On the board agenda – H2 2017

Governance in focus
On the board agenda – H2 2017
The Deloitte Academy: Promoting excellence in the boardroom
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The growing board agenda

Foreword from William Touche

Dear Board Member,

With Brexit and UK politics looking like they will dominate the headlines for some time, we are now turning our attention to half year reporting to the markets and to reviewing the board agenda for the second half of 2017. I was reminded of Franklin D Roosevelt’s wry observation: “In politics, nothing happens by accident. If it happens, you can bet it was planned that way”.

Those of us leading and working in international businesses will already know that the government’s attention has been on the board’s duties in considering the interests of a broader group of stakeholders and aligning executive pay to corporate performance. The likely outcome will be that boards will be invited to explain in annual reports how they have taken account of broader stakeholders in their material decisions.

For the board agenda we examine the calls from the Investment Association for annual reports to provide greater clarity on the long-term drivers of value creation and productivity – productivity now receiving greater focus as the UK prepares to leave the EU. We also examine the challenge of risk management in times of such uncertainty with a specific focus on addressing the imminent stricter requirements on data protection and cyber security, and the impact of Brexit.

For audit committees the agenda and expectations continue to grow. In particular, key financial judgements and forecasting are receiving increased attention. We also provide a reminder of the numerous transparency initiatives which have recently or will shortly be coming into force (gender pay gap reporting, modern slavery and payment performance). These fall outside the annual report and therefore may also fall outside the usual diligence processes for production of the annual report disclosures. Given the profile of these disclosures we recommend that audit committees are given the opportunity to consider the disclosures, and the processes for their development, before publication.

For remuneration committees we provide a summary of the key matters arising from the AGM season so far – a season in which many companies have taken their remuneration policy back for a second binding vote.

For nomination committees the number one issue which is consistently raised is board composition – particularly succession planning and diversity. We also see some nomination committees taking on more responsibilities for the people/talent agenda and we highlight the key findings from our review of 2017 HR trends.

This mid-year round-up is fuller than normal, to help you look forward to the year end. Do get in touch with your Deloitte partner or our governance team if you would like to discuss any areas in more detail. And don’t forget that 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 has all of our publications and useful checklists.

Yours faithfully,

William Touche

Vice Chairman
Leader of Deloitte UK Centre for Corporate Governance
Looking ahead to the remainder of 2017

Areas of focus for the board

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<td>Robust planning scenarios</td>
<td>We are hearing that, with the outcome of the election now confirmed, boards are setting aside time in the next six months for deeper consideration of potential risk and opportunity areas and scenario planning. In particular, the board should be really challenging where Brexit will impact the business.</td>
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<td>Technology matters</td>
<td>The date from which the GDPR becomes enforceable is rapidly approaching. It’s time to review management’s readiness assessment and activities. Is cyber security included as one of your principal risks? If not, are you comfortable with this and has there been a robust discussion to decide this with a clear justification recorded. Should the worst happen, will you be in a position to respond swiftly and effectively? Consider how you will report on the board’s activities on cyber security in the annual report.</td>
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<td>Broader stakeholders</td>
<td>Expectations have already been raised that the board should be explaining in the annual report how it has discharged its duty to broader stakeholders as envisaged in s172 of the Companies Act – i.e. employees, customers, suppliers and others. Will your board be in a position to do this, if required to or voluntarily, in the 2017 annual report? Will the board be able to describe activities which demonstrate meaningful consideration and action in respect of the interests of all key stakeholders?</td>
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<td>Remuneration</td>
<td>With the outcome of the election now confirmed, the remuneration committee should allow time in the next six months to consider their executive pay policy and how the political landscape is changing. This should include considering potential changes to policy or disclosure that may be required to meet the needs of investors or other stakeholders.</td>
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<td>Talent and culture</td>
<td>Is communication strong throughout your organisation such that the company purpose and values are clearly articulated, consistently understood and applied at all levels? Does the organisation have a clear and appropriate talent strategy with sufficient resource to attract, retain, train and motivate staff for the longer term?</td>
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Publications to look out for in the second half of 2017

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On the board’s agenda
Corporate governance reform remains high on the political agenda

Corporate governance reform

It is almost exactly a year since Theresa May became Prime Minister with her vision of an economy that, in her words, works for everyone. Her campaign speech referenced putting employees onto company boards and the need to ensure that non-executive directors are undertaking their role effectively.

There have been a number of developments since that speech:

1. The BEIS House of Commons Select Committee has carried out an inquiry into corporate governance focusing on directors’ duties, executive pay and the composition of boards and issued a set of recommendations.

2. BEIS has issued a Green Paper on corporate governance reform setting out a number of options on executive pay, strengthening the voice of employees, customers and wider stakeholders and proposing raising the bar for large, privately-held businesses.

3. The FRC has announced that it is undertaking a “fundamental review” of the UK Corporate Governance Code.

4. The Conservative party manifesto has made it clear that reform of corporate governance will continue to be an area of focus for the new government.

The recommendations of the BEIS Select Committee were set out in Governance in brief: BEIS Select Committee inquiry calls for reforms to the UK Corporate Governance Code and greater enforcement and the BEIS Green Paper was summarised in Governance in brief: Government issues Green Paper on governance reform.

Election pledges on corporate governance

At this stage of the new Government, the pledges made in the Conservative election manifesto give some indication of future policy direction.

On regulation of executive pay – legislation will be introduced to make executive pay packages subject to strict annual votes by shareholders. Companies will have to explain their pay policies, particularly complex incentive schemes, better. An examination of the use of share buybacks will be commissioned, with a view to ensuring these cannot be used artificially to hit performance targets and inflate executive pay.

On strengthening the wider stakeholder voice – company law will be amended to ensure that listed companies are required either to nominate a director from the workforce, create a formal employee advisory council or assign specific responsibility for employee representation to a designated non-executive director. Subject to sensible safeguards, employees will also be given the right to request information relating to the future direction of the company.

On pension regulation – the Pension Regulator and pension schemes will be given the right to scrutinise, clear with conditions or in extreme cases stop mergers, takeovers or large financial commitments that threaten the solvency of the scheme. The Pensions Regulator will also be given new powers to issue punitive fines for those found to have wilfully left a pension scheme under-resourced and disqualify the company directors if necessary. Consideration will be given to the introduction of a new criminal offence for company directors who deliberately or recklessly put at risk the ability of a pension scheme to meet its obligations.
On diversity in the workplace – the Government will introduce a requirement for companies with more than 250 employees to publish more data on the pay gap between men and women. There would be further push for an increase in the number of women sitting on boards of companies and large employers will be asked to publish information on the pay gap for people from different ethnic backgrounds.

On pay conditions for the wider workforce – listed companies will have to publish the ratio of executive pay to broader UK workforce pay. The National Living Wage will continue to increase to 60% of median earnings by 2020 and then by the rate of median earnings. People working in the gig economy will be properly protected.

On governance of private companies – there will be a consultation on how the corporate governance of privately-owned businesses can be strengthened.

The timetable for change – our current expectation
It is likely that BEIS will issue a White Paper or other Government response along the lines described above either before the Parliamentary summer recess or in the autumn. The FRC will have to respond to BEIS and its review of the Code will address the matters that Government expects to be implemented through Code changes, so we expect to see a consultation from the FRC on the Code in Q4.

Strengthening the wider stakeholder voice

Duty to promote the success of the company (s172, Companies Act 2006)

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to;

(a) the likely consequences of any decision in the long term,
(b) the interests of the company’s employees,
(c) the need to foster the company’s business relationships with suppliers, customers and others,
(d) the impact of the company’s operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.
Investors call for better long-term reporting

Investors believe that a company’s annual report is an important source of information on how their investee companies are planning for the long term and that the annual report should allow them to judge whether capital is being utilised efficiently. However, some investors have expressed concerns over the quality of reporting on the long-term drivers of value creation.

The Investment Association has issued guidance which highlights five potential areas for improvement.

**Focusing on the longer-term** – companies should stop issuing quarterly reports and quarterly earnings guidance in favour of greater attention being given to longer-term performance and strategic issues over the next three to five years, at least.

**Productivity** – companies should provide greater clarity of the drivers of productivity within their business and how planned investments are expected to drive productivity gains over the longer term. To do this, companies are asked to provide the following discussion in the strategic report:

- the main drivers of productivity in the business;
- the process by which productivity is regularly assessed;
- the criteria used to conduct this assessment;
- planned investments to improve productivity; and
- the significant opportunities and challenges facing the company in terms of productivity.

This narrative should be supported by some measures of productivity to provide evidence of the investments being made. Measures to consider include:

- **Infrastructure**
  - Capital expenditure on new equipment and machinery
  - Improvements in resource allocation

- **Innovation**
  - Total spend on research and development, patents and technological advancements

- **Skills**
  - Spending on training, personal development and recruitment and retention of talent

- **Culture**
  - Employee engagement
  - Satisfaction in the workplace
  - Changes in company structure
  - Management of human capital

**Capital management** – investors want to understand a company’s capital position, how it manages its capital and to be able to assess the performance of its capital allocation decisions. A narrative discussion of the following is recommended to be included in the strategic report:

1. The key criteria and underlying assumptions used to assess capital allocation opportunities.
2. How the company distinguishes between maintenance capital and capital that is used for growth.
3. The process by which capital allocation decisions are made by the company.
4. How performance of these decisions is assessed over the long term.
5. The role of the board in setting and having oversight of Capital Management Strategy.
6. The significant capital allocation decisions made during the past year plus their outcomes in terms of productivity improvements achieved.
7. An explanation of shareholder dialogue on capital allocation decisions.
8. Details of any cancellations or withdrawals from past capital allocation decisions.

**Consideration of environmental and social risks** – the annual report should explain the environmental and social risks and opportunities that may significantly affect the company’s short and long term value, and how they might impact on the future of the business. In addition, the guidance calls for disclosure on whether the remuneration committee is able to consider performance on environmental and social matters when setting remuneration of executive directors.

**Human capital and culture** – company disclosures should foster improved investor understanding of the role played by the company’s workforce in generating sustainable, long-term value creation. Metrics such as total headcount, annual staff turnover, investment in training, skills and professional development and employee engagement score are identified as particularly helpful.

On culture, the guidance makes it clear that investors believe it is the board’s role to determine the purpose of the company and to ensure that the company’s values, strategy and business model align to this purpose. Boards should explain their role in shaping, overseeing and monitoring culture.

Brexit risks and opportunities demand renewed focus

Our survey of FTSE 100 disclosures
We have just published the results of our first survey of disclosures of Brexit risks and opportunities, covering 60 annual reports issued by FTSE 100 companies for September 2016 to January 2017 year ends. Although we have seen some thought-provoking disclosures so far, we expect company communications to become more detailed as their arrangements to navigate Brexit take shape.

The FRC offered some advice on how to report on Brexit in a letter to investors ahead of the 2016 reporting season, “Companies may well be currently considering the risks and uncertainties associated with the UK’s renegotiation of its EU position and potential exit. If the board considers this to be a principal risk they should disclose that to their shareholders.”

Some interesting findings
95% of the companies surveyed mentioned Brexit and, of those, 62% had changed their principal risk disclosures in response to Brexit.

38% disclosed some form of contingency planning or scenario planning in response to Brexit (examples include Barclays, HSBC). Other disclosures around managing the risk included forming a working group or sub-committee to consider the ongoing risk (Easyjet), liaison with the UK Government or EU regulators (LSEG), and working with industry trade bodies to influence negotiations (GSK).

Barclays offered a helpful case study outlining their contingency planning process (2016 annual report, p72):

Example disclosures:
- Geopolitical or economic environment – BAE Systems, Capita, Schroders
- Foreign exchange/treasury – GKN, British American Tobacco
- Access to talent – Schroders, Persimmon
- Access to markets – Aviva, Easyjet, ITV
Governance in Action –
contingency planning for the UK’s EU Referendum

A significant external risk event in 2016 was the UK’s Referendum on its continued membership of the EU. The Board Risk Committee actively tracked this emerging risk throughout 2016, both before and after the vote.

Pre-EU Referendum activity by the Committee included:
- debating the UK's potential exit from the EU, including evaluating an assessment of the potential impacts on Barclays of a leave vote and discussing the key messages for policymakers and prudential authorities on the risks
- evaluating Barclays' potential exposures if there were to be a vote to leave the EU, including assessing the steps taken by management to mitigate any risk (such as reducing any currency mismatches) in order to position Barclays defensively to manage the impact of any volatility on market and funding risk
- assessing the likelihood of any operational risk issues that might arise if there was a period of market volatility following a leave vote
- conducting an overall review of the appropriateness of Barclays' preparations for any market dislocation
- reporting to the Board on the Committee’s deliberations.

In addition to the activities undertaken by the Committee, Board members, including certain non-executive Directors, participated in a Group crisis management planning exercise based on the UK voting to leave the EU. The exercise focused on Barclays' response and communications planning in the event of a vote to leave; articulating some of the high level impact scenarios following a vote to leave; and determining the decisions and ensuing direction required from Barclays' Crisis Leadership Team.

Post-EU Referendum activity by the Committee included:
- convening a special meeting to discuss and evaluate the effectiveness of Barclays' preparations, concluding that the plans developed had been executed satisfactorily
- assessing the performance of the actions taken to manage the impact of volatility on market and funding risk
- evaluating a revised stressed outlook, based on revised economic assumptions, and its impact on Barclays' risk profile, deliberating the effect of the revised outlook on forecast impairment and on capital and funding, market risk and credit risk
- considering Barclays' exposures to European banks in anticipation of potential market disruption in the Eurozone and the actions that had been taken to limit such exposures
- discussing with management the actions that had been taken to reduce risk appetite and limits on exposures to residential property development, high loan-to-value mortgages and buy-to-let lending and other actions that had been implemented to manage risk in higher risk retail segments and corporate portfolios
- encouraging management to consider the strategic implications of the leave vote
- emphasising to management the need to fully and openly engage on matters of mutual concern with the UK government and regulators given the new political and economic environment
- continuing to track the potential impact of the leave vote and the actions being taken by management to deal with any emerging signs of stress in Barclays' portfolios
- reporting to the Board on the Committee’s deliberations.

The full Board also met in the aftermath of the vote result to be briefed on how Barclays had performed during the period of volatility immediately following the result, including discussing Barclays' capital and liquidity position; market conditions; communications with employees and with customers and clients; contact with regulators and the UK government; the outlook for the UK economy; share price performance and potential strategic impacts.

Read more about Barclays’ risk management on pages 145 to 162 and in our Pillar 3 report, which is available online at barclays.com/annualreport

Extract from page 72 of Barclays Annual Report 2016
Advice for preparing annual report disclosure

So, what advice do we have for companies considering how to tackle the topic of Brexit in their annual reports?

- Almost every company mentions the outcome of the referendum and whether they consider Brexit to be a principal risk – even if it isn’t a principal risk for you, it is worth letting shareholders know the topic is on your radar.

- The better communications are specific to the individual company’s circumstances and explain the risks or opportunities most relevant for shareholders to consider.

- For some, Brexit has not introduced new risks so far, companies preferring to describe enhanced impacts for existing risks – such as cost volatility or general economic conditions.

- The complexity of the range of outcomes makes it difficult to provide detailed analysis of the potential impacts at this stage. Some better company communications focus on explaining how companies are analysing the possibilities.

- Necessity being the mother of invention, some companies are discussing investment in technologies and techniques to cope with some of the potential impacts.

- Finally, companies should remember as they approach this year’s reporting season that the end of the two year negotiation period offered by Article 50 will be well within the lookout period for longer-term viability statements, so we will expect to see enhanced disclosures around Brexit impacts within those statements.

Brexit challenges – accounting for taxation

For UK entities and groups with UK operations, triggering Article 50 also raises the question of whether there are any immediate financial reporting effects of the possible withdrawal of tax reliefs. IAS 12 Income Taxes requires a change in tax law to be “substantively enacted” before accounting for that change.

There continues to be significant uncertainty around the precise steps to be followed before withdrawal of the UK from the EU takes effect. Tax arrangements are also complex and may not always be uniform across the EU – certainly they do not address explicitly the effect of withdrawal of a member state.

Due to these complexities and uncertainties it is difficult to conclude that a change in tax law has indeed been substantively enacted in line with IAS 12 as a result of the triggering of Article 50 or what effect any such change would have on current and deferred tax balances.

What transactions could be affected?

The following directives have been identified as providing reliefs which may not be available following the conclusion of the Brexit process:

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<td>Concerns the elimination of withholding taxes on dividends paid to ‘parent companies’.</td>
<td>Concerns the elimination of withholding taxes on certain interest and royalties.</td>
<td>Concerns the deferral of tax on gains for certain cross-border transactions, transfers of assets and exchange of shares within the EU.</td>
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Any potential changes to the applicable withholding tax rates/laws on distributions, interest or royalties would, depending on the applicable legislation, apply to distributions etc made after the date of withdrawal from the EU. By contrast, withdrawal may trigger the immediate payment of tax previously relieved or deferred arising from earlier transactions in the scope of the Mergers Directive.
Boards should encourage their tax departments to identify previous transactions that may have benefited from these arrangements, so that changes to the tax environment can be kept under close review. Such transactions could include:

- cross-border reorganisations involving the UK, such as incorporation of a pre-existing UK branch with an immediate parent outside the UK; and

- transfers of some large intangible assets such as a brand within an EU tax group that includes a UK entity, where the tax group will be broken on the UK’s exit from the EU.

Given the geographical proximity, transactions of this type are particularly likely to have arisen in Ireland. The potential consequence of each transaction will need to be assessed on its individual circumstances. It is worth bearing in mind that any requirement to recognise additional tax will arise in the transferor entity and is more likely to arise in an entity outside than within the UK.

**Reporting recommendations**

Although we do not expect entities to change recognised tax balances in response to the triggering of Article 50, we would expect an entity to provide disclosures on significant risks and uncertainties around future tax rates and payments if material. These could be included in any or all of:

- the discussion of principal risks and uncertainties in the entity's strategic report, and possibly, in extremis, the viability statement;

- discussion in the tax note on possible future changes in the entity's effective tax rate; and

- discussion of sources of estimation uncertainty as required by IAS 1 Presentation of Financial Statements, which often includes discussion of tax risks.

The extent and nature of the disclosure will depend on the individual entity's exposure to any change in those reliefs.

Disclosure might also be appropriate regarding any existing current or deferred tax balances that might be affected by changes resulting from withdrawal and, in circumstances where a reasonable estimate can be made, the likely amounts.
The advance of technology – GDPR and cyber risk

**General data protection regulation (GDPR)**

Organisations increasingly recognise that the responsible use of people’s data allows privacy to be a business enabler rather than just another compliance headache. Getting privacy right gains the trust and confidence of consumers who are in turn more likely to repay that trust with loyalty, revenue and further access to their much sought after personal data.

On 25 May 2018, the GDPR comes into force in the UK, described by the Information Commissioner, Elizabeth Denham, as “a game changing piece of legislation [that] will reshape the data protection landscape.” The Information Commissioner’s Office (ICO) is responsible for regulating organisational compliance with the GDPR in the UK.

The GDPR will impact organisations across all sectors with regulatory requirements that concentrate on improving consumer protection and harmonising existing EU privacy laws, but will also introduce extra burdens and restrictions for organisations that collect, store or use personal data relating to EU citizens.

For Lead Supervisory Authorities, tasked with overseeing compliance, there will be powers to impose substantial fines – for the most serious offences up to the greater of €20 million or 4% of worldwide turnover. The ICO has indicated that the increased powers will be used “in ways which target the most serious areas of non-compliance.”

**What about Brexit?**

There is no indication that any part of the GDPR will be rolled back based on the ICO’s Information Rights Strategic Plan 2017-2021, which states that it plans to work closely with EU data protection authorities post-Brexit, including the European Data Protection Board (which will replace the Article 29 Data Protection Working Party). The ICO also intends to take the opportunity, in the UK public interest, to engage with regimes outside the EU.

This position is no surprise as common data standards are fundamental to the UK’s ambition to be a tech hub.

**Is there any new information available?**

The Article 29 Data Protection Working Party, so-called because it was set up under Article 29 of the Data Protection Directive, includes representatives from each Member State, a representative from the European Commission and the European Data Protection Supervisor. It has now adopted guidelines on the right to data portability, Data Protection Officers and how to identify the lead supervisory authority. These are available online at http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=50083.

The Article 29 Working Party plans to produce further guidelines during 2017. Draft guidelines on data protection impact assessments are available on its website and consultation on this draft closed on 23 May 2017. Further guidelines on consent, profiling, transparency and administrative fines are to be issued. The ICO issued draft guidelines on consent earlier in the year and its consultation closed on 31 March.

A Department for Culture, Media and Sport (DCMS) consultation on derogations available to the UK closed on 9 May 2017. The outcome of this public feedback is expected to be published under the new Government and must be finalised prior to the GDPR coming into force.

**GDPR messages for the boardroom**

The Information Commissioner issued a video of “GDPR messages for the boardroom” on 25 May 2017, which can be viewed at: https://ico.org.uk/for-organisations/data-protection-reform/gdpr-messages-for-the-boardroom/

She highlights that the response to GDPR will need board level support and calls out both the reputational damage and the large fines that can be suffered by organisations that aren’t able to show that data protection is “a cornerstone of your business policy and practices.”

She recommends that if the organisation needs to formally designate a Data Protection Officer, that individual needs to be properly resourced and to report directly to the board.

**Contacts – Data Protection**

For more information on the GDPR or to discuss how best to approach data in its broadest sense please contact our Data Privacy Team. Our data privacy team works closely with technology and data experts, offering a holistic view of legal and compliance, technology, and data to enable long term, business-focused data strategy solutions.

Peter Gooch – Data Privacy Leader
020 7303 0972
pgooch@deloitte.co.uk
FTSE 100 survey on cyber risk reporting
Earlier this year we published the results of our first survey of cyber risk disclosures in FTSE 100 annual reports. This is an area of ever-increasing risk and regulatory focus, highlighted by recent high profile exposures in both the public and private sectors to attacks such as the WannaCry ransomware.

Our survey showed some encouraging practice across different sectors but also demonstrated that there are real opportunities for all listed companies to improve disclosure around cyber risk reporting. Here are some of our key findings regarding the reporting of cyber risk, management or mitigation and the role of the board.

Reporting of cyber risk
- 95% mentioned cyber risk in the annual report; 87% across all sectors disclosed cyber risk as a principal risk.
- Principal risks identified most often were the risk of cyber crime/attack/threat and the failure of IT systems.
- 68% identified the main impact of the risk as business disruption; 58% mentioned reputational damage.
- Only 10% disclosed cyber security incidents in their organisation – substantially fewer than mentioned an increase in such incidents in their industry.

Management or mitigation
- 29% identified IT policies as a mitigating factor
- 5% said that they have insurance against cyber breach
- 28% have undertaken staff training or education
- 27% identified a person or team with executive responsibility for cyber risk
- 38% identified internal controls as a mitigating factor

The role of the board
- Only 76% mentioned cyber risk in corporate governance or board committee reports – 11% fewer than those who identified it as a principal risk.
- 5% identified a board member with direct specialist expertise.
- 10% disclosed cyber training provided to the board.

Cyber risk – an area of increasing regulatory focus
To find out more about how financial services boards should respond to growing cyber risks, please access our regulatory compliance blog:

http://blogs.deloitte.co.uk/financialservices/2017/05/how-should-financial-services-boards-respond-to-growing-cyber-risks.html
FTSE 350 Cyber Governance Health Check

DCMS has been running its fourth annual FTSE 350 UK Cyber Governance Health Check, the results of which are anticipated in the next two months. This is part of the UK’s strategy to lead in digital innovation and cyber security. As in previous years, the Health Check was sent to Audit Committee Chairs for completion, with the aim of promoting awareness and providing insight into how boards are strategically managing and responding to cyber risk.

This year for the first time questions have been included on the General Data Protection Regulation to find out how advanced companies believe they are in preparing for the requirements. Anecdotally, the risk of high fines is gaining significant attention at board level and we await the results of the DCMS survey with interest.

For information, the questions asked in the Health Check are set out below. If not already done, boards should consider how they are addressing these matters.

1. Does the main Board have a good understanding of what the company’s key information and data assets are (e.g. IP, financial, corporate/strategic information, operation data, customer/personal data etc), their value to the company and to a competitor or criminal?

2. Does the main Board have a good understanding of the potential resulting impact (for example on customers, share price or reputation) from the loss of disruption to key information and data assets (e.g. IP, financial, corporate/strategic information, operation data, customer/personal data etc)?

3. To what extent has your Board explicitly set its appetite for cyber risk, both for existing business and for new digital innovations?

4. How significant or important is cyber risk, where risk is a product of likelihood and magnitude, when compared with all the risks the company faces?

5. To what extent is your Board’s discussion of cyber risk underpinned with up-to-date management information and threat intelligence?

6. Which of the following statements best describes how cyber risk is handled in your Board governance processes? (Responses range from cyber risk being a technical topic not dealt with at board level through to actively managing the cyber risk profile throughout the year)

7. Does the board review and challenge reports on the security of your customer’s data?

8. Does your company have a plan in place to respond to a cyber incident?

9. If you do have a plan in place to respond to cyber incidents, does the Board play a role in the incident response?

10. Has your board received any training to deal with a cyber incident?

11. How aware are you of the General Data Protection Regulation (GDPR) and what these new requirements will mean for your business?

12. How prepared is your organisation to meet the GDPR requirements?

13. Which of the GDPR requirements are causing you the most concern in terms of meeting compliance?

14. Which of the following best describes how the GDPR is being handled by your board? (Responses range from GDPR being a technical topic not dealt with at board level through to actively managing the GDPR risk profile throughout the year)

Contacts – Cyber risk

Deloitte’s cyber risk practice assists organisations throughout the public and private sectors with their cyber challenges, including cyber risk assessment and strategy, implementing cyber defences, providing threat intelligence and managed cyber services and helping organisations deal with the aftermath of a breach.

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Global HR trends – the organisation of the future

Global HR trends
Technology is advancing at an unprecedented rate: artificial intelligence, mobile platforms, sensors and social collaboration systems are revolutionising the way we live, work and communicate. This accelerated pace of change causes stress for individuals and societies – employees and organisations can feel overwhelmed.

On the other hand, business productivity has not kept pace with technological progress. Productivity remains stubbornly low despite the introduction of new technology – since 2008, growth in business productivity has been at its lowest rate since the early 1970s. How can companies bridge the gap between technological sophistication and the amount of work actually performed?

Annually, we perform a survey of business and HR leaders worldwide to identify the key areas of focus for organisations to better organise, manage, develop and align people at work. This year our survey covered more than 10,000 leaders from 140 countries, with companies of all sizes across a broad cross-section of industries. 44% of UK respondents were from the C-suite.

Building the organisation of the future
This year, we found that 88% of survey respondents believe that this issue – building the organisation of the future – is an important or very important issue, top of our survey for the second year in a row. This statistic is exactly the same looking at the worldwide data. However, only 11% of survey respondents believe they understand how to build the organisation of the future.

We think the answer lies in HR strategies. The way high-performing organisations operate today is radically different from how they operated 10 years ago and it is organisations operating according to decades old models, with legacy practices, systems and behaviours that stand in the way of true change.

Respondents to our survey identified collaboration, agility and customer-centric models as the critical characteristics that will enable future organisational success – however only 6% of respondents believe their organisations are highly agile today.

Companies are on a journey and the challenge is how they can leverage new technologies to reach their destination more quickly.

Next steps
We believe that there are a couple of practical steps leaders can consider to help their organisation get to their destination more quickly:

1. Work to establish a culture of trust and experimentation, where risk-taking and learning from mistakes (within a suitable ethical framework) is encouraged and appropriately incentivised.

2. Find a niche in your company where it makes sense to disrupt and the changes can have a clear and measurable impact. Seek to learn from small experiments and use those initial successes to create a climate in which change can flourish.
Diversity and inclusion

Another of the trends emerging from our 2017 survey was diversity and inclusion. 69% of leaders rated diversity and inclusion as very important or important – higher in the UK, at 74% – and the proportion who put inclusion as a top priority rose by 32% compared to our 2014 survey.

Fairness, equity and inclusion have become a CEO level priority around the world. The digital organisation of today operates as a network of teams and thrives on empowerment, open dialogue, and inclusive working styles. Leading organisations now see diversity and inclusion as a comprehensive strategy woven into every aspect of the talent life cycle to enhance employee engagement, improve brand, and drive performance – diversity is no longer a “check the box” initiative.

A full 78% of respondents believe diversity and inclusion is a competitive advantage – the ideological battle appears to have been won. However achieving a diverse and inclusive organisation continues to frustrate and challenge leaders. Only 38% of respondents reported that the CEO was the primary sponsor of the company’s diversity and inclusion programme.

Next steps

A couple of practical steps leaders can consider to improve the organisation’s diversity performance:

1. Focus on communication, ensuring leaders have sight of research on the value of inclusion to build consensus throughout the organisation.

2. Set challenging targets and hold leaders accountable through regular reporting on diversity in hiring, promotion and pay, bearing in mind that specific challenges for diversity and inclusion will vary across geographies.

Traits of an inclusive leader:

- Cognisance of bias
- Collaboration
- Commitment
- Courage
- Curiosity
- Cultural intelligence

UK diversity initiatives

In addition to the HR Trends considerations, there have been two recent UK skills and diversity initiatives that we recommend should be taken into account when deciding how to set and prioritise activity and reporting on diversity and inclusion.

The Hampton-Alexander Review

In 2011, Lord Davies launched an independent review of women on boards, commissioned by the Government, which recommended that FTSE 100 companies aim for at least a 25 percent representation of women on boards by 2015. Five years later, in his final report on improving the gender balance on British company boards, Lord Davies reported that 26.1 percent of FTSE 100 board seats were now held by women.

The final report called for further work and a renewed focus on key boardroom appointments, notably the board chair and senior independent director roles. It also called for an increase in the number of women appointed to executive director positions, noting that further diversifying the pipeline and the executive can lead to more women serving on boards in the future.

In July 2016, the successor Hampton-Alexander Review launched its initiative, supported by the Government, with a focus on FTSE 350 executive committees and direct reports to the executive committee. The Review calls for a voluntary target of 33 percent women directors serving on FTSE 350 boards by 2020. Additionally, the report calls on CEOs of FTSE 100 companies to strive to increase the representation of women on executive committees and their direct reports to 33 percent by 2020.

The report also requests transparent reporting on the gender balance of executive committees, with reporting on the proportion of women on the executive committee and on the proportion of women directly reporting to the executive committee in the annual report. It also calls for the support of nomination committee chairs, the FRC, investor groups, and executive search firms to help achieve these targets.
Race in the workplace – The McGregor-Smith Review

In February 2017, Baroness McGregor-Smith published her review on issues faced by businesses in developing Black and Minority Ethnic (BME) talent in the workplace. She set out a “roadmap to success” which outlines her key recommendations. Baroness McGregor-Smith values the full utilisation of BME talent as a £24 billion annual benefit to the UK economy (1.3% of GDP).

Key recommendations

The full list of recommendations runs to 26 items, the last of which is a call for government support and action if opportunities have not improved for ethnic minorities in twelve months. Baroness McGregor-Smith’s recommendations include:

- Publish five-year aspirational targets and report against these annually – for listed companies and all businesses and public bodies with more than 50 employees.
- Publish a breakdown of employees by race and pay band – for listed companies and all businesses and public bodies with more than 50 employees.
- For all employers, take positive action to improve reporting rates amongst the workforce, explaining why supplying data will improve diversity and the business as a whole – for those impacted by the first two recommendations, this would be expected to improve the quality of data published.
- Introducing a board-level sponsor for all diversity issues, including race, to be held to account for the overall delivery of aspirational targets. In order to ensure this happens, Chairs, CEOs and CFOs should reference what steps they are taking to improve diversity in their statements in the annual report.
- Including a diversity objective in all leaders’ annual appraisals to ensure they take positive action seriously.
- Using contracts and supply chains to promote diversity and seek bidders who show a real commitment to diversity and inclusion.

There are also recommendations around mentoring, workshops or training on unconscious bias, recruitment and interview, reward and recognition and transparency around career pathways, achieving success and diversity policies.


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On the audit committee’s agenda
Corporate reporting matters

The time draws near for IFRS 16 Leases
IFRS 16 Leases will be effective for periods commencing on or after 1 January 2019 (subject to EU endorsement). However, it will require either full retrospective application or a cumulative day one “catch up” to ensure the full historical effect of the change is reflected in retained earnings.

Despite the time coming closer and encouragement from regulators such as ESMA, we have not seen much in the way of disclosure of the impacts of the standard. Our 2016 annual reporting survey, published last year, looked at 100 annual reports of listed UK companies.

We asked: how much disclosure have companies given about the expected impact of IFRS 16? Well over half of companies had made no substantive comment on IFRS 16.

It is important to remember that IFRS 16 will have broad implications and could fundamentally alter the balance sheet and income statement of many companies, including key measures such as operating profit and debt.

developed a series of questions to consider and to ask management when planning to implement the new leasing standard:

<table>
<thead>
<tr>
<th>Questions underlying the assessment</th>
<th>Areas to consider</th>
<th>Questions to ask management</th>
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<tbody>
<tr>
<td>Do you know which of your contracts are, or contain, leases?</td>
<td>The new definition of a lease is based on a customer having a right to control an identified asset. A transitional relief means that companies don’t need to re-assess on transition whether existing contracts contain a lease.</td>
<td>Do we know which parts of the business hold technology and other operating leases?</td>
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<tr>
<td>Are your systems and processes capturing all the required information?</td>
<td>Do you have all your lease data recorded in a database or master spreadsheet? Is the data up to date, reliable and in a format that can be manipulated and does it cover everything you will need to know and report?</td>
<td>Is all of our lease data recorded in the same system or the same format?</td>
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<tr>
<td>Are systems and processes capable of monitoring leases and keeping track of the required ongoing assessments?</td>
<td>Lessees are required to remeasure the liability under a range of circumstances, including changes to the lease term and rent reviews. Modifications to lease terms will also need to be monitored. Systems and internal control activities will need to be suitably robust.</td>
<td>Has management set up an implementation roadmap for changes required to systems or internal controls?</td>
</tr>
<tr>
<td>Have you considered the potential use of IFRS 16’s recognition exemptions and practical expedients?</td>
<td>Leases with a lease term of 12 months or less and no purchase options and leases for low-value assets (such as small IT equipment or office furniture) can be kept off balance sheet. Certain contracts that combine leases and services can be treated entirely as leases. Portfolios of similar contracts can be treated in the same way in some circumstances.</td>
<td>Do we need a new system or can we build out elements of our existing system?</td>
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Governance in focus | On the board agenda – H2 2017
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<tr>
<th>Questions underlying the assessment</th>
<th>Areas to consider</th>
<th>Questions to ask management</th>
</tr>
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</table>
| Do you know what transitional reliefs are available, and whether you will apply any of them? | An early decision to be taken is whether to apply the full retrospective approach or the modified accounting approach of applying the cumulative effect on opening retained earnings and leaving comparatives unchanged. | Have we performed an impact assessment of the effort required to implement each approach and the financial effect?  
Note: the conclusion is likely to vary according to the business involved. |
| Do you know what discount rates you’ll be using for your different leases? | Lessees are required to discount their liabilities to a present value, using the rate implicit in the lease if this is readily determinable. Where it is not readily determinable the incremental borrowing rate is used.  
For properties which tend to increase in value the pure mathematical approach may produce unreasonable answers. | Have we performed our assessment of discount rates bearing in mind that these will be asset-specific rather than one rate for the business as a whole?  
Have we identified how much effort will be needed to determine the discount rates across our portfolio? |
| Have you considered the impact of the changes on financial results and position? | Lessees will become more asset rich and more heavily indebted. The expense profile will typically shift to being more front-loaded. This could have a knock-on effect on debt covenants, remuneration schemes and various key performance indicators. | Have we assessed the impact on an overall financial statement level as well as an individual asset level?  
Have we identified any covenants or KPIs that will be affected by the changes?  
Have we considered the impact of the changes in the executive pay policy? |
| How will you communicate this impact to affected stakeholders? | Loan agreements, remuneration plans, earnouts and similar may all need to be re-negotiated if entities are affected by the changes and will also need to be considered when entering into similar, new agreements.  
Also worth bearing in mind that regulators are expecting much of this communication to happen through required annual report disclosures. | Have we identified which stakeholders this could impact?  
Do we have a plan to manage analyst and investor expectations and explain potential impacts they will see on our results? This could be through annual report disclosures.  
Has a communication timetable been set up? |
| Have you planned when you will consider the tax impacts? | The UK tax treatment for leases is currently based on the IAS 17 model of operating and finance leases, but IFRS 16 could prompt changes to tax legislation. | Does management have a plan to keep up to date with developments in tax legislation in this area? |
| Have you considered whether your leasing strategy requires revision? | It is worth assessing the accounting implications of the leasing strategy. For instance, entities may wish to reconsider lease-buy decisions or renegotiate terms of existing leases, considering shorter-term leases to avoid or reduce the impact. | Is management running down leases or agreeing shorter lease periods?  
What is the current leasing strategy and what could cause that to change? |

We will be looking at the disclosures around implementation of IFRS 16 again, together with the earlier implementation of IFRS 15 and IFRS 9, as part of the Deloitte 2017 Annual Reporting Survey. For information on how Deloitte can help and our suite of IFRS 16 resources, visit [www.deloitte.co.uk/ifrs16](http://www.deloitte.co.uk/ifrs16).
New EU Non-Financial Reporting Regulations for Public Interest Entities

For financial years beginning on or after 1 January 2017, all public interest entities (PIEs) that have over 500 employees either in the company itself or in the group headed by the company will need to meet new non-financial reporting requirements in their annual report. For quoted companies, already required to provide a strategic report under existing UK reporting regulations, the changes will be limited to:

In the strategic report

1) Inclusion of information about any policies in relation to anti-corruption and anti-bribery, any due diligence process implemented by the company in pursuance of those and the outcome of those policies, or a clear and reasoned explanation for not having those policies.

2) Where relevant and proportionate, disclosure of the principal risks arising from the company’s business relationships, products or services which are likely to cause an adverse impact on environmental, social and community, employee and human rights, anti-corruption and anti-bribery matters. The company must also disclose how it manages those risks.

In the corporate governance statement

Companies within scope are required to describe their diversity policy in relation to administrative, management and supervisory bodies (in the UK context, the board) including aspects such as age, gender, geographical diversity and educational and professional background.

As well as describing the policy, or providing a clear explanation if no such policy exists, they must explain the objectives of the policy, how it has been implemented and the results of the policy in the reporting period. Where this information is incorporated into existing disclosures in the directors’ report or strategic report, a suitable cross-reference should be provided.

Scope

As a reminder, a PIE is a public interest entity, defined in EU law as being an EEA 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.

This differs from the definition of a quoted company for the purposes of the strategic report by extending the requirements to companies with listed and unlisted banks, building societies and insurers. For those companies, a fuller consideration of the new requirements will be necessary and they should refer to the appendix to determine which disclosures they will need to provide.

Companies with listed debt and no listed shares, or that meet the size criteria to qualify as small or medium-sized under company law, will be exempt from this corporate governance statement requirement (also see appendix).

A round-up of other hot topics
In this final section on corporate reporting matters we wanted to provide a summary of other hot topics which will be relevant when you start to consider your next annual report. We will return to these in more detail in our year-end round-up and will include any updated guidance from the FRC.

**Three FRC thematic reviews – findings due later this year**

A clear impact assessment is required, and based on our work helping companies to develop strategies in response to IFRS 16, we have

<table>
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<tr>
<th><strong>Key judgements and estimates</strong></th>
<th>The FRC would like to see improvements in disclosures relating to significant accounting judgements and sources of estimation uncertainty. For further information please read ‘Need to know – Spotlight on key judgements and estimates disclosures’ available from <a href="http://www.iasplus.com/en-gb">www.iasplus.com/en-gb</a></th>
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<tr>
<td><strong>Alternative performance measures (APMs)</strong></td>
<td>The FRC is conducting a follow-up thematic review on the use of APMs following the new ESMA guidelines. For further information please read ‘Need to know – A practical guide to alternative performance measures’ available from <a href="http://www.iasplus.com/en-gb">www.iasplus.com/en-gb</a></td>
</tr>
<tr>
<td><strong>Pension disclosures</strong></td>
<td>The FRC would like to see improvements in the disclosures required by IAS 19. In particular, it would like to see: • quantified information on funding levels and contributions expected to be paid not just in the next year but in future years; • any judgements made in assessing trustee’s rights in respect of a possible scheme surplus, and whether the entity has an unconditional right to economic benefits (which will support recognition of a net scheme surplus and/or not recognising additional liabilities in respect of a future potential surplus arising from committed future contributions); • clear identification and explanation of the risks inherent in the investment strategy, including whether complex financial instruments are being used; and • an explanation of how fair value has been determined for assets such as insurance contracts or longevity swaps.</td>
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Two other developments to be aware of

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<tr>
<th>Updated guidance on realised and distributable profits</th>
<th>New guidance on accounting for intragroup off-market loans has been added and the guidance on retirement benefit schemes has been rewritten. Clarity has also been provided on the application to long-term insurance businesses as a result of Solvency II. Other changes are in the nature of updating references to the revised standards, removing obsolete material that had become outdated in the previous guidance and providing further clarity in certain areas. For further information please read ‘Need to know – ICAEW and ICAS publish updated guidance on realised and distributable profit under the Companies Act 2006’ available from <a href="http://www.iasplus.com/en-gb">www.iasplus.com/en-gb</a>.</th>
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In pursuit of high quality audit

Assessing confidence in UK audit
In February 2017, six months after becoming the UK’s Competent Authority for Audit, the FRC issued an update to its report “Developments in audit” assessing confidence in UK audit.

The FRC is working to understand the differences between audit committee chairs’ views on quality, the views of investors and the findings of FRC inspections. The aim is to develop a mutually agreed view of quality and increased transparency of what the Audit Quality Review Team focus on in their reviews so that audit committees are better able to explain how they have assessed audit quality.

The report highlights that whilst progress has been made on improving audit quality, there remains a need to focus on the pace of improvement and consistency. The key findings of the report are set out below and should be considered by audit committees in their interactions with their auditors in the year ahead:

Conflicts of interest – in applying the new Ethical Standard in relation to auditor independence, not all audit firms were found to be demonstrably serving investors’ interests.

Audit firm governance and culture – the FRC acknowledges the link between effective leadership and audit quality and plans to review the effectiveness of governance and the culture of audit firms, including adoption of the Audit Firm Governance Code, and the public interest role of the independent non-executives of the firms.

Insufficient auditor scepticism – an emerging theme from the 2016/17 inspections is that there has been insufficient auditor scepticism in identified areas of significant risk such as the assessment of potential impairments and judgements concerning material accounting treatments.

Root cause analysis – firms can accelerate audit quality through better use of root cause analysis techniques of internal and external reviews to understand why audits have fallen below the standard expected.

Use of data analytics – audit firms are increasingly investing in and using these techniques to improve audit quality and to bring more insights to management. Audit committees should discuss use of these techniques with their auditors.

Good practices observed as part of an AQR thematic review on the use of data analytics
- Focused roll-out of a specific data analytics tool to enable staff to build experience and confidence in its use
- Clear positioning of data analytics techniques within the audit methodology
- Testing or trial running the use of these techniques at the interim in the first year
- Using specialist staff and standard scripts for data capture and loading data analytics tools
- Centrally running data analytics for group audits
- Clear documentation using flowcharts to aid understanding and subsequent re-performance

Transparency around AQR inspections – going forward the FRC will increase the transparency of its audit quality reviews by publishing periodic lists of those entities whose audits it has reviewed. The FRC expects increased reporting by audit committees of its findings and increased scrutiny from investors.

Actions for audit committees
The report also included some specific actions for audit committees:

- Focus on perceived conflicts and challenge auditors on significant judgements affecting matters of independence
- Report meaningfully on how audit quality has been assessed, including reflecting FRC findings
- Seek evidence from auditors of the quality of their impairment testing and their challenge of management
- Read the FRC updated notes on tendering and ensure an effective tender process

The FRC’s paper is available in full on their website.
**FRC’s Discussion Paper on the role of Auditors and Preliminary Announcements**

The FRC has issued a discussion paper which aims to update or replace the current guidance for auditors regarding preliminary announcements of annual results. This reflects the relatively low fall off in preliminary announcements since they ceased to be a legal requirement and thus the continuing need for auditor involvement. Options include extending the scope of the guidance, turning it into an auditor’s engagement standard, introducing additional regulation and potentially even requiring audits to be complete and the auditor’s report signed before preliminary announcements can be released.

In addition, the FRC poses questions about the change in the nature of the annual report since the previous guidance was issued in 2008. In particular:

- whether the auditor’s review should now need to consider whether the preliminary announcement is fair, balanced and understandable;
- how far it should reflect new guidance on APMs;
- whether any form of reporting by the auditor should be included in the preliminary announcement; and
- for unaudited preliminary announcements, whether the reading of “other information” in the annual report should be complete before the auditor agrees to the announcement.

For certain companies listed on the LSE that release an unaudited preliminary announcement, some of the areas under discussion, if adopted, could have a significant impact on the year end approach and reporting timetable.

The closing date for responses to the FRC’s Discussion Paper is 24 June 2017.

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**Audit committee effectiveness**

Earlier this year, we issued an updated edition of our audit committee effectiveness framework. The updates cover all the major changes since our first edition was launched arising from the 2016 UK Corporate Governance Code; the 2016 Guidance on Audit Committees; and the new Ethical Standard for auditors.

As well as updating all the mandated areas, we have added some key considerations around narrative reporting which audit committees will be considering in the current volatile economic and political environment.

Also included are considerations on reporting on wider stakeholder engagement to reflect the board’s duties under section 172 of the Companies Act 2006. With apologies to those who are allergic to checklists – they have their uses as a completeness check – you can access the full framework by clicking [here](#).

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Further developments in taxation

**New corporate criminal offence to prevent the facilitation of tax evasion**

The Criminal Finances Act, 2017 which received Royal Assent on 27 April, introduces a new corporate offence in response to the perceived inability to prosecute effectively larger organisations where those acting on their behalf have facilitated tax evasion by a third party. This covers both criminal facilitation of UK tax evasion and overseas tax evasion where this would have been a crime in the UK. There are unlimited financial penalties for this offence.

Organisations will be held liable automatically for the criminal facilitation by an “associated person” of the tax evasion unless they can prove that “reasonable procedures” were in place at the time of the facilitation, or that in the circumstances it was not reasonable for the organisation to have any such procedures in place. Once reasonable procedures have been identified and implemented, HMRC expects them to be kept under regular review and to evolve in line with the business’s risks.

Draft guidance issued by the Government recognises that many groups will already have some procedures in place in relation to Anti-Bribery and Corruption and other measures but confirms that it should not be assumed that these are sufficient. The commencement date of the rule will remain unconfirmed until after the General Election but it is understood that it will remain as September 2017 as previously communicated. Businesses are expected to have at least undertaken a risk assessment by this date and companies should have a roadmap to consider fully the risks of tax evasion facilitation, scope and implement reasonable procedures, initially focusing on the major risks.

**Risk assessment roadmap**

- Undertake a structured risk assessment of the organisation, documenting the findings and high risk areas.
- Implement proportional and pragmatic procedures that reflect the nature and complexity of the business.
- Develop responses and a timeline for implementation, on a plan that is reasonable and proportionate.
- Embed policies throughout the organisation through training and communication.
- Monitor and review preventative procedures and make improvements where necessary.
- Build a body of evidence to accurately show the proportionality and practicality of the organisation’s response.

**Developments in public Country-by-Country Reporting**

There is currently legal debate within the EU regarding proposals for public Country-by-Country Reporting of certain tax and other information by groups with turnover of €750 million or more. The report would be required to disclose the profit and the tax accrued and paid in each Member State and certain other countries with the goal of combating aggressive tax planning through exposure to public scrutiny.

An updated draft Directive to amend the Accounting Directive was released in December 2016. There is a question as to whether this can be approved with a Council qualified majority and a simple majority of the European Parliament, as an accounting matter, or requires Council unanimity and consultation with the European Parliament, as a tax matter. The proposals are stalled until this has been resolved.

The above should not be confused with the EU’s 2016 Directive which requires member states to implement Country-by-Country reporting to tax authorities only, in line with the recommendations of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project Action 13. This Directive is already in force.

Irrespective of the proposals themselves, there is investor pressure. The Financial Times has reported that Norway’s oil fund, the world’s largest sovereign wealth fund, is planning to encourage the companies it invests in to publish open disclosure about taxation on a country-by-country basis and to make public disclosure of reasons they locate subsidiaries in lower tax jurisdictions.
Developments in disclosure of taxation

Businesses have been quick to respond to findings published by the FRC following their thematic review of tax disclosures published in late 2016. We have found that the annual reports of the FTSE 100 groups with 31 December 2016 year-ends show a clear improvement in tax disclosure quality, particularly in relation to the two key areas of interest to the FRC: the transparency of tax reconciliation disclosures (and how well the sustainability of the effective tax rate is conveyed), and uncertainties relating to tax liabilities and assets. We have also looked at how companies have disclosed tax strategy.

Our Need to Know publication provides more detail on issues concerning the reporting of tax.

Our findings – companies have responded to the FRC’s calls for improved disclosure

Of the 61 FTSE 100 constituents with 31 December 2016 year-ends:

- 41 included narrative explaining their current year effective tax rate, and
- 17 included an estimate of their future expected rate;

Many explained the factors expected to affect their future effective tax rate, with 21 mentioning the OECD’s Base Erosion and Profit Shifting (‘BEPS’) initiative and 16 mentioning US tax reform;

- 45 included tax as a critical accounting estimate/key source of estimation uncertainty, and 12 discussed potential material adjustments in the next 12 months; and
- 15 provided background to their uncertain tax provisions, with 14 disclosing the amount of the tax risk provision.

Our findings – disclosing tax strategy

- 32 companies – just over half – disclosed some form of tax strategy statement, either contained within the annual report or as a stand-alone document. 29 have no disclosure.

Nine of those disclosures confirmed that their statement was intended to meet the requirements for disclosure of the UK tax strategy.

- 16 companies had a substantial tax strategy disclosure within their annual report, with 12 disclosures meeting all the requirements and four partially meeting the requirements.

Average page length:

- Less than one page: 14 companies;
- 1 – 3 pages: 14 companies; and
- More than 3 pages: four companies.

23 cited tax as a principal risk in their strategic report – almost 38% of the sample.

- 45 companies refer to governance and risk management either in their annual report or their tax strategy statement, however only 13 mentioned arm’s length pricing.

Examples include BAE Systems, which integrates the tax strategy disclosure into its annual report (page 30), and GSK which presents a stand-alone tax strategy on its website.
Beyond the annual report – an update on transparency initiatives

Modern Slavery Act
The Modern Slavery Act 2015 requires organisations with an annual turnover of at least £36 million that supply goods or services into the UK to make an annual statement regarding the steps taken to identify and combat modern slavery in both direct operations and supply chains. Large multinational groups should cover all operations which carry on a business or part of a business in the UK i.e. supplies goods and services to the UK. Specifically where a large foreign parent carries on a business or part of a business in the UK, it should cover all its foreign and UK direct operations and supply chain.

Our analysis of the first year statements has shown that organisations are still gearing up to comply with the requirements of the Act and supplementary guidance released by the Home Office.

Most disclosure thus far has been aspirational, talking in terms of the steps organisations are planning to take in the future when developing policies and internal training. Many companies are still grappling with the fundamentals of understanding and segmenting the supplier base and the underlying requirements for due diligence.

The Home Office guidance, Transparency in Supply Chains: a practical guide, leaves organisations to decide for themselves what is reasonable to include in their disclosure.

Key questions organisations ask themselves when preparing their statements include:

- How best to engage suppliers to provide necessary information for the due diligence process?
- How deep into the supply chain is the due diligence process expected to go?

Supplier engagement
So far, companies have taken a practical approach to supplier due diligence assessments, initially engaging their direct (tier-one) suppliers with the biggest spend. However, it is widely recognised that the risk is often more prevalent further down the supply chain and/or in non-standard products or services. Larger companies with global operations and supply chains can face significant challenges finding they have little or no visibility, let alone control, further down the supply chain than their direct suppliers.

In our experience, developing a robust risk management framework which gradually and continuously increases visibility over the supply chain, using collaborative and mutually beneficial supplier engagement procedures as well as predictive risk analytics tools, are key to achieving successful and pragmatic solutions.

Whilst first year disclosures reflect the concern corporates had in terms of the depth of disclosure and level of transparency expected, the Act does encourage progress in reporting year on year and stakeholders are increasingly calling for more mature reporting.

Expectations for next year’s disclosures have been raised by the likes of BT and ASOS who provide valuable insights into their business structures and supply chains as well as transparent disclosures on identified risk and related mitigation activities to demonstrate that they are taking the issue seriously.

Contacts – Modern Slavery Act
Deloitte’s experienced team provides a comprehensive compliance framework with tools to assist companies in developing medium-term strategies and actions plans, supply chain risk analytics to effectively and pragmatically map and identify risk in the supply chain, e-learning training modules, as well as maturity assessments of modern slavery act statements.

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Gender pay gap reporting

The regulations on gender pay gap reporting came into force on 6 April 2017, requiring all private and voluntary sector employers with at least 250 employees in Great Britain to calculate and publish information on gender pay gaps within their organisation.

The “snapshot” date on which companies and charities must capture pay data is 5 April. This means that the first disclosures are now required by 4 April 2018.

The reporting requirements apply to each separate legal entity within the group structure with at least 250 relevant employees. Each part time worker counts as one employee towards the headcount figure.

Non-compliance will be an unlawful act and will empower the Equality and Human Rights Commission to take enforcement action.

In addition to the required reporting, employers may want to undertake analysis on differences in pay and the composition and structure of the workforce in order to understand the story behind the figures and take specific actions to target any gender pay gaps. Gender pay gap results will not be the same as an equal pay audit and there may be good reasons for a gender pay gap that can be explained.

Where can guidance be obtained?

Time to act: Getting ready for the gender pay gap information regulations.

We have produced an interactive guide on the gender pay gap regulations to help employers understand and comply with the regulations. The guide also offers advice on additional measures which organisations may wish to consider to identify and reduce gender pay gaps.

The Government Equalities Office and Acas has issued guidance: Managing gender pay reporting.

Acas is also maintaining a website with further resources to assist employers, and the Government’s Gender Pay Gap campaign website is also available at genderpaygap.campaign.gov.uk, including guidance and case studies. This is also the portal on which companies are expected to submit their gender pay gap information.

Contacts – Gender pay gap

Deloitte can work with companies to identify any issues around gender pay and equality, collect and consider relevant data, help them through the design and implementation of action plans to address any gaps and assist in developing reporting plans and the disclosures required for internal and external purposes.

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What information must employers publish?

- Mean and median gender pay gap
- Mean and median gender bonus gap
- Proportion of men and women receiving a bonus payment
- Proportion of men and women in each pay quartile of the organisation
- A written statement, signed by an appropriate senior person, which confirms the accuracy of their calculations
Payment practices and performance

New regulations have come into force for large companies for years commencing on or after 6 April 2017. They require reporting within thirty days of every six month period, aligned with the financial reporting cycle. This means that for companies with a December year end, the first reports will be due by 30 July 2018. Reporting is required for each large company and can’t be submitted on a group basis.

Reports will be submitted on a Government web portal and must be approved by a director of the company, with potential criminal sanctions for those that fail to comply.

New proposed reporting requirements

<table>
<thead>
<tr>
<th>Type of reporting</th>
<th>Requirement</th>
<th>Further detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Narrative description</td>
<td>The organisation's payment terms.</td>
<td>Including:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Standard contractual length of time for payment of invoices;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Maximum contractual payment period; and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Any changes to standard payment terms and whether suppliers have been notified or consulted on these changes.</td>
</tr>
<tr>
<td>Narrative description</td>
<td>The organisation's process for dispute resolution related to payment.</td>
<td></td>
</tr>
<tr>
<td>Statistics</td>
<td>Average time taken to pay invoices.</td>
<td>From the date of receipt of invoice.</td>
</tr>
<tr>
<td>Statistics</td>
<td>Percentage of invoices paid within the reporting period.</td>
<td>In 30 days or fewer, between 31 and 60 days, over 60 days.</td>
</tr>
<tr>
<td>Statistics</td>
<td>Proportion of invoices due within the reporting period which were not paid within agreed terms.</td>
<td></td>
</tr>
<tr>
<td>Statements (tick-box)</td>
<td>Does the organisation offer e-invoicing?</td>
<td></td>
</tr>
<tr>
<td>Statements (tick-box)</td>
<td>Does the organisation offer supply chain finance?</td>
<td></td>
</tr>
<tr>
<td>Statements (tick-box)</td>
<td>Do the organisation’s practices and policies cover deducting sums from payments as a charge for remaining on a supplier’s list, and have they done this in the reporting period?</td>
<td></td>
</tr>
<tr>
<td>Statements (tick-box)</td>
<td>Is the organisation a member of a payment code?</td>
<td>If so, the name of the code.</td>
</tr>
</tbody>
</table>
What do we think you should do to prepare?
First, this will form part of your public reporting and will be accessible both to your suppliers and to the media, so companies should consider making this reporting part of the board’s agenda and putting it through formal review processes – it forms part of the board’s responsible engagement with suppliers.

Second it is worth reviewing your practices as they are now, including any supplier challenge/complaints regarding slow payments, and implementing any necessary changes ahead of time. Some companies don’t yet have a mechanism to capture supplier complaints and this is a good first step.

Finally, don’t forget to bear in mind your own working capital requirements when getting to grips with the new duty to report.

Contacts – Working capital improvement team
Our Working Capital Improvement team helps clients to release cash tied up in trade working capital, and also works with clients to assess the impact of and improve compliance with the Prompt Payment Code and Duty to Report.

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On the remuneration committee’s agenda
Remuneration reporting – the AGM season story so far

**Trends in FTSE 100 companies**

We anticipated that the big story this year, other than remuneration quantum, would be new remuneration policies. The first policies were approved three years ago under the 2013 remuneration regulations to hold a binding policy vote at least every three years.

43 out of the 61 FTSE 100 companies that have reported so far this year have put forward a new remuneration policy for approval by shareholders, mainly with minor changes to policies to reflect best practice. The story of this AGM season seems to be one of resistance to change:

- The ‘traditional’ combination of an annual incentive plan and performance share plan continues to be the preferred remuneration structure, with only one company having so far introduced a form of restricted stock.
- Some companies are reducing pension provisions (usually for new executive directors), reflecting calls from investors for pension provision to more closely align with the wider workforce.
- So far this season, only one FTSE 100 company has proposed the introduction of a restricted stock plan. One FTSE 250 company also proposed the introduction of a restricted stock plan for executive directors, although this was intended to be in addition to the current bonus and LTIP structure. This policy was withdrawn prior to the AGM.
- A further four FTSE 100 companies have so far disclosed in the remuneration committee chair’s statement that alternative arrangements, such as restricted share awards, were considered when determining the new remuneration policy, but were decided against.
- Five companies have reduced the number of plans in operation. In each of these companies, the ‘traditional’ combination of an annual incentive plan and performance share plan is now in place.
- 74% of companies offering their pay policy to a vote have not altered the overall level of remuneration available to executive directors in 2017.

**Proportion of votes in favour of the remuneration policy report – 2017**

(2017 includes meetings held up to the end of May 2017)

<table>
<thead>
<tr>
<th>Proportion of Votes</th>
<th>2017 FTSE 100 Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50%</td>
<td>3%</td>
</tr>
<tr>
<td>50% - 70%</td>
<td>8%</td>
</tr>
<tr>
<td>70% - 80%</td>
<td>21%</td>
</tr>
<tr>
<td>80% - 90%</td>
<td>69%</td>
</tr>
<tr>
<td>90% - 95%</td>
<td></td>
</tr>
<tr>
<td>95% or more</td>
<td></td>
</tr>
</tbody>
</table>

**Support for the annual remuneration report**

So far in 2017, the level of shareholder support for the remuneration report is consistent with historic trends over the last five years, having recovered from a slight dip in 2016:

- The median vote for the report is 96% in FTSE 100 companies, in line with the range of 96% – 97% we have seen over the last five years.
- To date in 2017, 82% of FTSE 100 companies received more than 90% of votes in favour of the directors’ remuneration report. Again, this represents a recovery from the dip in 2016.
- Just 4% of companies have received votes in favour of less than 70%, compared to 8% last year. So far, just one FTSE 100 company has not received a majority of votes in favour of the remuneration report.
How have proxy voting agencies responded?

- Proxy voting agencies have so far raised fewer concerns around remuneration than last year. Overall six companies (10%) have received a negative recommendation from at least one of ISS, IVIS and Glass Lewis so far:
  - ISS has recommended a vote against the remuneration policy in three companies (4% compared with 12% last year);
  - IVIS has raised serious areas of concern in relation to the remuneration policy in only one company; and
  - Glass Lewis has recommended a vote against the remuneration policy in two companies. It has recommended a vote against the remuneration report in a further four companies.

- Where issues have been raised these tend to relate to concerns around overall quantum and the link between executive pay and company performance, in line with the concerns of the corporate governance reform agenda.

Directors’ remuneration in FTSE 100 and 250 companies

Each year we produce reports on directors’ remuneration in FTSE 100 companies and FTSE 250 companies. These reports allow us to focus specifically on the different remuneration practices and issues faced by these two groups of companies. The reports provide detailed analyses of basic salary, salary increases, annual bonus payments and details of annual and long-term incentive design, pensions, notice periods, recruitment and termination arrangements and other aspects of remuneration policy. The reports will be available, free of charge, in the autumn.

Contacts – Executive remuneration

Deloitte’s executive remuneration practice helps clients develop executive remuneration strategies in line with corporate objectives and advises remuneration committees on the corporate governance and regulatory framework that applies to executive remuneration in the UK.

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# Appendix – Timeline of key changes in corporate governance

### Timeline of key changes in corporate governance

<table>
<thead>
<tr>
<th>Date</th>
<th>Code/Reform</th>
<th>Description</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>29 June 2010</td>
<td>2010 UK Corporate Governance Code</td>
<td>Board composition and selection Role of chairman and NEDs Board evaluation Annual re-elevation of directors Business model and significant risks Align performance-related pay to long-term interests</td>
<td>The UK Stewardship Code was launched in July 2010</td>
</tr>
<tr>
<td>1 October 2012</td>
<td>2012 UK Corporate Governance Code</td>
<td>Fair, balanced and understandable Audit committee reporting; significant issues relating to the financial statements; external audit effectiveness Gender diversity</td>
<td>Guidance on audit committees</td>
</tr>
<tr>
<td>1 October 2014</td>
<td>2014 UK Corporate Governance Code</td>
<td>Clawback and malus provisions Shareholder engagement Longer-term viability statement Ongoing monitoring of risk management and internal control</td>
<td>Guidance on risk management, internal control and related financial and business reporting</td>
</tr>
<tr>
<td>16 June 2016</td>
<td>2016 UK Corporate Governance Code</td>
<td>Minor changes reflecting EU law: Audit committee needs sector competence Advance disclosure of plans to retender the external audit</td>
<td>Updated guidance on audit committees</td>
</tr>
</tbody>
</table>

At a glance – a high level overview of the differences and which companies they affect

Existing non-financial information (Existing) requirements and EU NFR Directive (NFRD) non-financial information requirements for UK companies

<table>
<thead>
<tr>
<th>Company type</th>
<th>Principal risks</th>
<th>Environmental, social and employee matters</th>
<th>Human rights matters</th>
<th>Anti-corruption and bribery matters</th>
<th>Diversity matters</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Existing</td>
<td>NFRD</td>
<td>Existing</td>
<td>NFRD</td>
<td>Existing</td>
</tr>
<tr>
<td>Listed equity (&gt; 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td>✚</td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td>✚</td>
<td>❌</td>
</tr>
<tr>
<td>Listed equity (≤ 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
<tr>
<td>Listed debt (&gt; 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
<tr>
<td>Listed debt (≤ 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
<tr>
<td>Unlisted credit institutions (&gt; 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
<tr>
<td>Unlisted credit institutions (≤ 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
<tr>
<td>Unlisted insurance undertakings (&gt; 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
<tr>
<td>Unlisted insurance undertakings (≤ 500 employees)</td>
<td>✓ ✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>✓ ✓ ✓ ✓ ✓</td>
<td></td>
<td>❌</td>
</tr>
</tbody>
</table>

* Whilst some disclosures regarding diversity are already required in the existing UK framework, these differ from those in the EU NFR Directive.

** Whilst the disclosure of principal risks is a requirement of all UK companies within the scope of the strategic report requirements, the EU NFR Directive explicitly refers to principal risks relating to the non-financial information matters (i.e. environmental, social, employee, human rights, anti-corruption and bribery matters).

*** The diversity disclosures do not apply to issuers which do not have shares admitted to trading on an EU regulated market, unless the issuer has issued shares which are traded on an EU multilateral facility. Companies that meet the size criteria to qualify as small or medium-sized under company law are exempt from the diversity disclosures.
Appendix – Ten statements to assess the effectiveness of the external audit process

We have set out below a series of good practice statements which audit committees can use each year to consider the effectiveness of the external audit process.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The engagement partner demonstrates a strong understanding of our business, our values and culture, as well as the wider industry in which we operate and the challenges we face.</td>
</tr>
<tr>
<td>2</td>
<td>The planning process has involved early discussion with the audit committee to identify significant issues at the earliest opportunity and to develop an appropriate audit response.</td>
</tr>
<tr>
<td>3</td>
<td>The overall audit coverage and the judgements underlying audit materiality have been explained to us satisfactorily. The scope of the audit work at each entity has been individually evaluated and communicated to us under headings such as full scope, limited scope and high level review, with appropriate category description. The role of component auditors is accepted and understood.</td>
</tr>
<tr>
<td>4</td>
<td>Key accounting judgements and significant estimates were identified and addressed in advance where possible. They received appropriate resource, including any necessary specialist involvement and were challenged robustly, demonstrating sufficient professional scepticism.</td>
</tr>
<tr>
<td>5</td>
<td>The auditors have explained how their firm uses root cause analysis techniques on the results of internal and external inspection reviews to understand and address where audits have fallen below the standard expected.</td>
</tr>
<tr>
<td>6</td>
<td>The auditors have communicated their approach to using data analytics techniques as part of the audit methodology such that the audit committee can understand the benefits this will bring.</td>
</tr>
<tr>
<td>7</td>
<td>The audit partner provides support to the audit committee between meetings to the extent the audit committee requires, in the form of briefings on significant and emerging issues and updates on governance developments.</td>
</tr>
<tr>
<td>8</td>
<td>The audit committee welcomes the candidness of the audit partner's observations in private sessions with them.</td>
</tr>
<tr>
<td>9</td>
<td>The audit process and the audit team have challenged our thinking and contributed to improved standards at our organisation.</td>
</tr>
<tr>
<td>10</td>
<td>It is clear from the communications (both written and oral) received from the auditors that the objectives of the FRC's Ethical Standard regarding independence and objectivity have been achieved and are demonstrably serving the interests of shareholders.</td>
</tr>
</tbody>
</table>
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 a board member.

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

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 are available to read and download from www.deloitte.co.uk/governancelibrary.

Governance in brief

The longer-term viability statement – insights for year 2: The longer-term viability statement, now in its second year, continues to be an area of focus for investors and regulators. Both the FRC and the Investment Association have commented on areas in which they wish to see improvement. We have fielded a number of queries about disclosure enhancements for year 2 and have summarised these areas for improvement in this Governance in brief.

Changes to auditor independence rules: Audit committees should take action where they have not already done so to review their policy on non-audit services provided by the external auditor. This Governance in brief focuses on changes to auditor independence rules in the new Ethical Standard and explains the key considerations around prohibited services, the “70% cap” on non-audit services, plus areas for interpretation and a useful table outlining prohibited services for different types of company.

Other Deloitte publications

A clear vision: Annual report insights 2016 gives a comprehensive picture of narrative and financial reporting trends for UK listed companies, together with ideas to help them improve their annual reports.

Closing Out 2016 discusses the principal financial reporting issues in respect of current annual reports, covering areas of regulatory focus identified by the FRC, ESMA and issues arising from the current economic environment and developments in reporting standards.

Initial findings on Directors’ remuneration in FTSE 100 companies - the story of the 2017 AGM season so far presents analysis and insights regarding executive directors’ remuneration in the FTSE 100, based on the AGM season so far.

Your guide Directors’ remuneration in FTSE 250 companies presents analysis and insights regarding executive directors’ remuneration in the FTSE 250, based on the 2016 AGM season.

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.
Contacts

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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