or where we believe they can add insight to your role as an audit committee member. We have also created checklists to assist you in discussing these matters with your companies.

This section pulls together those additional resources with a brief introduction to each of them, so they are easier to refer to.

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

Governance *in Focus*

In this Governance *in focus* we reviewed the topics we believed audit committees needed to focus on in the 2015 reporting season, including engaging with the changes in risk management and internal control required by the 2014 updates to the UK Corporate Governance Code, the key decision points for the first longer term viability statements, tips on effective audit committee reporting and a round-up of emerging governance themes for 2016.

Governance *in Brief*

Our Governance *in brief* *The vote to leave – key considerations for half year reporting* explores the key reporting considerations for directors arising from the vote to leave the EU. For further information on the EU Referendum results, we have a dedicated webpage: www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-governance-in-brief-vote-to-leave.pdf.

EU Privacy Legislation explores the recent issues with transfer of data between the EU and the US and the existing solutions, the EU General Data Protection Regulation (GDPR) which is set to be enforced from 25 May 2018, and includes a series of questions to consider when determining how well prepared your organisation is for the upcoming changes.

FRC issues 2016 UK Corporate Governance Code, Guidance on audit committees and changes to auditor independence rules identifies and explores key changes arising from the FRC's 2016 updates to the UK Corporate Governance Code, the Guidance on Audit Committees and to standards for auditors. We highlight areas for directors to consider when approaching their first year of reporting under the 2016 UK Corporate Governance Code.

Risk, internal control and longer-term viability – unlocking the value identifies and explores some of the benefits we have seen for companies from implementing the new longer term viability statement, providing companies with areas to consider in order to ensure they are deriving the most value from this exercise as they approach their second year of reporting under the new requirements.

Risk, internal control and longer-term viability – how companies have tackled the new Code provisions surveys the risk management, internal control and longer term viability statement disclosures for 50 companies who were among the first to report under the new regime introduced by the 2014 UK Corporate Governance Code, including some of the largest December year end companies.

Publication of your UK tax strategy covers the recommendations from the recently published HMRC draft guidance on areas to consider when drafting the UK tax strategy, together with questions for audit committees to consider relating to tax strategy and planned reporting.

The Investment Association looks to boost UK productivity through enhanced investor engagement discusses the key elements of a framework for how investors can contribute to productivity improvements with long-term investment through the use of five investor productivity principles.

Gender pay gap information – draft regulations issued explores the draft regulations issued to tackle the gender pay gap. The Prime Minister has made clear the government's ambition to eliminate the gender pay gap in a generation, and the Government Equalities Office has now published draft regulations. Employers with 250 or more relevant employees are being asked to publish detailed gender pay information on their website for each financial year. The government intends to lay the regulations before the parliament over the summer.

Modern Slavery Act 2015 explores the background to the Modern Slavery Act 2015, the reporting requirements, including which companies must comply, and suggests some areas for organisations to consider when preparing to issue their first modern slavery and human trafficking statement, including adding the requirements to the board's central compliance register or risk register.

The Global Tax Reset and the reporting of tax in annual accounts explores the main issues that companies are addressing with regard to the reporting of tax in annual accounts, explains the drivers of change and introduces the process that companies are going through in order to respond to these external demands. We also include some key questions that Boards should be asking regarding tax transparency.

Is your organisation prepared for a cyber attack? sets out some key considerations for boards and audit committees when tackling cyber risk. The volume and sophistication of cyber attacks continues to increase and many organisations have not taken steps to protect themselves adequately against the attacks or to respond effectively when they do suffer an attack.

Other governance and accounting publications

Corporate Governance Disclosure Checklist: for periods commencing on or after 1 October 2014 is our detailed checklist used regularly by audit committee members, company secretaries and others. It sets out the key disclosure requirements under the Listing Rules, the 2014 UK Corporate Governance Code, the 2012 Guidance on Audit Committees, the Disclosure & Transparency Rules regarding corporate governance statements and audit committees (DTR 7) and the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

Other recommended publications

Risk appetite: Is your disclosure where you want it? presents a pragmatic, multi-stage approach to risk management and determining risk appetite, outlining the key content for each stage and concluding with a range of key questions for boards to consider.

Reputation matters: Developing reputational resilience ahead of your crisis identifies two fundamentals in building reputational resilience – identification of risks from an outside in perspective, and being prepared for a crisis through a robust crisis readiness programme. Looking ahead, it will be the organisations that understand, protect and develop their reputation asset that will be best placed to maintain shareholder value.

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The Deloitte Academy

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

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

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

Notes

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