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Governance in brief

The new board statement – fair, balanced and understandable and sufficiency of information provided

Headlines

- This is not meant to be an onerous requirement but does require some thought.
- Reinforces active engagement by the whole board in the annual reporting process.
- Most boards are likely to ask the audit committee to advise on the statement.
- There are early adoption examples available.

A reminder of the new requirement

With effect from 30 September 2013 year ends onwards, under provision C.1.1 of the UK Corporate Governance Code (the Code), boards of premium listed companies are required to make the following statement in the annual report:

"The board confirms that the annual report and accounts, take as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the performance, strategy and business model of the company."

This new provision supports the main Code principle previously in force that " The board should present a fair, balanced and understandable assessment of the company's position and prospects". The supporting principle in section C.1 of the Code states:

"The board should establish arrangements that will enable it to ensure that the information presented is fair, balanced and understandable."

Code Provision C.3.4 says that, where the board asks, the audit committee should provide advice to the board on this statement. Since the audit committee already has the task of reviewing the annual report on behalf of the board, we believe that in most cases this task will land on the audit committee's agenda.

What is the FRC trying to achieve with this requirement?

This new requirement was developed by the FRC in response to criticism of the way in which companies were seen as having failed to provide key information and sensitivities in their annual reports. It was felt that the narrative report should reflect the board's considered view of the information which investors and other users of the annual report and accounts needed, rather than being viewed as promotional in nature, and to ensure that the narrative and financial sections of the report were consistent. The report should represent a fair, balanced and understandable account of the board's stewardship of the company.

The first consultation paper on this requirement suggested that the board should explain in the annual report the reasons ***why*** they consider the annual report is fair, balanced and understandable, rather than just a statement from the board that it ***is*** fair, balanced and understandable. Whilst that level of disclosure did not make into the final requirements, in our view, boards (or audit committees) should consider how they would justify their statement if challenged.

At the recent Annual Open Meeting of the Financial Reporting Council, the CEO Stephen Haddrill made the following comment:

"It was an important step forward when we said that the company's report should be fair, balanced and understandable and that this should apply to the corporate report as a whole. I hope that will favour pressure in the boardroom against any tendency to use parts of the report as a kind of advertisement for the company. It should be good quality information and it should be balanced."

Key considerations in preparing to make the statement

Fair, balanced and understandable

From the outset, the FRC has said that whether or not the annual report, taken as a whole, is 'fair, balanced and understandable' is a matter of board judgement. Stephen Haddrill has commented that 'fair, balanced and understandable' should be interpreted in accordance with the standard meaning of those words in the English dictionary. The recent consultation draft of the FRC guidance on the Strategic Report (available from www.frc.org.uk) includes further reference to the meaning of 'fair, balanced and understandable' and those considerations are incorporated below.

Fair – Definition: not exhibiting any bias, reasonable or impartial, done according to the rules

- A "fair" story does not omit important elements – Is the whole story being presented? Have any sensitive material areas been omitted?

- Segmental reporting – are the business segments described in the business review consistent with those used for financial reporting in the financial statements? Are the messages in the front half reflected in the segment performance? Are the KPIs disclosed at an appropriate level based on the segments we are reporting?

Balanced – Definition: even-handed, taking account of all sides on their merits without prejudice or favouritism

- Is the annual report properly now a document for shareholders? Is there a good level of consistency between the front and back sections of the annual report? Do you get the same message from reading the two sections independently?

- Is there an appropriate balance between statutory and adjusted measures and are any adjustments explained clearly and with appropriate prominence? This is likely to be an area of further focus by accounting regulators across Europe.

- Are the key judgements referred to in the narrative reporting and the significant issues reported in the Audit Committee Report (see Code Provision C.3.8) consistent with the disclosures of key estimation uncertainties and critical judgements set out in the financial statements? How do these compare with the risks that the external auditor is planning to include in their report?

Understandable – Definition: having a meaning or nature that can be understood, able to be accepted as normal, reasonable or forgivable

- Is there a clear and cohesive framework for the annual report? Are the important messages highlighted and appropriately "themed" throughout the document?

- All the changes this year represent an excellent opportunity to identify areas of duplication or disjointedness. Is information set out in the annual report easy to find and do sections link well together to tell the whole story?

- is the report written in accessible language? Are the messages clearly drawn out? Excessive use of specialist terms, acronyms and other jargon can make the annual report impenetrable – where the use of such language is necessary, is there a glossary that indicates how they are defined for clarity and consistency?

Logistical considerations

- Is the board interpreting this requirement consistently amongst themselves?

- Has the reporting timetable been amended to allow sufficient time for planning out and review of the annual report as a whole?

Performance, strategy and business model

The following are key questions that non executives could ask when challenging the presentation of your company's performance, strategy and business model. For a deeper dive please see our December 2013 publication Governance *in focus*: Describing your strategy and business model available from **www.corpgov.deloitte.com/site/uk/**

Performance	• Is it clear how outcomes are measured using key performance indicators? • Is there a good mix of financial and non-financial key performance indicators? • Is it clear that the stated key performance indicators measure the achievement of the company's strategy not just short term performance? • Are movements in key performance indicators over time, both favourable and adverse, open and well-explained? • Can the reader understand why those measures are key performance indicators and how they are derived? • Are key performance risks explained?
Strategy	• Is the company's purpose clearly articulated? • Does the strategy discuss how the business intends to achieve its objectives in the context of the market outlook? • Are the value drivers explained clearly? • Is there enough information to assess strategic risks?
Business model	• Are the key elements of the business model clearly explained? • Are business model risks and disruptions adequately drawn out? • Do the business risks disclosed in the narrative sit well with the risks or sensitivities set out within the financial statements?

What we have seen from early adopters

Only a small number of companies included this new board statement in their December 2012 and March 2013 annual reports. In these examples the location of the statement varied between:

- the audit committee report
- the directors' responsibility statement
- the corporate governance statement

The board of BAE Systems provided some detail on the basis on which they were making the statement.

> One of the key governance requirements of a group's financial statements is for the report and accounts to be fair, balanced and understandable. The co-ordination and review of the Group-wide input into the Annual Report and Accounts is a sizeable exercise performed within an exacting time-frame which runs alongside the formal audit process undertaken by the external Auditors.
>
> Arriving at a position where initially the Audit Committee, and then the Board, are satisfied with the overall fairness, balance and clarity of the document is underpinned by the following:
>
> – comprehensive guidance issued to contributors at operational level;
>
> – a verification process dealing with the factual content of the reports;
>
> – comprehensive reviews undertaken at different levels in the Group that aim to ensure consistency and overall balance; and
>
> – comprehensive review by the senior management team.

BAE Systems plc (extract from audit committee report) – Annual Report 2012

> In addition, each of the directors considers that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

BAE Systems plc (extract from the Directors' responsibility statement) – Annual Report 2012

Other early adopters who included the new statement without further amplification of the basis include Barclays, Taylor Wimpey, Great Portland Estates, Mothercare and United Utilities.

What evidence should be prepared to support the statement?

We believe that it is helpful to have a framework and a document of record setting out the key considerations – it can be a short one, even perhaps just a separate note in the minutes of any Board Disclosure Committee or the Audit Committee, but the essence of the considerations should be captured so if a later challenge were to arise, a diligent process can be seen to have been observed.

What will the benefits be?

If the underlying processes for making the statement are established in the ways we have discussed above then the resulting benefits should be enhanced corporate reporting which will meet the FRC's aim of giving investors greater insight into what company boards are doing to promote their interests, and to provide them with a better basis for engagement. It is also hoped that the nature of these considerations could help to reduce duplication and cut clutter. The requirement also reinforces the diligence and oversight role of the audit committee.

Applicability to AIM companies

AIM companies are not required to report compliance against the UK Corporate Governance Code. However, many AIM companies comply with the UK Corporate Governance Code voluntarily.

Deloitte view

- The processes being followed to meet this requirement are likely to differ between companies.
- In our view most companies will ask the Audit Committee to advise the board on the statement.
- We encourage a document of record.

The Deloitte Academy

The Deloitte Academy has been designed for main board directors of listed companies. The Deloitte Academy provides support and guidance to boards, individual directors and company secretaries of listed companies through a programme of briefings and update sessions. Bespoke training for the whole board or individual directors is also available.

If you would like further details about the Deloitte Academy, including membership enquiries, please email enquiries@deloitteacademy.co.uk

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UK Centre for Corporate Governance

For further information on corporate governance matters please click here
http://www.corpgov.deloitte.com/site/uk/

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