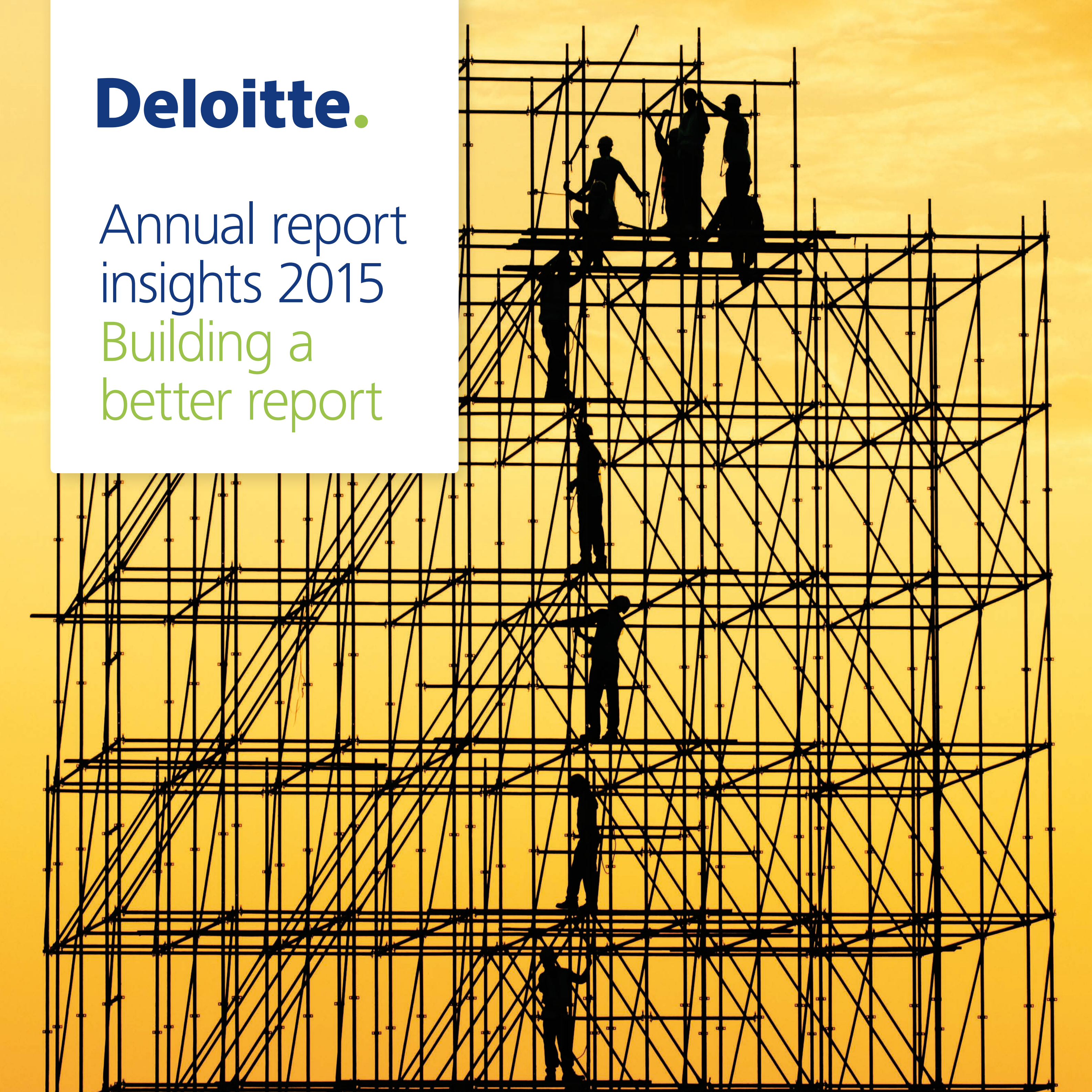
Deloitte.

Annual report insights 2015

Building a better report



Key

Best practice

Cross-reference

More infomation

Contents

Executive summary

was the average report length

Survey of Annual Reports

Overview

Deloitte has been surveying annual reports for over ten years. And while the building blocks of annual reports have grown in number over that time, they have also become ever more sophisticated and varied. Back in 2006 the average report was a mere 85 pages long. Now the average report is over 50% longer, due to the increasing complexity of regulations. Efforts and initiatives, not least those of the Financial Reporting Council to make reports ever more clear and concise, continue. But we live in a complicated world and it is the task of this survey to make sense of it and provide timely and useful guidance.

Each year we survey a sample of 100 LSE premium listed companies, selected to be as representative of the entire market as possible. The purpose of this survey is simple. Our aim is to provide a clear view of how annual reporting is evolving and unfolding. We look at how things have changed and show how companies have dealt with the new challenges. We highlight innovation and link it to broader discussions in the reporting world. We identify the areas where improvement may be needed and provide examples of good practice to show the way forward and ease future change. In short, our survey opens up the world of annual reporting and enables the depth of understanding that people need.

Here are some of our key findings.

Length of reports

One measurement of how successful the FRC's drive to make annual reports clear and concise has been is a simple one – the length of reports. And this year, once again, the average length of the reports we surveyed, inexorably, still moved up. It wasn't a huge jump, but an increase of three pages up to a total of 135 shows that the size of reports is still creeping in the wrong direction and over time these changes add up. When we conducted our first survey of IFRS annual reports back in 2006, the average length of a report was just 85 pages. The increase since then is driven by new and revised regulations. But it is clear that companies are making a real effort to keep the increase to a minimum. Indeed, on average, their financial statements were two pages shorter this year. Though that was offset by an increase in the average length of the narrative reports of five pages.

Linkage

Linkage remains a weak link. The level of linkage shown in annual reports has largely remained the same as recent years. Worryingly, only 10% of companies demonstrated comprehensively how all of the various elements of the report linked together, not just through providing cross references between them, but also by providing clear evidence of a coherent thought process showing the process by which the information had been pulled together. This is another of the FRC's campaigns. Their 'Guidance on the Strategic Report' sets out ideas for how companies can effectively demonstrate this kind of linkage.

Integrated reporting

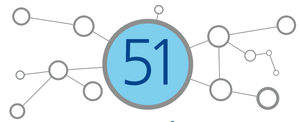
Integrated reporting (‘<IR>’) is not mandatory in the UK but many investors are calling on companies to adopt its principles in preparing their annual reports. Our survey shows that seven of the companies in our sample made an explicit reference to <IR>. There is, of course, a significant crossover between the suggestions for effective reporting in the <IR> Framework and what is seen as best practice in complying with the existing requirements for the content of a strategic report. For example, some 51 companies included a clear reference to relationships or resources used as inputs or outputs, what <IR> terminology would call ‘capitals’, within the description of their business model. So companies with good strategic reports often look as if they are some way along the path to an <IR>-style report. But, of course, a truly integrated report is an output of integrated thinking. In particular, the linkage in it comes naturally - it flows from the integration of business processes and behaviours.

Alternative Performance Measures

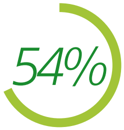
Alternative Performance Measures, or non-GAAP measures as they are also known, have always been a regulatory focus. Our survey shows that the use of non-GAAP measures by companies continued to be almost ubiquitous, with 81% of companies highlighting them to investors as part of the summary section of the report, while some 54% presented them more prominently than the associated GAAP measures. So, quite clearly, companies view non-GAAP measures as essential to tell their story. But there are a couple of things that they should bear in mind when doing this.

- A recent survey of investment professionals, by CFA UK, showed that only 40% of respondents said they trusted the non-GAAP measures presented in company reports as much or more than the IFRS-compliant numbers.

- ESMA’s recently published ‘Guidelines on Alternative Performance Measures’ require both that the closest comparable IFRS measures be presented for each APM used and that APMs are not presented more prominently than IFRS measures. On top of this the guidelines will also require companies to reconcile all APMs to the financial statements. Our survey shows that a significant proportion of companies do not do this at the moment. Some 42% of the companies using non-GAAP measures as KPIs did not provide enough information to reconcile the measures to the financial statements. But on a note of encouragement companies are moving in the right direction. Last year’s comparable figure was 64%.



companies give information on relationships and resources in their description of the business model



gave non-GAAP measures more prominence than the associated GAAP measures

20%
of companies explained their board succession plan

76%
provided a meaningful explanation for any non-compliance with the Code

Readiness for the 2014 Code

As companies gear up to prepare reports for September 2015 or later, they need to take the requirements of the 2014 version of the UK Corporate Governance Code into account. So we surveyed what companies were saying about how they would comply. The new Code will affect the whole of the front half of the report, with new requirements expanding the disclosures around principal risks, introducing the new longer-term viability statement, and further requirements for remuneration and governance reports. What we found was that 52% of the companies surveyed referred to the changes that would be necessary to adopt the 2014 Code, but only a handful had early adopted any of the new provisions. One company noted that they had done so in relation to the new requirements around directors' remuneration. Another included a viability statement. And two companies specifically discussed how the directors had made a robust assessment of the risks facing them.

Compliance with the 2012 Code

It is harder to judge the level of compliance with the existing Code given the nature of its 'comply or explain' basis. But our survey showed that full compliance had fallen from 57% to 51% this year. But on a more positive note, 76% of those companies that did not fully comply provided a meaningful explanation for their non-compliance with the Code. Similarly, 57% made it clear that this non-compliance was temporary. Most of them explained that non-compliance with the Code had arisen from current circumstances rather than a decision that compliance with certain of the provisions was inappropriate for the company.

Audit committee reporting

Our survey suggests that most companies could still improve their audit committee reporting. Only 23% of companies included comprehensive descriptions of the significant financial reporting issues considered by the committee. This was, admittedly, an increase on last year's figure of 16%. But only 9% gave detailed insights into how they had assessed the effectiveness of the external audit process.

Board diversity

As we all know the issue of board diversity continues to be high on the news agenda. Our survey reports that the average number of female directors on the Boards of the FTSE 100 companies in our sample rose to 24%, up from 21% last year. But only 22% of FTSE 100 companies claimed to have met Lord Davies' recommended target that a quarter of Board members should be female by 2015, and only 13% of the FTSE 250 companies surveyed provided a target for the proportion of women on the Board, though both of these percentages were up on last year. References to other aspects of diversity, like experience, nationality, disability and age, were up from 52% to 63%.

Succession planning

Our survey shows that currently some 80% of companies do not provide a clear explanation of their succession plans. This year the FRC has made it clear that it sees Board succession planning as an issue it wants to concentrate on. A project on this is under way and a report and recommendations will be published. Another area of focus for the FRC is corporate culture. Only 15% of companies in our survey provided a meaningful discussion of the Board's responsibilities in this area, and only one referred to assurance activities having been undertaken in respect to corporate culture. This is another area that would repay early thinking and effort.

Implementing IFRSs 10, 11 and 12

The biggest and most significant change in financial statement requirements this year was the introduction of what became known as the 'package of five' new consolidation standards. For most companies this didn't have a large impact. The survey shows that only two companies reported that the adoption of IFRS 10 has had an impact on the scope of their consolidation. Some 42 companies reported they had to assess the impact of adopting IFRS 11 on their joint arrangements. But for most companies it didn't result in a change in the accounting treatment. Only five companies reported that they had joint arrangements that were classified as joint operations rather than joint ventures. And a few companies had to apply equity accounting to their joint ventures instead of proportional consolidation. Only twelve companies included specific disclosures about judgements that had been made when classifying interests in other entities, as is now required by IFRS 12.

New UK GAAP readiness

Looking ahead, 2015 is the year when new UK GAAP comes into force. The 51 companies in the survey sample that currently use old UK GAAP to prepare their parent company-only financial statements will need to select and apply either full IFRSs, FRS 101 or FRS 102 instead. The most attractive option is likely to be FRS 101 but to be able to apply it a company has to have notified its shareholders in writing that it intends to do so. And only twelve of the companies in our survey gave notice of such an intention in their current year report.

How to improve your report

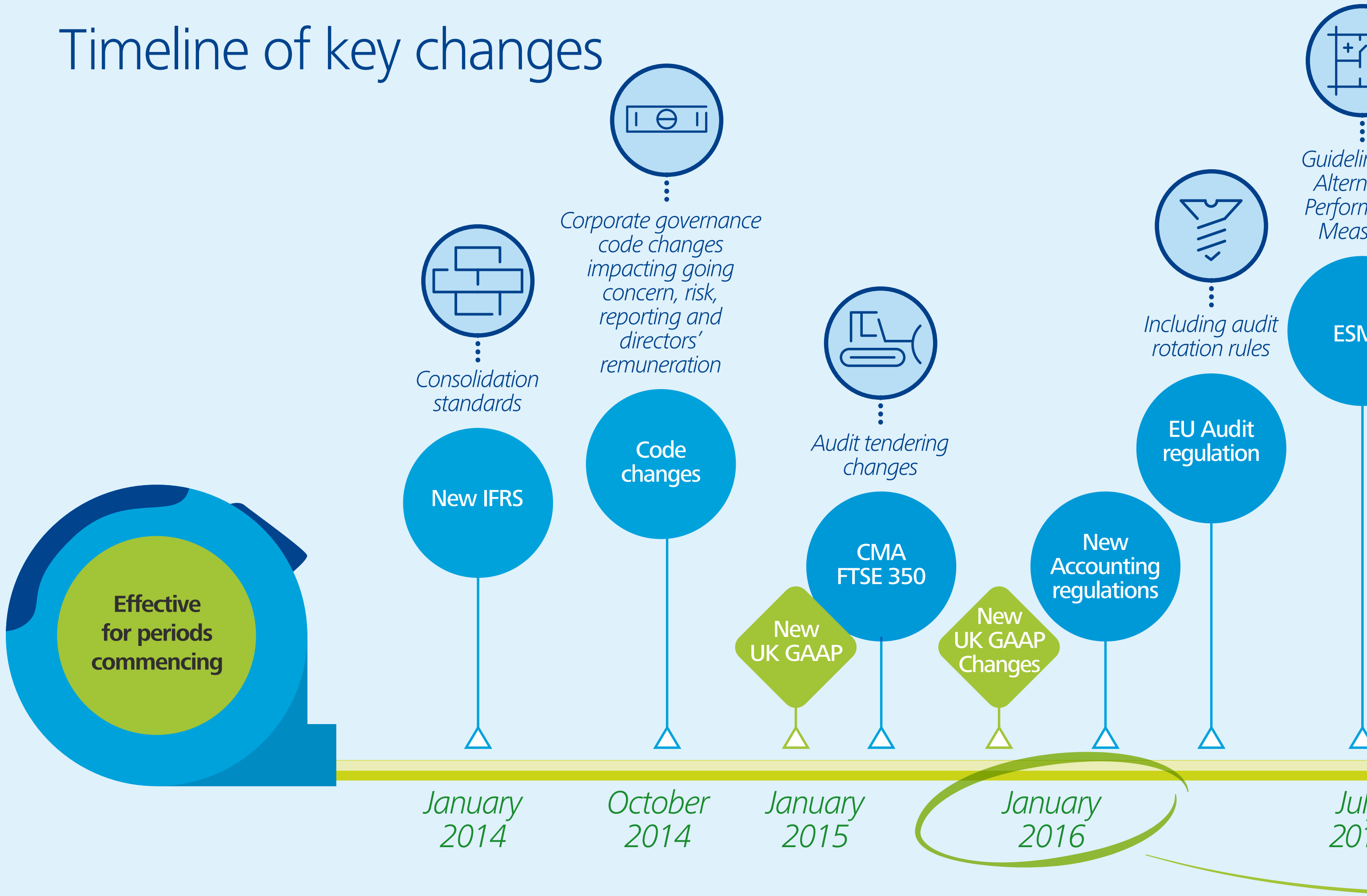
Companies looking to improve their annual reports should consider the following.

- The Financial Reporting Lab has recently issued several reports on how companies can make their financial statements clearer and more concise.
- Investors are demanding more information on areas such as the level of reserves available for distribution. 40 companies in our survey included some disclosure of this.
- The FRC's conduct committee keeps an eye on the quality of financial statements. Building solid foundations in this booklet, and chapter three of our full survey, the Reporting Landscape, highlight some of the areas where companies often make mistakes.

40%
provide information about distributable profits

Changes that will influence the build of your corporate reporting and the steps you can be taking now

Timeline of key changes



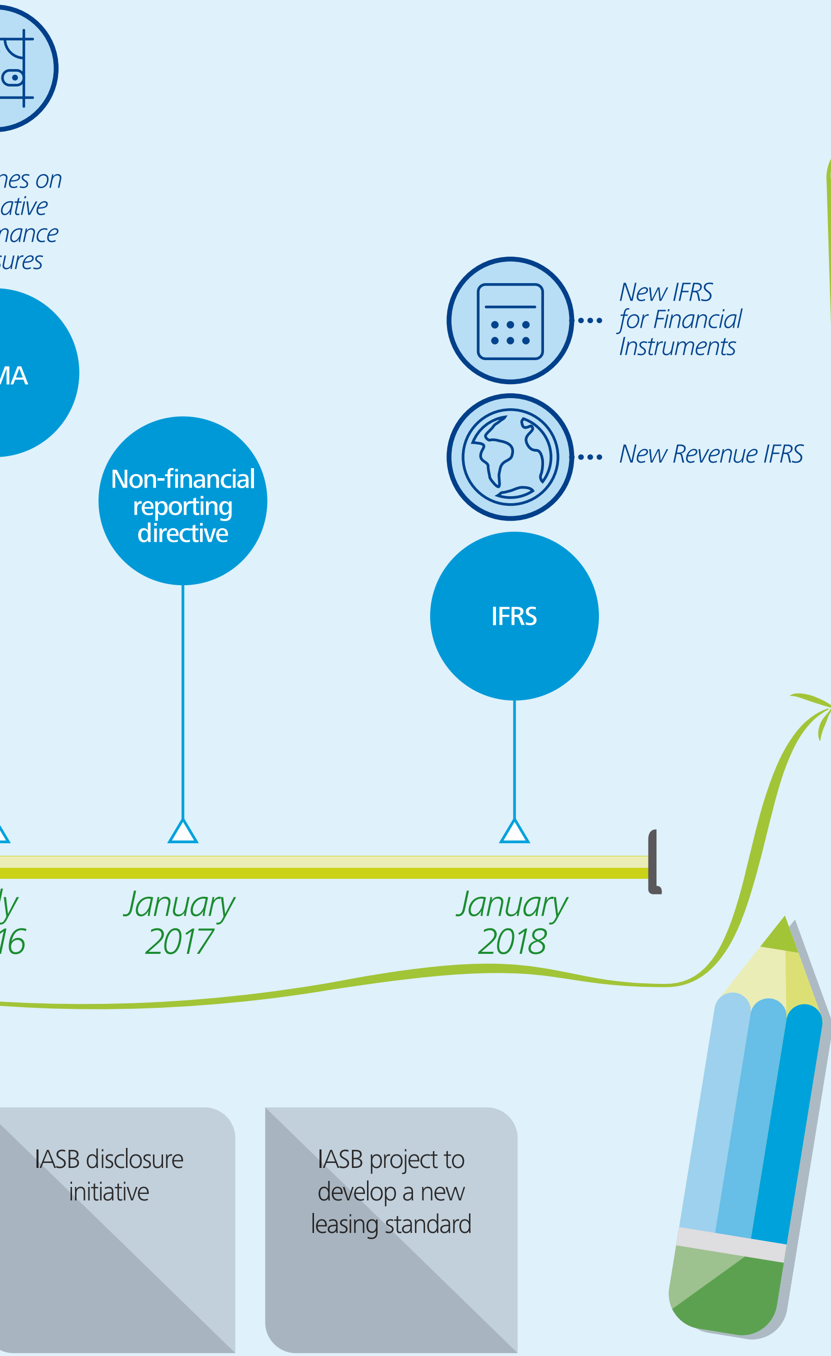
Ongoing initiatives

FRC's 'Clear & Concise' initiative and 'Smaller listed and AIM company reporting' project

IASB conceptual framework and FRC/European contribution to 'Getting a Better Framework'

IIRC's International <IR> Framework

Financial Reporting Lab projects on business models, dividend policy and digital reporting



Your 2016 plan (for December reporters)

October 2015

By mid October

- *Planning meeting of contributors to agree responsibilities, process governance (including process to assess FBU) and overall framework for report*

See 'What to discuss at the planning meeting' page 9

November 2015

Early to mid November

- *Contributors draft templates for their areas of responsibility*
- *Draft report amalgamated and reviewed for duplication Areas of linkage identified and highlighted in the draft report*

Late November/early December

- *Auditors review the draft report and provide comments*

Particular focus on the application of materiality to audited information

December 2015

By mid December

- *Disclosure Committee (or equivalent) approve overall structure and technical compliance of the report*

January 2016

- *Draft report presented to the Audit Committee for comments*

By late January/early February

- *Report sections updated for final messages based on year-end results*

February 2016

By late February

- *Audit Committee focus on 'fair, balanced and understandable' assessment*
- *Remuneration report presented to remuneration committee for review and approval*
- *Owners of each section formally present their area of the report*

By late February/March

- *Final report presented to Audit Committee, Remuneration Committee and Board for approval*

The preparation process

When implementing the recommendations set out in this document, it is important to be working to an appropriate timetable. Getting as much as possible done in advance of the year-end, when there is less pressure on the timetable, reduces the burden during your post year-end reporting cycle. We have set out on the left, a useful timeline for your annual report preparation process, based on a December 2015 year-end.

What to discuss at the planning meeting

- *Consider how you will ensure that the foundations, structure and finish of your annual report tick the regulatory boxes and effectively convey strategically important information to shareholders*
- *Agree the key messages and themes, as far as they can be agreed at this stage, to flow throughout the report including getting Board buy-in as necessary*
- *Discuss and agree how materiality will be applied*
- *Meet with the design team to discuss the key messages and themes and investigate how these can be brought to life through design*
- Plan how you will avoid the 'silo effect':
  - *Arrange for regular communication between all those involved*
  - *Create a storyboard straw man identifying all elements to be included in the front half at the beginning of the process*
  - *Identify the links to be made in the report*
  - *Identify who will do a 'cold read' of the report to assess duplication, conciseness and clarity of message, as well as ensuring that the report is fair, balanced and understandable*

Building for success
Preparing for your 2015/2016 annual reporting cycle

Understanding where you stand and what you can do to enhance your annual report to best meet the needs of your company, industry regulators, investors and the wider public needs is a common challenge. This document helps, by highlighting the findings from our research of 100 UK listed companies' annual reports to provide accurate and timely insight along with real life examples to help you optimise your annual reporting cycle.

Our framework for benchmarking your annual report is broken down into four levels for simplicity:

Building solid foundations

Making your structure watertight

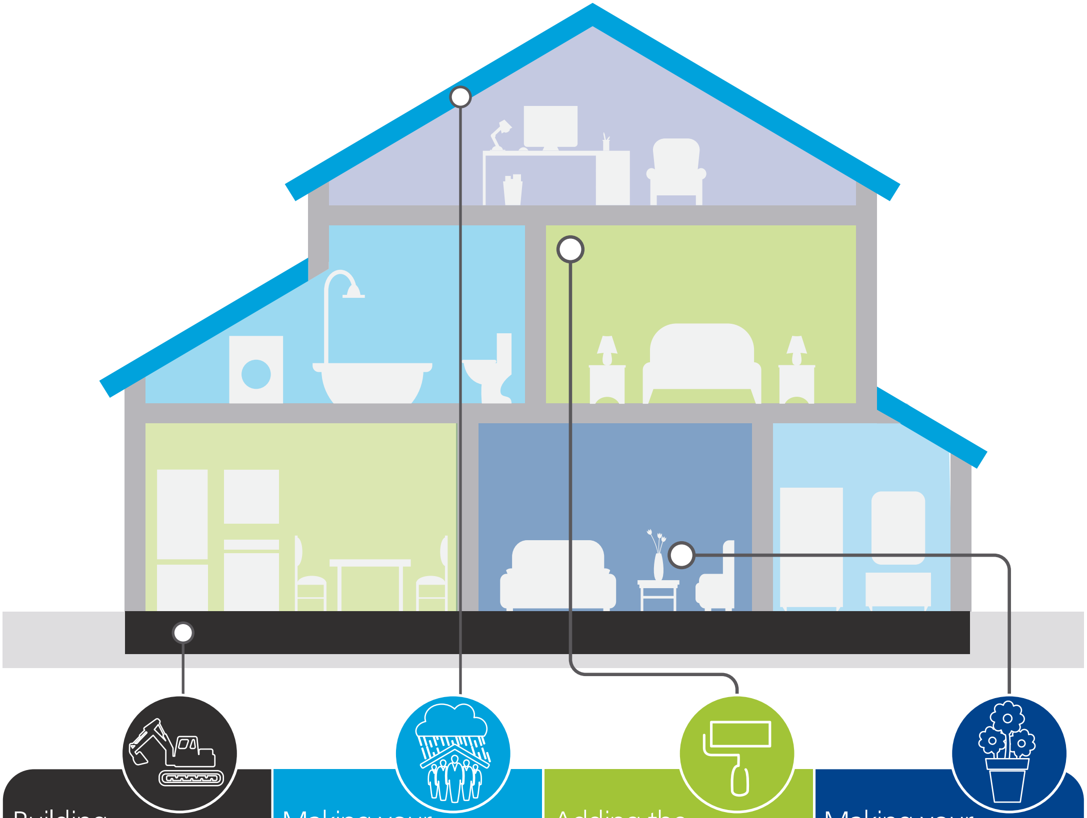
Adding the finishing touches

Making your house a home

Throughout this document we have included references to UK Accounting Plus, Deloitte's one-stop-shop for all accounting, governance and regulatory matters where you can learn more about the developments.

You will also find links to good examples of how UK companies have recently addressed these topics in their real life annual reporting.

Each level is tailored to reflect the differing appetites as to how far preparers would want to go in improving their annual reports, from simply ensuring regulatory compliance, to becoming an early adopter of new requirements. We end by asking you a question, "Are you living your story or are you merely telling it?" By considering the principles of integrated thinking, we believe <Integrated Reporting> has the clearest potential yet to help you enhance the value of your annual report in telling your company's true story.



Building solid foundations

The foundations of a good report are compliance with the rules. Reporters need to consider addressing new requirements and the key areas of regulatory challenge. Getting it right helps to deliver real benefit across your organisation, helping to attract new investment and encourage dialogue with existing shareholders.

Making your structure watertight

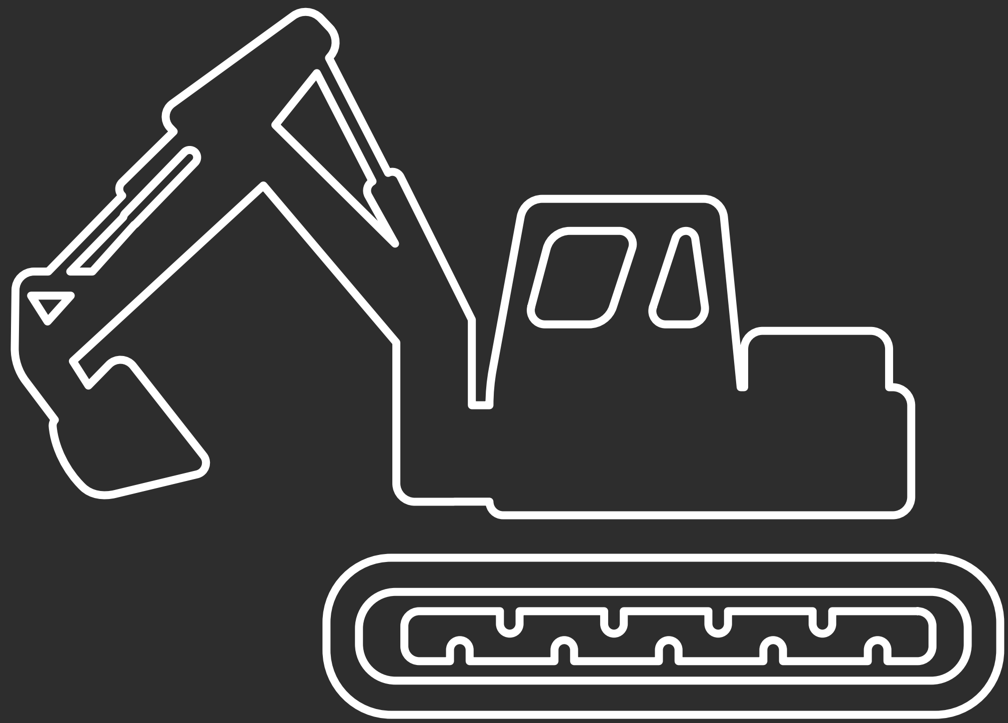
With the basic foundations to comply with the rules in place, you have a structure to communicate effectively your company's messaging and strategy. You know your report is watertight when you are able to deliver a clearer and more concise report.

Adding the finishing touches

Going that bit further provides the opportunity to respond to calls from investors, deliver deeper insight for stakeholders and even look to become an early adopter of new and emerging requirements. Taking a number of well-designed steps can help to shift your report into the top tier.

Making your house a home

Are you living your story or are you merely telling it? Many UK companies and investors are talking about integrated reporting, or <IR>. A truly integrated report is the output of integrated thinking within an organisation. In particular, the linkage in it comes naturally – it flows from the integration of business processes and behaviours.



Building solid foundations

This year is no different to any other, with a number of new reporting requirements to address. However, for some companies the existing foundations are a little shaky in places. In this section we look at the elementary factors that every annual report needs to consider. We begin by identifying the areas where we anticipate stronger regulator focus before identifying the changes that you will need to make to deal with this year's new requirements.

Regulatory scrutiny

A regulator can, and will, look at anything they see fit, but experience shows that there are some key areas where regulators commonly challenge whether companies have complied with reporting requirements.

For ease of navigation we have broken this section into a number of broad areas of focus: cohesiveness of the report, issues surrounding narrative reporting and corporate governance and challenging areas within financial statements. There are quite a few areas that regulators are focusing on so cast your eye down the list and see which might be relevant to you. Don't get caught out!

1. Cohesiveness of the report

Fair balanced and understandable

Is the annual report, taken as a whole, fair, balanced and understandable? This includes balancing analyses that use non-GAAP measures with analyses that use unadjusted metrics and ensuring discussions of performance and position are suitably comprehensive and not omitting 'bad news'. **The European Securities and Markets Authorities (ESMA)'s** Guidelines on Alternative Performance Measures, which are anticipated to become mandatory from July 2016, will clarify the requirements. As well as the prominence given to non-GAAP measures in narrative reports, other topics covered include the need for reconciliations between non-GAAP measures and the financial statements.

81% used non-GAAP measures (2014: 73%)

54% of these gave more prominence to non-GAAP measures than the associated measure (2014: 63%)

36% reconciled some or all non-GAAP KPIs to the financial statements

Persimmon plc and BT Group Plc

Consistency of information

Is there *consistency* of information reported across the 'front half' and the 'back half' of the annual report?

For example, is there consistency between adjusted measures presented prominently in the narrative, those presented in the income statement, those in the **IFRS 8** segmental disclosures and the metrics identified as key performance indicators (KPIs)?

Of the companies in our sample that presented adjusted performance measures in the summary section of their report, **27%** of these differed to the measures reported internally and included in the IFRS 8 segmental disclosure.

See further detail about the importance of linkage and connectivity in section 4 of Building a watertight structure.

Level of disclosure

The Financial Reporting Council (FRC) has identified poor explanations of performance and limited references to exceptional items as two key areas where smaller quoted companies are struggling.

Of those companies with significant restructuring costs, impairment charges or exceptional items - smaller companies seemed to be a little better at discussing these 'prominently' in the narrative section of their reports. **86%** did compared to only 75% of the FTSE 350 companies.

2. Narrative reporting and corporate governance

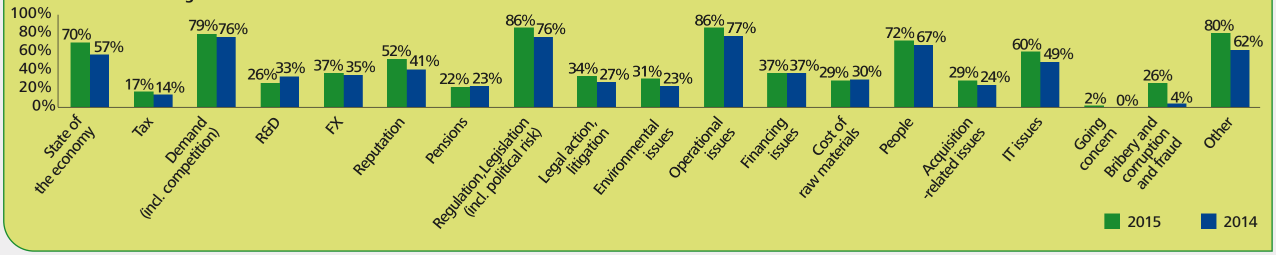
Principal risks and uncertainties

Are all the risks 'principal' risks? Do they keep the board awake at night? Companies need to focus on this given the changes introduced by the 2014 Code. Are the mitigating actions undertaken explained? This seems to primarily be a problem for smaller companies.

Four companies also chose to present an additional section of 'other' risks – it could be questioned whether this is really within the spirit of the requirements.

Average no. of principal risks 9

What are the main categories of risk disclosed?



For additional information on disclosing principal risks and uncertainties, see chapter 9 of **The reporting landscape**

Consistency of significant issues

Are there significant discrepancies between the significant issues discussed by the audit committee, the risks discussed by the auditor and the critical judgements and key sources of estimation uncertainty in the financial statements?

Regulators are likely to challenge this if there is no clear reason why this is the case.

48 audit committees discussed significant issues that were not disclosed as risks by the auditor (2014: 43)

The most common of these were:

- going concern **12**
- identification and disclosure of exceptional or non-recurring items **10**
- provisions for a variety of exposures **10**

Quality of explanation

Have you provided a meaningful explanation for any non-compliance with the Code?

Of companies which did not comply fully with the Code:

76% provided a meaningful explanation of this (2014: 60%)

67% failed to provide a description of how the company remains compliant with the overriding Code principle, or how any resulting risks have been mitigated

Johnson Matthey plc, Mothercare plc and Bodycote plc

Audit tendering

What information is given on auditor rotation? Bear in mind the new EU rules on auditor rotation in the process of being implemented in the UK.

85% gave Information on the tenure of the incumbent auditor

48% indicated when an audit tender would take place

Audit Committee Report detail

Is the level of detail given in the audit committee report, including the required disclosures on significant financial reporting issues considered by the committee, the effectiveness of the external audit and safeguards on non-audit services appropriate?

Average number of significant financial reporting issues discussed in the Audit Committee report **4**

Only **22%** gave comprehensive disclosures of the financial reporting issues

Only **9%** gave a comprehensive explanation of how the effectiveness of the external audit process had been assessed

Marks and Spencer Group plc, The Weir Group plc and Halma plc

3. Financial statements

Exceptional Items

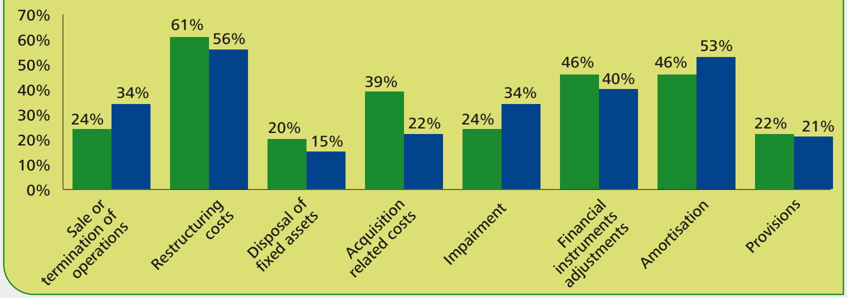
Have you given a detailed explanation of why any items are identified as 'exceptional'?

This might include the objective and criteria for stripping out certain items as well as information regarding their comparability and relationship with the IFRS figures.

Various issues in relation to the identification of items as exceptional have been highlighted by the FRC so it is one to watch out for.

Only **49%** of those that presented non-GAAP measures (such as 'profit before exceptional items'), gave a detailed explanation

What do non-GAAP measures strip out?



Disclosure of accounting policies

Are the accounting policies specifically tailored to the current circumstances of the business and not just regurgitating the requirements of IFRSs, particularly in relation to revenue recognition?

Depending on the nature of the business, such a disclosure need not be enormously lengthy.

Has meaningful disclosure regarding the expected impact of IFRS 15 *Revenue from Contracts with Customers* on your financial statements been given? The FRC is expecting companies to do this.

49% gave a detailed, company-specific summary of their accounting policy for revenue recognition

Only one company gave detail about the impact that IFRS 15 would have.

35% simply stated that the impact had not yet been assessed

The Cardiff Property plc

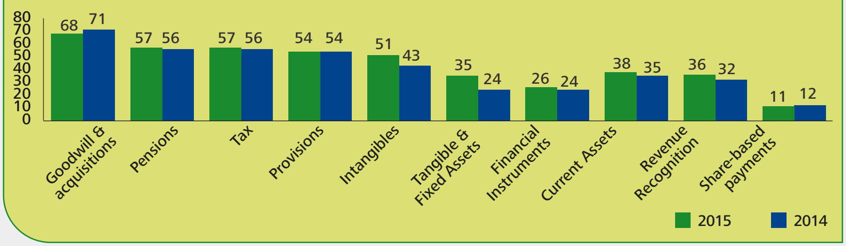
Clarity and completeness of critical judgements

Does the disclosure of critical judgements explain the judgement made and its application, rather than just repeating the company's accounting policy?

Is there a clear distinction made between critical judgements and key sources of estimation uncertainty, even where they relate to the same item?

70% combined the disclosure of critical judgements and key sources of estimation uncertainty into a single undifferentiated list

How many companies include the following items as critical judgements or key sources of estimation uncertainty?



Skyepharma PLC

Disclosures regarding the application of IFRS 10 *Consolidated Financial Statements*

Has disclosure around adoption of IFRS 10 been made, where relevant? And the disclosure requirements of the complementary IFRS 12 Disclosure of Interests in Other Entities? In particular, the FRC is focussing on the impact of the guidance on de facto control, where one entity is able to control another despite holding less than 50% of the voting rights.

Only two noted that the adoption of IFRS 10 had changed the scope of their consolidation

12 included disclosure about significant judgements that had been made when classifying interests in other entities

EVRAZ plc

Correct accounting for business combinations

Have any business combinations been accounted for correctly?

Has the acquirer for accounting purposes been correctly identified? Care should be taken, particularly when entities of a similar size are brought together in a business combination. This will not always be the legal acquirer.

Has sufficient diligence been exercised in identifying intangible assets acquired in a business combination, rather than just assuming that any excess paid above the fair value of previously recognised assets of the acquiree represents goodwill?

Should any contingent payments be accounted for as remuneration expenses?

Have you clearly disclosed what gave rise to the goodwill recognised on a business combination? Don't leave shareholders guessing as to why the company paid a premium for the acquisition.

The value of intangible assets recognised, excluding goodwill, was, on average, **42%** of the total difference between the consideration paid and the fair value of previously recognised assets of the acquiree

16% of companies recognising goodwill on an acquisition did not clearly disclose what gave rise to goodwill (2014: 10%)

Calculation and disclosure related to impairment reviews

Have any impairment reviews been done correctly and all disclosures been made?

This is an area where regulators have noticed improvements in recent years and our survey also indicated this is the case.

Are all key assumptions fully described and how values assigned to them been explained?

Are the assumptions regarding the turnaround of a loss-making business realistic?

Have sensitivity disclosures been included which are clear in setting out the situations in which impairments could arise?

Is there consistency between assumptions made in goodwill impairment calculations and others such as going concern forecasts or deferred tax calculations?

Of those with goodwill on their balance sheet:

89% disclosed the cash-generating units with significant goodwill balances allocated to them

77% used different discount rates for their different cash generating units

Creston plc

Fair value disclosures

Focusing on IFRS 13 *Fair Value Measurement* disclosures for items in level 3 of the fair value hierarchy it can be easy to miss new or revised requirements during the process of rolling them forward from year to year. Along with employee benefits disclosures (average: 5 pages), financial instruments disclosures (average: 6 pages) are some of the most voluminous in a set of financial statements.

Tax accounting

Are there any unexpected, unexplained or inconsistent items presented in tax reconciliations?

Cash flow statements

Are any items misclassified?

Have any cash flows been netted inappropriately?

Are any non-cash movements reported as cash flows?

Disclosure issues relating to intangible assets

Where there are material intangible assets has adequate disclosure been given to comply with IAS 38 *Intangible Assets?*

Accounting issues relating to pension schemes, primarily defined benefit schemes

If there is a surplus, has IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* been applied correctly?

66 companies had defined benefit pension schemes

14 recognised a surplus as an asset

3 disclosed that the recognition of a plan surplus as an asset was restricted by IFRIC 14's requirements *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Capital management disclosures

Do the disclosures on capital management reflect company-specific circumstances?

They are often boilerplate.

In our view, **56** did not give a full, company specific picture of their policies and processes for managing capital

Although not required, **52%** talked about capital management in their narrative report

The Unite Group plc

4. New requirements

The 2014 UK Corporate Governance Code ('the 2014 Code') is a significant new requirement and is effective for periods commencing on or after 1 October 2014.

To help in applying the new Code, the FRC has issued supporting guidance:

Guidance on Risk Management, Internal Control and Related Financial and Business Reporting,

Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting.

Many of the companies we surveyed were already looking ahead to these changes

52% made reference to the 2014 Code in their report

A. Going Concern and longer term viability statement

Directors need to include two statements regarding the health and financial stability of the business, replacing the single statement on going concern:

1. A statement whether the directors consider it appropriate to adopt the going concern basis of accounting, along with any material uncertainties identified in assessing the company's ability to continue to do so. As at present, this is expected to cover a period of at least twelve months from the date of approval of the financial statements.
2. A new statement, commonly referred to as the 'longer term viability statement', confirming that, taking account of the company's current position and principal risks, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over a period of the board's choosing. The statement will also have to draw attention to any qualifications or assumptions made by the directors. The period covered by this assessment (which the FRC Guidance suggests should be significantly longer than twelve months) will need to be stated, along with the reason why that period is considered appropriate.

We are aware of four companies which, at the time of writing, have early adopted this requirement of the 2014 Code – two provided a longer term viability statement covering a 3-year period and two covering a 5-year period. However, it is important to stress that the appropriate period will depend on the circumstances of the particular company.

Intermediate Capital Group plc

B. Risk management and internal control

Boards need to confirm they have undertaken an assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. It also requires them to describe those risks and explain how they are being managed or mitigated.

Rather than the one-off annual assessment required by previous versions of the Code, Boards will have to monitor risk management and internal control systems on an ongoing basis.

Only three of the companies we surveyed had included a confirmation in this regard in advance of the requirement being mandatory.

Savills Plc

The guidance associated with the new Code also suggests that, when discussing principal risks and uncertainties, companies should talk about significant changes in principal risks such as a change in likelihood, or possible impact, or the inclusion of new risks.

Only **35%** of the companies we surveyed provided an indication of the change in the level of the risk from the prior year

Cobham plc

C. Remuneration

Remuneration policies should be designed to promote the long-term success of the company. In addition, company remuneration schemes should now include arrangements for clawback and withholding of remuneration.

D. Shareholder engagement

Boards need to set out what action they intend to take in response to situations where a significant proportion of votes have been cast against a resolution at any general meeting, for example the advisory vote on the annual report on remuneration.

Choosing a new GAAP for your parent's company-only financial statements

'Old' UK GAAP is no longer available for periods commencing on or after 1 January 2015, so companies that currently use it for their parent company or subsidiary financial statements will need to change framework.

One option is to move to full EU-adopted IFRSs for the company-only financial statements, which has the advantage of consistency with the group financial statements. However, we expect that the companies will find it more attractive to adopt FRS 101 Reduced Disclosure Framework, which uses the recognition and measurement requirements of EU-adopted IFRSs but provides adopters with exemptions from some of the more onerous disclosure requirements.

One of the qualifying conditions for FRS 101 is that shareholders must have been notified in writing and make no objection to its use, so those that have not yet done so will need to either adopt IFRSs in full, apply FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland or notify their shareholders of their intention to use FRS 101 in an alternative manner.

51 companies still using existing UK GAAP for their parent company financial statements

Only **12** *disclosed an intention to adopt FRS 101 next year,*

2 *companies had adopted FRS 101 already*

A variety of new UK GAAP resources can be found on UK Accounting Plus

New IFRS requirements

For companies thinking about their 2015 or (pre-December) 2016 accounts, the changes to IFRS are relatively minor. They may include mandatory application of IFRIC 21 Levies, amendments to IAS 19 Employee Benefits and amendments as a result of the Annual Improvements to IFRSs 2010-2012 and 2011-2013 Cycles.

For more information see chapter 3 of the full survey, Annual Report Insights 2015: **The reporting landscape** and **UK Accounting Plus**

Making your structure watertight

You have prepared the foundations for your report. Now turn your attention to how you communicate your message more effectively and build the most appropriate structure to fit your company. We have split this level into four subsections:

1. Harnessing the right guidance
2. Designing the right structure
3. The concept of materiality
4. Linkage and connectivity

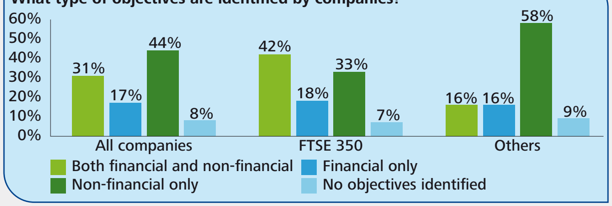
1. Harnessing the right guidance

The FRC Guidance

The FRC's Guidance on the Strategic Report ('FRC Guidance') is a helpful source of reference when preparing your annual report. It sets out how the FRC believe a company can meet the legal requirements for a strategic report in a useful, complete way. Here are some of their key suggestions:

1. When setting out your strategy, clearly specify the objectives it is intended to achieve. These may be financial or non-financial in nature and could be expressed in quantitative or qualitative terms.

What type of objectives are identified by companies?



Crest Nicholson Holdings plc and Lloyds Banking Group plc

2. To provide context to your business model, provide shareholders with a high-level understanding of the markets in which you operate and how you engage with those markets.

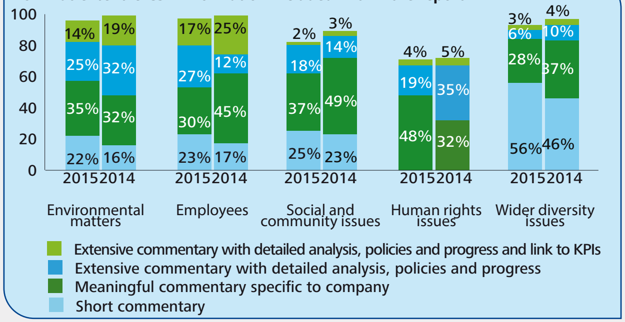
73% of the companies we surveyed (2014: 57%) included an overview of the markets that the company operates in

AO World plc provided a particularly clear and useful disclosure

3. When explaining material environmental, employee-related, social, community or human rights issues, consider including a description of the entity's policy in respect of the matter, together with any measures taken to embed the commitment within the organisation.

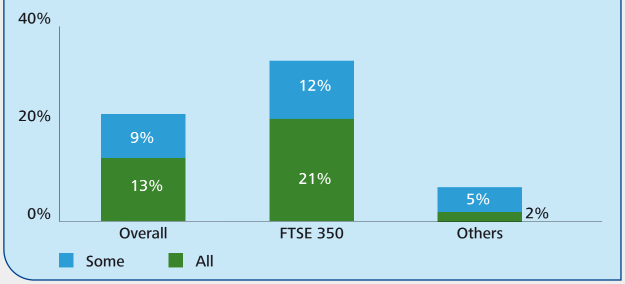
   Where KPIs are used to monitor performance in respect of any of these areas, the most efficient way of communicating information on the effectiveness of your policies on those matters will often be through reference to those measures.

To what extent is CSR information included within the report?



Although companies are only required to include non-financial KPIs 'to the extent relevant for an understanding of the business', 68% (2014: 64%) of the companies in our sample did clearly identify non-financial KPIs.

How many companies disclosed the source of the underlying data used in non-financial KPIs?



64% of the companies we surveyed clearly defined their KPIs and explained the calculation method.

while 56% clearly set out the purpose of each measure.

Only 22% of companies disclosed the source of underlying data for some or all of the non-financial KPIs they presented.

4. Provide information that enables shareholders to understand each KPI used in the strategic report. For example, the definition and calculation method; purpose; and the source of underlying data for KPIs may all be useful to shareholders. 64% of the companies we surveyed clearly defined their KPIs and explained the calculation method, while 56% clearly set out the purpose of each measure. However, only 22% of companies disclosed the source of underlying data for some or all of the non-financial KPIs they presented.

National Express Group plc

2. Designing the right structure

Whilst the strategic report section of your annual report needs to contain all of the information that is of strategic importance, it is equally important to ensure that the report communicates this information in an effective manner.

Considering the communication principles set out in the FRC Guidance can help.

Per the FRC Guidance, the strategic report should:

1. *be fair, balanced and understandable;*
2. *be comprehensive but concise;*
3. *be forward-looking, where appropriate;*
4. *be entity-specific;*
5. *highlight and explain linkages to the rest of the annual report;*
6. *have its structure reviewed annually to ensure that it continues to meet its objectives efficiently and effectively; and*
7. *have its content reviewed annually to ensure that it continues to be relevant.*

In applying these communication principles, the following questions may be helpful to you

Q: Does my report contain large blocks of unbroken narrative?

A: If so, why not break it up using graphics, iconography or even white space? Make sure that graphics used are relevant and do not distract from the overall message.

Q: Are acronyms and key concepts clearly explained?

A: Excessive use of acronyms or industry jargon when discussing challenging messages is likely to be off-putting to a reader.

Q: Has the information disclosed changed year-on-year?

A: If not, could this "standing data" be included in an appendix to maintain the document's flow and be cross-referred to as appropriate?

The law already caters for this in some respects, by requiring that certain disclosures are made in the directors' report unless they are of strategic importance, when they should be made in the strategic report instead.

Ensure that disclosures are only 'promoted' in this way where necessary.

Q: Is the front half broken up into multiple sections, increasing the risk of duplication?

A: This is something that is unlikely to be a problem for those companies embracing the concept of integrated thinking.

For those companies that are less integrated, more effort may be needed to ensure consistency without repetition.

One way to address this is to focus the chairman's report on discussing governance matters and have the chief executive introduce the strategic report, rather than repeating detail that is already included later on in the report.

Unilever PLC illustrates how this can be done. United Utilities Group PLC demonstrates an alternative option, having a joint chairman and CEO's report

Q: Am I really telling this year's story?

A: The FRC's Financial Reporting Lab (in its report Towards Clear & Concise Reporting) recommends starting the annual reporting process with a blank piece of paper each year.

"Be ruthless and cull information that was included last year but is no longer relevant or material this year"

Q: Can I cut down my accounting policy disclosures?

A: In its report Accounting policies and integration of related financial information, the FRC's Financial Reporting Lab notes that investors think accounting policy disclosures include unnecessary repetition of language from accounting standards where there is no choice or judgement involved in their application to the company.

While all investors agree that significant accounting policies should be prominent within the report, many agree that non-significant policies, if included, could have less prominence, for example being included in an appendix and immaterial accounting policies not included at all.

The Lab's follow up case study report **Clear & Concise case study: William Hill – accounting policies** includes an example of how this can be done and can be found online at IASplus.com

Q: Have I considered adopting FRS 101 for the parent's separate financial statements?

A: With the withdrawal of existing UK GAAP, there is no obvious reason why parent companies wishing to use the recognition and measurement requirements of IFRSs should not take advantage of the disclosure reductions available if they adopt FRS 101.

This will have the dual benefit of consistency with the group financial statements in terms of recognition and measurement with significantly reduced disclosures.

With a recent amendment to FRS 101 giving companies the option to apply IFRS primary statement formats as well, the company-only financial statements could be integrated alongside the group figures, eliminating the need for a separate company-only section of the report and further reducing clutter.

3. The concept of materiality

The FRC Guidance states that "Information is material in the context of the strategic report if its omission from or misrepresentation in the strategic report could influence the economic decisions shareholders take on the basis of the annual report as a whole." In particular, it relates the concept of materiality to the use of terms such as 'principal' (as in principal risks) and 'key' (as in key performance indicators) in the law.

34 of the companies we surveyed (2014: 21) included only summarised information on corporate social responsibility in their annual report, with a cross-reference to a separate CSR publication or a section of the company's website that contained further detail.

This is a good way of minimising immaterial information not required to be in the annual report, but providing a signpost to related, more detailed information that may be of interest to readers.

Applying materiality to financial statement measurement issues is a well-trodden path. However, how and when to apply materiality to disclosures has historically been less clear, something that standard setters have been trying to address.

For more information and guidance about applying materiality see Deloitte's latest insight series, Thinking allowed

As part of their disclosure initiative, in December 2014 the IASB issued amendments to IAS 1 intended, among other things, to clarify that materiality considerations apply to all parts of the financial statements, including disclosures.

Rather than approaching the standards as a checklist, preparers need to think carefully about whether disclosures are material, particularly in areas where the requirements are extensive such as share-based payments or pensions.

16 of the companies in our survey clearly indicated that certain disclosures had been omitted from the financial statements on the basis of materiality.

HSBC Holdings plc provided an explanation of their disclosure philosophy, explaining why certain items had been omitted

4. Linkage and connectivity

Both the FRC Guidance and the <IR> Framework make it clear that effective linkage (referred to as 'connectivity' within the <IR> framework) is key to producing an effective annual report. This goes beyond simply cross-referencing information in your annual report – the underlying information itself needs to relate in a meaningful way.

Those companies embracing 'integrated thinking' should be able to do this naturally as a result of running the business in a holistic way. Despite over half of the companies we surveyed displaying some linkage between the elements of their report, only 10% exhibited comprehensive linkage between all of the elements.

Although cross-referencing, or 'signposting' as the FRC Guidance refers to it, is not the same as linkage, it is still useful to include it to help users navigate your report.

To help assess how effective the linkage is in your report, we have set out nine elements for you to consider.

Upfront summary

Q: Does your report clearly set out in the summary section how the various elements (such as business model, objectives, strategy, KPIs and principal risks) relate to one another?

A: This can be a very effective way to demonstrate linkage.

Only **22%** of the companies we surveyed did this

Intertek Group plc

KPI consistency

Q: Have all of your KPIs been presented in the summary or highlights section of your report?

A: KPIs are important in understanding the performance of your business and so if identified correctly it would be surprising if they are not referred to when summarising your year.

Only **5%** of the companies we surveyed did this

Huntsworth plc

KPIs vs strategy

Q: Is it clear how your KPIs measure the achievement of your objectives and the success of your strategy?

A: This works both ways – for each element of your strategy you should be able to identify how performance is measured. If a measure that identifies strategic success is not a KPI, why not? For each KPI you should be able to identify one or more strategic priorities to which it relates. If you can not then is the KPI really 'key'?

Only **24** of the companies we surveyed clearly linked their discussion of all objectives to relevant performance metrics

Ladbrokes PLC provides a clear, two-way illustration

Principal risks

Q: Has the relationship between principal risks and strategy elements been clearly highlighted?

A: This works in a similar way to the linkage between strategy and KPIs – a good disclosure will clearly set out the linkage in both directions.

27% of the companies we surveyed clearly indicated which strategy elements each of their risks related to

National Grid Plc uses the popular approach of including symbols to represent each strategy element that can be included with the description of each risk

Directors' remuneration

Q: Are the measures used to assess directors' remuneration consistent with the company's KPIs?

A: Metrics designed to measure the success of directors, for determining their pay, should bear a close relationship with measures that illustrate the company's performance.

67% of the companies we surveyed showed reasonable consistency in this respect.

Halma plc effectively illustrated the link between KPIs and remuneration

Audit committee reporting

Q: How well aligned are the significant financial reporting issues identified by the audit committee, the key risks discussed in the audit report and the critical judgements and key sources of estimation uncertainty in the notes?

A: We would not expect 100% consistency as each is from the perspective of a different stakeholder, but if, for example, the auditors have identified goodwill impairment as a key risk, we might expect to see this mentioned by the audit committee and in the notes.

Correlation between the auditor's report and audit committee report was actually highest among the smaller listed companies with almost half demonstrating good degree of alignment (FTSE 250: 41%; FTSE 100: 22%).

Kingfisher plc

Disclosure consistency

Q: Is the extent of disclosure in the notes to the accounts consistent with the identification of areas of judgement or uncertainty?

A: We would expect to see proportionately more disclosure given for areas identified as higher risk. For example, if goodwill impairment is identified as a key judgement, we would typically expect to see more fulsome disclosure in the goodwill note e.g. the sensitivity analysis presented giving information on the likelihood that an impairment could arise.

Risk management disclosures

Q: Are the risk management disclosures in the corporate governance section, principal risks and uncertainties and the going concern and viability statements suitably consistent?

IFRS 8 consistency

Q: Is the information presented in the segmental reporting under IFRS 8 consistent with information elsewhere in the report? Do any divisional reviews presented in the strategic report call into question the number of reportable segments presented under IFRS 8?

In addition to the above pointers, it is useful here to consider both consistency and cohesiveness discussed under 'Regulatory scrutiny' in Building Solid Foundations.

"Where immaterial information is not required by law to be contained in the annual report, why not instead harness your company's website, with a brief summary in the annual report and a link or signpost to additional information online."

Adding the finishing touches

If you so wish once you have developed strong foundations and an effective structure for your report, it is time to add the finishing touches. These could include adopting new requirements early or providing additional information in response to the demands of users, bearing in mind the desire for clear and concise reporting.

Some ideas for finishing touches

Include additional non-financial and diversity information

In anticipation of the requirements of the new EU Directive (which will not be mandatory in the UK until 2017) you could include the additional information on employee diversity (for example policies on age, gender, educational and professional background) and bribery and corruption which the existing UK narrative reporting regulations do not cover.

66 mentioned bribery and corruption in their annual report

59% of these discuss in the strategic report

St James's Place plc

Provide disclosure around the level of reserves available for distribution and the company's dividend policy

This has become an area of focus for institutional investors who have requested greater disclosure by FTSE 100 companies – the FRC's Financial Reporting Lab also has an ongoing project in this area.

10 companies clearly set out the level of distributable reserves available to them

Another **30** included some disclosure, for example highlighting certain amounts that are not distributable or discussing transactions designed to improve the company's level of distributable reserves

Include a net debt reconciliation

This is an area of interest for many investors. The IASB also has an ongoing project to explore requirements in this area, having published an exposure draft in late 2014 proposing a requirement for information similar to a net debt reconciliation.

48% provided a net debt reconciliation or a reconciliation of net cash flows to changes in net debt

Compass Group plc

Consider cyber risks

With recent high-profile attacks on companies in the retail, media and industrial sectors highlighting the type of damage that can be done by hackers and cyber terrorists, cyber governance is high on the agenda for regulators, investors and senior executives.

Only **32%** of the companies in our survey referred to the Board's involvement in activities around cyber risks and security within their corporate governance statements

National Grid Group plc

Provide information on tax strategy

It is an area of regulatory interest, with the recent publication by the UK government of proposals to require large UK companies to publish their tax strategy on an annual basis.

Although this disclosure may not be required to be in the annual report, companies should consider whether this information is material to shareholders – tax is often the third largest expense for a business after payroll and raw materials.

Only **9** of the companies in our survey sample provided such information in their report

Centrica plc

Clearly identify the opportunities that exist for the business to develop in the future

This goes beyond the strategic report's requirement to discuss "the main trends and factors likely to affect the future development, performance and position of the company's business."

38 of the companies in our sample identified opportunities, usually in the Chairman or CEO's statement

Increase the level of disclosure provided on corporate culture and succession planning

These are both areas in which the FRC has announced they will be undertaking projects in 2016.

Only **20** gave a clear explanation of their succession planning

BT Group plc and Johnson Matthey plc give good examples of disclosure.

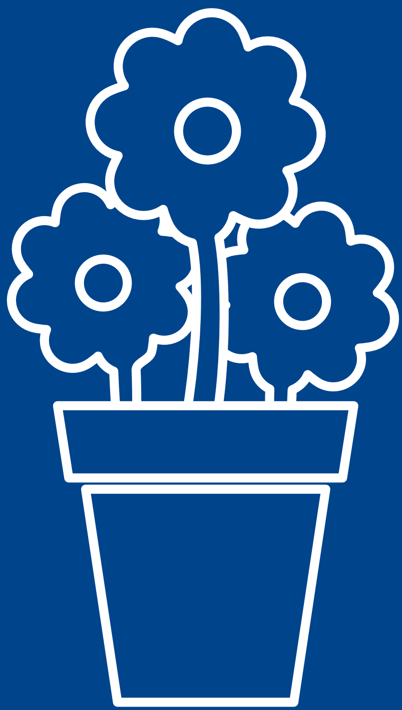
St James' Place plc and Howden Joinery Group Plc present a meaningful discussion of the Board's responsibilities around corporate culture.

Optimise your report for digital viewing

The recent Lab report Digital present: Current use of digital media in corporate reporting highlighted that investors preferred medium for a digital report is a simple pdf, but that companies could make better use of pdfs. Suggestions included tailoring the report to look better on screen by using a landscape orientation or reducing use of columns, optimising the pdf for searching by using consistent terminology and reducing the 'clutter' of interactive elements.

Please visit IASplus.com to access the report.

The recent Lab report Digital present: Current use of digital media in corporate reporting highlighted that investors preferred medium for a digital report is a simple pdf, but that companies could make better use of pdfs. Suggestions included tailoring the report to look better on screen by using a landscape orientation or reducing use of columns, optimising the pdf for searching by using consistent terminology and reducing the 'clutter' of interactive elements.



Making your house a home

You may have perfected your report, but are you embracing Integrated Reporting (‘<IR>’)?

The question to ask yourself is “Are you living your story or are you merely telling it?”

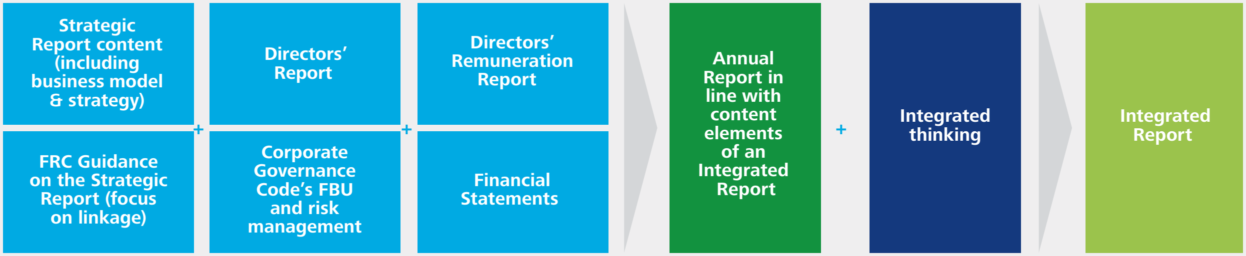
Corporate reporting requirements in the UK are pretty comprehensive and should enable a company to tell its story well. As discussed below and in Deloitte’s publication *<IR>: how does it fit into the UK corporate reporting landscape?*, the reporting requirements of <IR> match up pretty closely to these. Yet this year we saw seven companies make an explicit reference to <IR> in their annual report. So why are companies and investors talking about <IR>?

The missing link is ‘integrated thinking’, which challenges and enables companies to ‘live their story’, rather than merely tell it. A truly integrated report is the output of integrated thinking within an organisation. In particular, the linkage in it comes naturally – it flows from the integration of business processes and behaviours. To find out more about the process of embedding integrated thinking within your organisation see Deloitte’s *A Directors’ Guide to Integrated Reporting.*

Living your story

How does <IR> fit into the UK reporting landscape?

How is an integrated report different from the strategic report, particularly when applying the FRC’s *Guidance to the Strategic Report?*



The <IR> Framework is a principles-based framework aimed at empowering and encouraging businesses to explain and disclose better how they create value. The FRC Guidance is very much consistent with the <IR> Framework in terms of content elements and guiding principles - the missing link is integrated thinking (‘<IT>’). <IT> requires a business to consider whether its business model is sustainable in the short, medium and long-term. This involves consideration of not only of the outputs of the business, but also the outcomes, i.e. the effects that outputs have on other ‘capitals’, including those capital related to the sustainability of the business. Embedding <IT> can help break down silos and look at connectivity and interdependencies between the range of factors that affect an organisation’s ability to create value over time.

1. The capitals

Six categories of resource and relationships on which a business may depend in the broadest sense: not only 'the 3 Ps', as they are often referred to, being people (human capital), planet (natural capital) and profit (financial capital) but also other non-financial value drivers such as brand, reputation and know-how (intellectual capital), property, plant and equipment and infrastructure (manufactured capital) and relationships, such as relationships with suppliers and customers amongst others (social and relationship capital).

The FRC Guidance also suggests that companies should discuss relationships, resources and other inputs when setting out their business model. 51% of companies provided clear reference within the description of their business model to relationships or resources used as inputs or created as outputs.

GlaxoSmithKline plc and Aggreko plc both include business model disclosures which clearly set out the resources and relationships that are key to their businesses.

GlaxoSmithKline plc and Aggreko plc

2. Value creation

This is 'value creation for the organisation and value creation for others'. The premise here is that if a business creates value for others, in the long term, this creates value for the business.

Over half of the companies in our survey sample explicitly referred to value creation when explaining their business model, although only a quarter clearly explained how value is created for a variety of stakeholders. Of those discussing value creation, one third specifically referred to how the business creates value over the long-term rather than just the near future.

Johnson Matthey plc

3. The value creation process

The traditional business model concept (inputs, activities and outputs in the form of goods or services) is extended to consider the 'outcomes' of the business's activities for the <IR> capitals above. This is because negative or positive outcomes (or impacts) today could have future repercussions (value at risk).

One of the most effective ways that this can be communicated is by including a meaningful visual representation of the company's business model. Although 57 of the companies we surveyed included a visual representation of their business model, in our view only 67% of these actually contributed to making the business model and the value creation process more understandable.

Generic, boilerplate diagrams (frequently circular in design) will often not be able to express how value is created and captured by the company and what it is that makes the company unique.

BT Group plc

The missing link is 'integrated thinking', which challenges and enables companies to 'live their story' rather than merely telling it.

Your snagging list

Useful contacts

If you would like further, more detailed information or advice, or would like to meet with us to discuss your reporting issues, please contact your local Deloitte partner or:

Veronica Poole
Partner
vepoole@deloitte.co.uk

Tracy Gordon
Director
trgordon@deloitte.co.uk

Amanda Swaffield
Director
aswaffield@deloitte.co.uk

For more information and to access the complete report visit
www.deloitte.co.uk/annualreportinsights

To keep up to date with the latest in regulatory requirements around your accounting standards including regular podcasts and news visit **www.ukaccountingpluc.co.uk**

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. J1255