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On the board agenda 2023

December 2022

MAKING AN IMPACT THAT MATTERS since 1845

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Foreword

Foreword

Dear Board Member,

We end the year with the "VUCA" acronym to describe the current business environment: volatility, uncertainty, complexity and ambiguity. Inflation caused by the continuing war in Europe, by supply chain squeezes, by climate impacts on harvests, and by labour and skills shortages is provoking a severe cost of living squeeze. This is compounded by the rapid reversal of historically low interest rates in an attempt to dampen demand and ease inflation. Using well developed "crisis muscle" built during the pandemic, boards are taking a range of difficult decisions. In the current environment, this requires constant attention to stakeholder issues and continuous reappraisal of scenarios. The near term will be as much about value protection as it is about value creation.

"On the Board Agenda 2023" has two objectives – first, to act as a reminder of key matters for the reporting season, and second, to help you set the agenda for the year ahead. To emerge stronger, boards will maintain a diligent focus on innovation, performance and high standards at their companies, promoting growth and differentiation to enhance customer experience, to attract talent and to enhance trust. Expectations of business continue to rise – business is not just the wealth creator; business is the driver of improvements in social mobility, fairness and inclusion; business is the trusted protector of our data; business is the guardian of our environment, and the innovator and investor to solve the climate crisis.

The issues of today call for directors who are up for these many challenges, directors who believe in trust being the cornerstone of business, who are willing to speak up, who are transparent in communications and who don't just embrace but advocate for change and for high standards. Now especially, the matters we are discussing are relevant across public and large private companies alike – many of which will soon become public interest entities for the first time.

It is with all these issues and challenges in mind that we have constructed the content of this publication. We hope you find it a helpful and interesting read. And we look forward to welcoming you at our discussions in the Deloitte Academy in the New Year.

William Touche
London Senior Partner
December 2022

The State of the State 2022/23

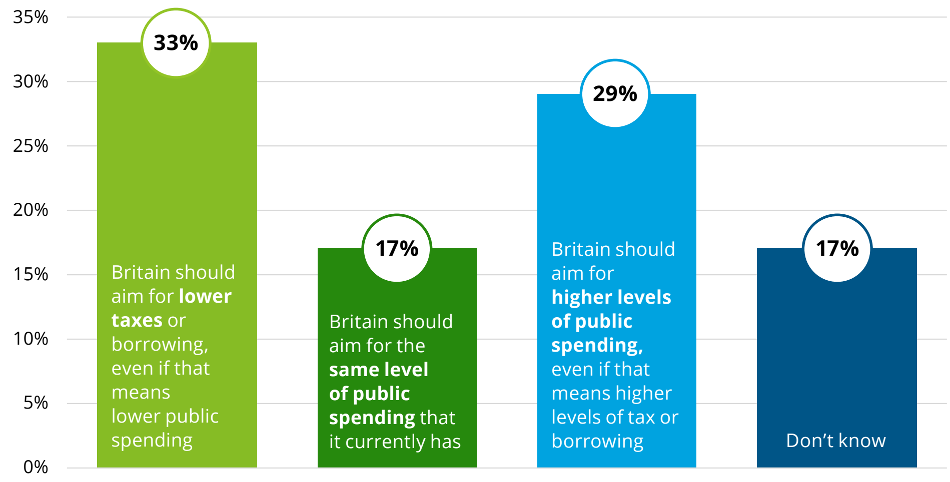
The State of the State 2022/23

The debate about the role of companies in society and the role of the state is very live, so we thought we would include a short article on Deloitte's annual 'State of the State' report in this year's On the Board Agenda.

State of the State blends two forms of research. To understand public attitudes, Deloitte and Reform commissioned Ipsos UK to survey more than 5,000 people. We then interviewed more than 50 senior public sector figures including permanent secretaries and other senior civil servants, police chief constables, council chief executives, NHS leaders and elected representatives past and present. Together, this blend of quantitative and qualitative data provides a view of the state according to the people who depend on it and the people who run it.

This year's State of the State finds public attitudes to government deeply affected by the economic situation. It also finds public sector leaders eager for reform after years responding to crises. Our interviews with senior officials heard compelling visions for the future of a sector that better empowers communities, realises the potential of its data and doubles down on its mission.

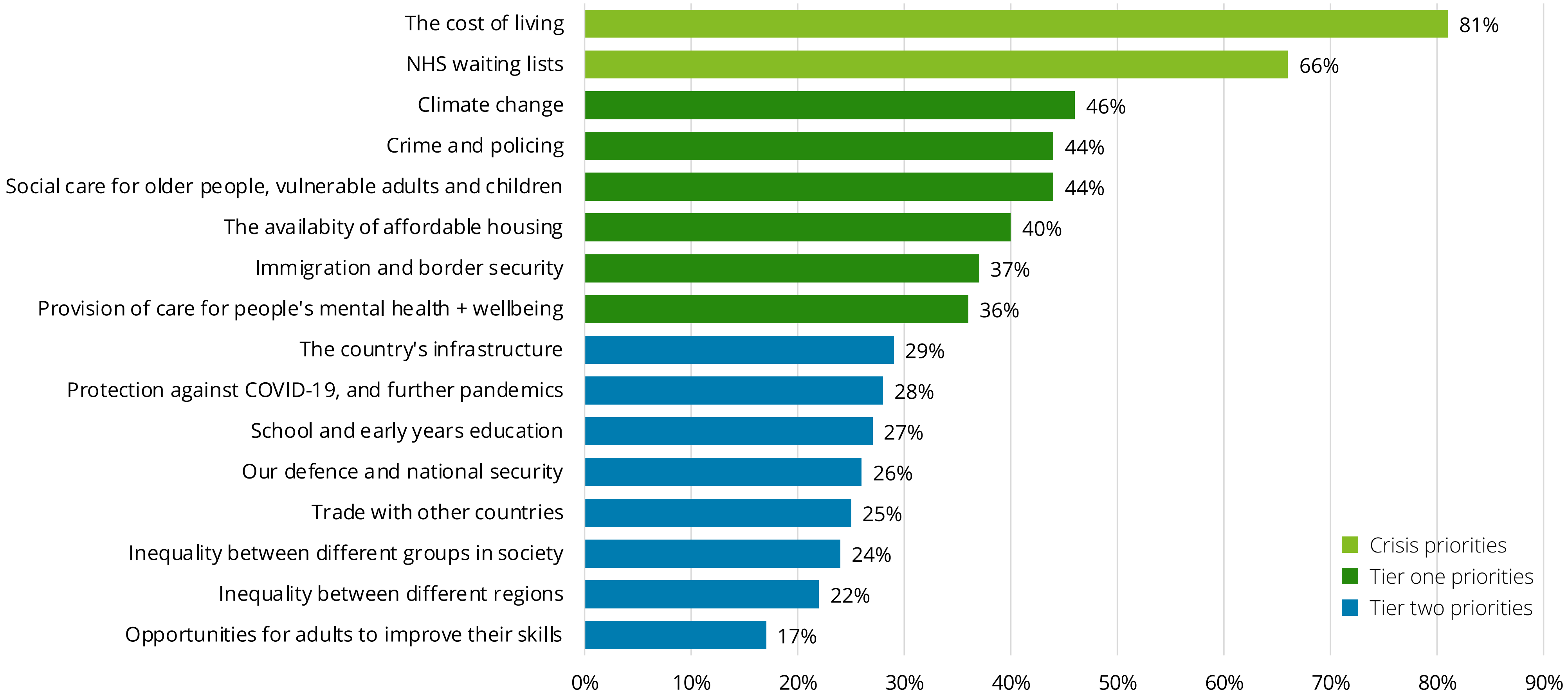
Governments have to make decisions to set the right balance between the advantages of higher public spending and the advantages of less tax or public borrowing. As part of our research we asked the public where the balance between public spending and the levels of taxation and public borrowing should fall. The results show that the public is split on the balance of taxes, borrowing and spending.



Base: 5,813 Online UK adults 16-75

We also asked what the top priorities for improvement in the UK should be over the next few years. The results reveal that the public's message to government is to address the immediate issues around cost of living and NHS waiting lists, whilst also not neglecting net zero.

The State of the State 2022/23 continued



As in previous years, the report draws on more than fifty interviews with public sector leaders. In the past ten years, we have spoken with hundreds of exceptional leaders from government and public services, but this year stands out – never before have we heard so many leading figures so eager for bold reform. So, what kind of public sector do its leaders want in 2030?

The State of the State 2022/23 continued

01 **Streamlined government, reshaped by bold reforms**
Public bodies need to be focused on their missions, through choices about the scope, size and shape of the state

02 **A public sector greater than sum of its parts**
Joining-up across Whitehall departments and local services will deliver greater impact and value

03 **Empowering, enabling and delivering through others**
Resource constraints mean that the sector needs to be in the business of empowering and leading through others

04 **Data-led and digital to the core**
By 2030, digital will be inherent in everything, and interoperability will allow for data-driven insight

05 **Inspiring leaders and an engaged, resourced workforce**
After navigating through COVID, senior fugures told us about the game-changing importance of inspirational leadership

Check out the full report for our thinking on how government can accelerate into the future.

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Your workforce: Wellbeing and skills fit for the future

Your workforce: Wellbeing and skills fit for the future

In this article we set out some characteristics of the current labour market, including the necessary shift to a skills-based workplace. We also consider ways to address the demands and needs of the workforce in times of uncertainty. Areas include focus on wellbeing of the workforce and internal metrics to ensure the board is well-informed about workforce actions and outcomes. We also consider potential areas of reporting relating to the workforce where boards may wish to consider the quality of current data.

Other areas that boards might consider in order to support the workforce in this challenging time are covered in Remuneration committees and workforce pay – navigating a volatile environment.

Current labour market characteristics

The current labour market can be characterised through the following statistics:

- Vacancies remained close to record-high levels, at 1.246m in the three months to August but are now falling, leading to some suggestions that the jobs market has peaked.
- The UK unemployment rate is the lowest recorded since 1974, at 3.6% in the three months to September; the Bank of England expects this to rise to 4.4% in one year's time, 5.5% in two years and 6.3% in three years.
- UK wages are failing to keep pace with inflation, squeezing household incomes for many.

Source: Deloitte Economics Monitor | Deloitte UK

It may seem that since the pandemic, when the economy reopened, the labour market recovered. However, there are now certain challenges faced by businesses – about half a million people of working age have left the UK workforce since late 2019. The causal factors behind the shrinkage cited include increased number of people aged 50 to 64 who are long-term sick or disabled, increased student numbers, and early retirement.

In addition, rising inflation over the past year has reversed the gains in purchasing power from a long period of low inflation – and some industries have still not fully recovered from the pandemic, including arts, entertainment, accommodation, and food services, due to social distancing measures and residual fear COVID-19 affecting consumer behaviour.

Further to this, the Federal Reserve, the European Central Bank and the Bank of England are aiming to cool labour demand by raising interest rates. The latest Deloitte CFO survey shows just over half of CFOs (53%) expect hiring by UK corporates to decrease over the next 12 months, and movement between jobs peaked over the summer and has since eased.

Skills-based organisations

The environment in which business operates has changed significantly over the last few years, with new ways of working and significantly more skill-based recruiting, but there is more to come.

Deloitte's report on Skills-based organizations, based on a survey of 1,021 workers and 225 business and HR executives around the world and across industries, found that 73% percent of business executives expect to continue to experience talent shortages over the next three years, and 70% of respondents say they are getting creative about sourcing for skills rather than just considering

Your workforce: Wellbeing and skills fit for the future continued

job experience. For example, some companies explore how to match the skillset of identified underutilized talent pools to an entirely different industry and set of roles.

Since the pandemic, there have been many reported success stories of companies managing to reskill employees into alternative roles. The report described the skills-based organisation as a "new operating model for work and the workforce, that turns talent management on its head, redefining and reimagining every talent practice to be based more on skills than on jobs".

The survey also asked what types of skills-based practices they are adopting, and to what extent. Although organisations still largely value education, degree qualifications and job experience over demonstrated skills and potential in making decisions about the workforce (only 17% of HR and business executives said their organisation values demonstrated skills and potential over degrees and job experience), the vast majority (89%) of respondents said that skills are becoming more important for the way organisations define the work, rather than job positions.

Wellbeing

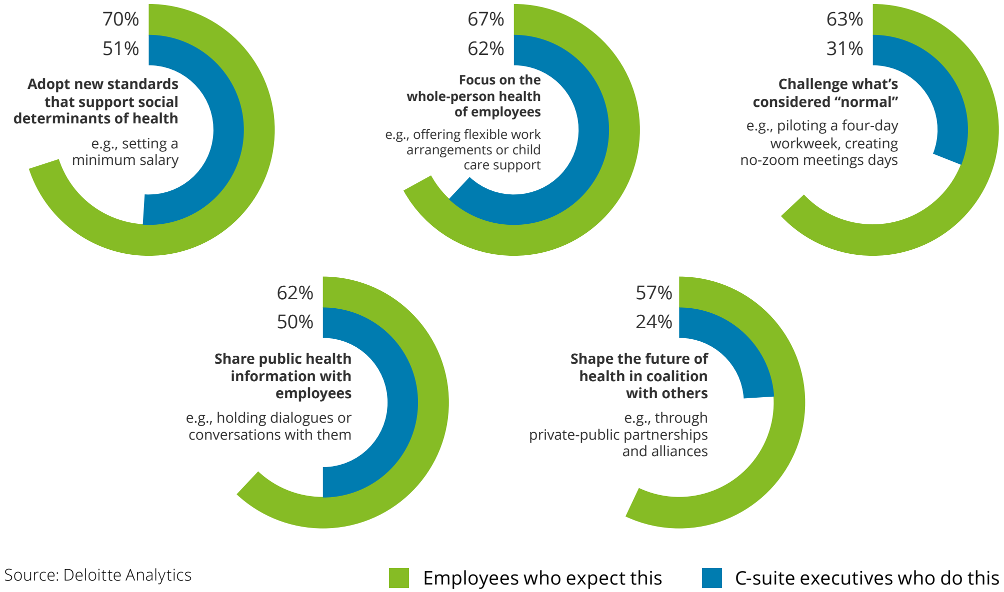
In our annual survey Corporate Reporting Insights 2022, all companies acknowledged employee wellbeing specifically and distinctly from broader health and safety concerns (compared to 96% last year), with 64% clearly describing how wellbeing is being assessed by management, and a further 44% describing how this information was delivered to the board.

This demonstrates that, while the pandemic accelerated worker safety into the spotlight, there's also been a significant increase in focus on workforce wellbeing and the role that organisations play in it – and the role they should play.

Research[1] conducted by Deloitte in partnership with Workplace Intelligence revealed that only 61% of workers are satisfied with their company's current offerings with regards to wellbeing benefits. In response companies are reconsidering the benefits packages offered as well as embedding a culture of transparency where leaders share their own stories that will resonate with their teams, for example, how they're feeling, how they manage their well-being, or if they've set any personal wellness goals.

There are a few other interesting considerations from the survey:

Workers have high expectations, but leaders aren't moving quickly enough



Source: Deloitte Analytics

[1] A survey conducted in June 2022 of 2100 employees and C-level executives across four countries: the United States, United Kingdom, Canada and Australia.

Your workforce: Wellbeing and skills fit for the future continued

In order to improve wellbeing companies need to know where they stand compared to their peers. Transparency through public disclosure is a good place to start. For example, 88% of fifty FTSE 350 companies surveyed in Deloitte's Corporate Reporting Insights 2022 reported staff turnover/attrition as a principal risk, however only 38% gave a staff turnover or retention metric in their annual reports, with just 14% including such a metric as a KPI. This suggests a gap in how this principal risk is being measured and whether it is monitored at board level.

Reporting on wellbeing

Looking ahead, companies may in future be required to collect and report metrics on employee wellbeing and similar topics as international sustainability standards develop. The SASB Human Capital project references the need to explain how companies ensure the physical and mental health of their workforces. Whilst some companies may find it tricky to disclose data self-reported by the workforce, it will likely be a crucial point in understanding the gaps that companies need to fill. Companies can measure observable metrics that track the percentage of workers who use their entire time-off benefit, overtime by individual, the volume of work-related emails sent on weekends, or attrition rates, all of which could give insights.

A growing recognition of the importance of wellbeing is likely to lead to the next evolution in workforce-related disclosures. For more details on current practices of reporting in this area, see our report Reporting on workplace wellbeing.

Questions for the board to consider:

1. Do we have a clear view on what our workforce will look like in future? Have we defined the jobs skillset required?
2. Have we embedded clear mechanisms with defined KPIs and Risk Indicators to monitor workforce wellbeing and to enable us to react quickly to address concerns or gaps identified?

Further reading materials

1. The Deloitte Economics Monitor analyses the unfolding economic cycle across the world. Updated frequently, it provides a succinct, easy-to-navigate selection of charts illustrating the most important issues facing the global economy.
2. The quarterly CFO Survey is firmly established with media and policy makers as the authoritative barometer of UK corporates' sentiment and strategies.
3. Deloitte Insights, Moving your organizational strategy from jobs to skills: unleashing agility and human potential with the skills-based organisation.
4. Deloitte Insights, The C-suite and workplace wellness: Work often works against wellbeing. What can C-suite leaders do about it?

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Human capital perspectives on technology trends

Human capital perspectives on technology trends

Rapid shifts in technology don't take place in an isolated vacuum; nor do the equally dramatic shifts in the ways people work. Because the work humans do and the capabilities technology provides are so closely related, it's important to understand their evolution and acceleration as a shared trajectory—people and machines, each shaping the other. The technologies that enhance our organisations and our lives are more powerful (and more essential) than ever before.

Deloitte surveys illustrate this energy at work: CEOs say technology is the largest growth driver they're seeing, but they also believe the shortage of people and skills is the factor that could bring the most disruption to their business strategies. Alignment of technology and people is the key. A recent Deloitte report, Elevating humans in the digital workplace explores the importance of this mutual dependency.

In this article we highlight selected findings of Deloitte's annual Tech Trends report and focus on the human element, explored in more detail in Mutual acceleration: Humans + technology propelling each other into the future.

If after reading this article you feel a bit lost, we commend the reports to you!

Three key tech trends

Tech trend: Data sharing made easy

What is the trend?

A host of new technologies promise to simplify the mechanics of data-sharing across and between organisations while preserving data privacy for individuals. As part of a growing trend, organisations are unlocking more value from their own sensitive data while also leveraging data-sharing with outside sources, with access to large volumes of both proprietary and external data. And of course, when more data flows easily, concerns about privacy, security and the need for trust in human behaviour follow.

It is critical to balance this new arena of opportunities for positive use of secured data within a value chain with values and processes that mean individuals use data access for the right purposes and customers don't feel they are being manipulated, for example with a too-personal sales appeal.

The human element

Embracing the new data-rich environment will require both individual skills and larger cultural shifts. Large parts of the workforce, including those not traditionally tied to IT, will need more data literacy and proficiency in the tools that handle data and the related privacy and security skills.

Human capital perspectives on technology trends continued

Whole organisations will also need to develop data-first cultures and become comfortable with data aggregation, mining, and analysis—much of it automated—as the foundations of decision-making. A good focal point for automation can be on lower-level decisions that require less human judgement, and which may otherwise feature as distractions in a person's workday. This can provide a double benefit, as the technology is put to work in reliable, repeatable ways and the human workforce can use and develop the output by making higher-level, value-added decisions. There is also a significant role for leadership here, as leaders need to demonstrate that they are comfortable devolving decision-making and empowering their teams to take data-driven decisions.

Tech trend: The cloud goes vertical

What is the trend?

The centre of gravity around digital transformation has shifted from meeting the generic IT needs of an industry-agnostic organisation to addressing the unique strategic and operational needs of each sector and even subsector.

Hyperscalers and SaaS vendors are working with global system integrators and clients to provide modular, vertical-specific business services and accelerators that can be easily adopted and built upon for unique differentiation.

As this trend gains momentum, deploying applications will become a process of assembly rather than creation. Business processes will become strategic commodities to be purchased, freeing organisations to focus precious development resources on critical areas of strategy and competitive differentiation.

The human element

Many organisations are amassing useful experience with vertical clouds. The more effective ones are those which bring as much organisational agility to the operating model and to the workforce implications, as they do to the technology transformation. Boundaries within the technology function, or between it and the business, are less important now than a product operating model that puts decisions closer to where the work for customers happens.

For those embarking on the journey to vertical clouds, it's important to have an honest assessment of how ready you are to move at speed; how you can align people, performance, and the approach of management to embrace the new capabilities; and what metrics can capture this new pace of performance and innovation. The accompanying diagram shows some possible shifts to contemplate in the tech workforce as a reaction to this change.

Shifts in the IT workforce
Illustrative Roles

Jobs that change	Jobs that disappear	Jobs that are new
Enterprise Architect	Release Manager	Cloud Orchestration
IT Finance	Testing	Product Development
HR Business Partner	Services Managers/Helpdesk	Data Scientists
Testing Orchestration	Tech Architecture	Data Analysts/Insights
	System & Network Admins	Human Centred Design
	Portfolio Managers	Open Talent Orchestration
	Business Architecture	Virtual Reality Designer
	Project Managers	
	Business/Functional Analysts	

Human capital perspectives on technology trends continued

Tech trend: Field notes from the future

What is the trend?

A bold, technologically sophisticated future awaits—this we know. Yet from our vantage point today, we cannot discern precisely what this bold future looks like, or how we can prosper in it. How can we plan for events that are likely, yet vaguely defined?

There are three technologies that will likely dominate the digital landscape a decade or more from now: quantum, exponential intelligence, and ambient experience. Though currently nascent, each of these technologies has captured the imagination of researchers and the investment dollars of venture capitalists, startups, and enterprises, who all agree: Something interesting will happen, and with experimentation, diligence and groundwork planning, we can be ready to act when the future finally arrives.

The human element

To make the most of emerging technologies, organisations would do well to build resiliency and adaptability into their cultures. The potential of this trend awaits in the future, but the work of benefiting from it starts today.

In a world where transformation is the norm, it is critical to build adaptability into the fabric of the organisation. It's not clear today what each organisation will look like in the future, what skills and talent will be most required and how organisations can best work towards rightsizing their workforces. Organisations are moving away from the race for talent and moving towards the consolidation and retention of the right talent in a less stable economic environment: there will be more on this in 2023's Tech Trends.

What we do know is that in a world of increasing automation and augmentation, softer skills and mindset become more critical: growth mindset, experimentation, collaboration, influencing, storytelling.

Some questions boards can start to consider:

1. What should this company do to start the conversation and craft the vision for the tech-enabled future of talent?
2. What are the human capabilities and talent categories that must stand alongside technical skills and should be the focus of investments today so they can be the source of value later on?
3. What controls and education do we need to put in place so that the company workforce will be able to work with trust alongside future external providers?

In addition to the links embedded in this article, we would also like to draw your attention to the following related podcasts:

1. The Future of Cloud and Digital Skills
2. Perfect 10
3. What's your possible?
4. Deloitte Cloud Readiness Assessment
5. Cloud Speed Podcasts

Digital transformation: The board's role in leading change

Digital transformation: The board's role in leading change

Technology and digital engagement is pervasive in all our lives – and that even for those organisations that haven't yet embraced the reality of *total digital transformation*, it is on the way.

Boards are acutely aware that they are responsible for oversight of technology risks and protection of customer data, with sizeable regulatory fines able to be levied and a patchwork of regulation around the world. However, not all boards are as engaged in guiding and overseeing the strategic digital development of their organisations.

This article explores the findings of Deloitte's research and associated recommendations on how boards and C-suite can step up to lead digital innovation.

Stepping up to the challenge

Boards today have been hearing for many years about the benefits – and the risks – of total digital transformation. Many directors are already on board with the idea that companies need to reinvent their digital realities on an ongoing basis. The big question is how directors determine their personal role in driving digital transformation, and where their time and energy should best be spent.

In How to lead digital transformation from the top, Deloitte offers the results of a series of quantitative and qualitative interviews with leaders, a "practical guide" to leaders facing the challenge of digital transformation[2].

Through a series of informative case studies, the results demonstrate that the one constant for businesses embracing digital transformation is the importance of direct leadership involvement. The report sets out three guiding principles or "truths" for leadership involvement.

Three guiding principles

There is a spectrum of digital ambition that can be envisioned, building from incremental digitisation of services and processes with minimal change in the business as a whole, all the way through to new business models and innovative digital capabilities which necessitate enterprise-wide transformation. All models of transformation require capable leadership.

1. Your role as leader is important for any digital ambition— no matter the scale	Boards can focus on the following areas: • **Breaking through roadblocks:** empower people to break through business silos and overturn the status quo, where that is needed to make progress. • **Help others see the bigger picture:** show how digital transformation fits into the company's larger strategic context of value creation, competitiveness, and growth. • **Assign full-time ownership:** ensure there are people who have full-time roles dedicated to digital transformation – it's too big a job to sit alongside other commitments.

[2] Results of this research can also be read in How the CEO's leadership in digital transformation can tip the scales toward success (June 2022)

Digital transformation: The board's role in leading change continued

2. As the digital vision gets more ambitious, your involvement should increase

Boards can focus on the following areas:

- **Tell a compelling story:** create an integrated vision and a narrative demonstrating why change is essential to achieve the company's long-term strategic goals. This can't be delegated to communication and PR teams – it should either be owned by a board member or delegated to a named person.
- **Align incentives:** if incentives continue to reward previous behaviours, they will persist. Work with reward and HR teams to design into the reward system the behaviours needed for a digital future.
- **Address weaknesses exposed by the digital journey:** listen and think critically about process or control weaknesses that have been identified and set accountability for actions to remediate short-term disruption. Don't be afraid to ask: "how well is it really going?"
- **Create options for different future directions:** digital transformation is not static and new technologies continue to emerge and disrupt. Aim to build strategic and skills flexibility into the organisational structure in order to take advantage of future digital initiatives.
- **Think beyond your tenure:** look to communicate the board's vision of the future clearly and engage with successors to ensure that it can be perpetuated by new board members and beyond the C-suite.

3. Organisations with high digital savvy and readiness still need leadership to lead on strategy, innovation, and growth

Boards can focus on the following areas:

- **Keep nurturing innovation:** in order to pivot and grow as technologies develop, it's important to keep active in driving transformation – this should be a regular topic on the board's agenda.
- **Don't be afraid to look into the future:** use your knowledge of the market and perspective as directors to inform and challenge the CEO's vision and direction.

Boards have the opportunity during annual strategy days to take the time and space to work together in planning the vision for the organisation and indeed, determining which directors have the skills to be personally involved in shaping the company's digital transformation. As the report concludes, "digital initiatives are simply too important to delegate and then ignore."

Digital transformation: The board's role in leading change continued

Disclosing the security journey in the annual report

Alongside transforming the business, boards will want to keep investors up to date with their journey and reassure all stakeholders that digital security continues to be top of mind.

Regulators are increasingly focused on how companies report on digital risk and breaches in cyber security. The FRC's Financial Reporting Lab published its report **Digital Security Risk Disclosure** over the summer and earlier this year the US Securities and Exchange Commission (SEC) published **its proposal** to improve disclosure in this area – at the time of writing this is still awaiting finalisation. It is clear more focus is needed to match the needs of investors as identified by these two market regulators.

In September we published our own analysis of cyber opportunity, risk and governance reporting across the FTSE 100: **Cyber risk and governance reporting in the UK: Improvement required!** This is designed to help you identify examples of good practice and offer insights about how to keep the users of annual reports informed in this important area.

Reporting in uncertain times

Reporting in uncertain times

As highlighted in the FRC's Annual Review of Corporate Reporting, rising inflation, slowing economic growth, increasing interest rates, stresses in supply chains, constraints in the labour market and changing consumer behaviour, are just some of the challenges businesses are currently facing. In this environment of heightened uncertainty, recognition, measurement and disclosure becomes increasingly challenging and forecasting, judgements and estimation uncertainties require careful consideration, with laser focus on assumptions used and the appropriateness of sensitivities selected.

In this article we set out the key areas of focus and the matters boards should be challenging management on this reporting season.

The following graphic, taken from the FRC's Annual Review of Corporate Reporting, demonstrates the connected thinking being encouraged to be evident within reporting in these uncertain times:

Principal risks and changes in business environment → Strategy and business model → Going concern and viability → Business performance and position → Financial reporting

As a starting point, the FRC's review states that companies should explain:

- the risks and changes in the business environment they are facing and how the risks and uncertainties have been reflected in the strategy, business model and in going concern and viability assessments;
- the business performance and financial position at the end of the year in the context of the business strategy and related change in risk profile; and
- any changes to definitions and/or calculations of alternative performance measures (e.g. inflation-adjusted measures).

Key matters suggested to focus on are as follows:

- The net realisable value of inventories may be affected by the changing economic environment.
- Impairment assessments of non-financial assets should reflect the most recent management expectations, budgets and forecasts and asset-specific risks.
- Expected credit loss measurements of financial assets need to be updated to take account of forward-looking information and historical default data adjusted accordingly.
- Deferred tax assets may no longer be recoverable due to uncertainty over future profitability.
- Contracts may become onerous and a liability may need to be recognised for the unavoidable costs.
- Investing, financing and hedging strategies may need to be revisited and appropriately reflected in the financial statements.
- Entities will need to consider the impact of inflation on the business and financial reporting (e.g. any inflationary features embedded in revenue, supply, leasing and other financing contracts may need to be separated and accounted for as derivatives, and where inflation assumptions represent a source of significant estimation uncertainty entities will need to explain how the inflation assumptions have been calculated and disclose sensitivities).

Reporting in uncertain times continued

- More areas of financial reporting may involve significant judgements and estimation uncertainty, which will need to be disclosed (e.g. going concern assessment and fair value measurement).
- Key assumptions and estimation uncertainty involved in the measurement of recognised assets and liabilities need to be explained and appropriate sensitivities provided.

Specific considerations for forecasting

Forecasts are used in a variety of accounting estimates, including the assessment of goodwill and other non-financial assets for impairment, expected credit loss assessments, recoverability of deferred tax assets, liquidity analysis and the appropriateness of the going concern assumption.

In developing forecasts and assessing the accounting implications, companies should consider whether the effects of the uncertainties are short-term or long-term and how that determination will affect the various accounting estimates. The forecasts used in business planning should be consistent with those used in accounting estimates.

Companies should of course carefully consider their unique circumstances and risk exposures when analysing how the current economic environment and resulting uncertainties may affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material current or potential effects.

Key messages for directors:

- Ensure that there is a good level of connectivity in the disclosure on operating in the current business environment
- Ensure appropriate disclosure of assumptions and sensitivities so the reader can understand where the board has landed in the range of possible outcomes
- Scrutinise and challenge changes to key disclosures such as APMs to ensure that appropriate transparency is provided regarding the underlying reasons for change

Restoring trust in audit and corporate governance: Where are we and what is coming next?

Restoring trust in audit and corporate governance

In 'On the board agenda – half year 2022' we provided an update on the Government's Response to the BEIS White Paper 'Restoring trust in audit and corporate governance' which was issued on 31 May 2021. Since then, the FRC has issued a Position Paper on the Government's Response.

In this article we outline the current position and expectations for next steps. The scope of the new reform package is complex and so we have developed a simplified guide showing which proposals apply to which type of entity – accessible here.

The Government's Response, issued in May, summarises the feedback that BEIS received on the White Paper and sets out the measures it intends to pursue. It is a long document (almost 200 pages) covering proposals which impact a number of different market participants - company directors, auditors and professional bodies. We provided a comprehensive summary of the key areas that are likely to impact you as board directors and audit committee members in our Newsflash.

In July, the FRC published a short Position Paper setting out the next steps for those areas of the Government Response that fall within the FRC's remit, providing a high-level summary for stakeholders on how and when the reforms will be delivered. In addition to ongoing activities behind the scenes to prepare the FRC for the transition to the Audit, Reporting and Governance Authority (ARGA), other FRC activities relate to the following areas:

- Minimum standards for audit committees
- Revisions to the UK Corporate Governance Code including the introduction of a new board statement on the effectiveness of internal controls plus updates to supporting guidance
- Revisions to the Ethical Standard for auditors

The detail of the matters which each of these will cover is set out in a further Newsflash. The expected timetable for consultation and implementation of these is as follows:

	Minimum standards for audit committees (FTSE 350 only)	Revisions to the UK Corporate Governance Code	Revisions to the Ethical Standard for auditors
2022	**Q4 2022** - Draft Standard issued for consultation		
2023	Minimum standards for audit committees available to use on a voluntary basis **for 2023 year ends**	Consultation to be issued in **Spring 2023**	Consultation to be issued in **Q1 2023**
2024 & beyond	Enforcement of minimum standards for audit comittees commences (subject to appropriate legislation being in place) **in 2024**	Revised UK Corporate Governance Code applies plus formal inclusion of corporate governance disclosures within CRR activity **for periods commencing on or after 1 January 2024**	Revised Ethical Standards applies **for periods commencing on or after 15 December 2024**

Restoring trust in audit and corporate governance continued

In addition to these formal consultations from the FRC, we also expect BEIS to publish draft legislation for the following reform policies:

- The Resilience Statement
- The Audit & Assurance Policy
- Statement on activities to prevent and detect fraud
- Statements on distributable reserves, legality of dividends and distribution policy

Publication of this draft legislation is expected in the Spring and is likely to take the form of short consultations focusing on the details of the legislative wording. These will be statutory instruments or regulations attaching to the existing Companies Act. The introduction and passing of the Bill required for the establishment of ARGA, the amended PIE definition and the new enforcement regime for directors is likely to be more complex - the current best estimate expressed by BEIS is that, assuming smooth progress of the draft legislation, the new requirements could be implemented for periods commencing on or after 1 January 2024. The timetable could change, however, and will be confirmed during the consultation process in the first part of 2023.

Call to action for directors:

- SCOPE – establish a clear understanding of how the new requirements will impact your organisation and consider getting ahead in the following areas if applicable to you
- CONTROLS - continue the focus on your definition of, and monitoring and review of the effectiveness of internal controls (financial, operational and compliance controls as defined in the UK Corporate Governance Code, not just internal controls over financial reporting)
- RESILIENCE - start to incorporate consideration of the material resilience matters into your annual process and build capability in reverse stress testing
- FRAUD - assess the quality of your fraud prevention and detection activities and consider how well it will stand up to public scrutiny
- ASSURANCE - map out current assurance landscape on all key aspects of corporate reporting (including what will be reported on the effectiveness of internal controls) and build a clear understanding of different assurance offerings; consider developing your Audit & Assurance Policy for discussion at the Audit Committee and Board
- DISTRIBUTIONS - ask for a review of distributable reserves across your group so that you can have a clear picture of the areas of the group where gaps in knowledge may exist and ensure that robust procedures exist around approval of proposed dividends

Restoring trust in audit and corporate governance continued

Resources to help you get ahead:

- Navigating the scoping requirements of the reform package webpage
- Developing your company's Audit & Assurance Policy
- Audit and Assurance Policy webpage
- Internal control and the board: what is all the fuss about?

Draft Minimum Standard for Audit Committees issued for consultation

The FRC has launched the consultation on its draft proposal for a minimum standard for FTSE 350 audit committees. This follows the Government's Response to its 'Restoring Trust in Audit and Corporate Governance' consultation and was driven by a specific recommendation from the Competition & Markets Authority's Statutory Audit Services Market Study that the FRC "should have the power and a requirement to mandate minimum standards for both the appointment and oversight of auditors". Comments are requested by 8 February 2023.

Further details are provided in our Newsflash. We strongly encourage audit committees to respond to this consultation. For those companies in the process of running a tender or about to start a process, it is recommended that consideration is given to the tendering section of the draft standard.

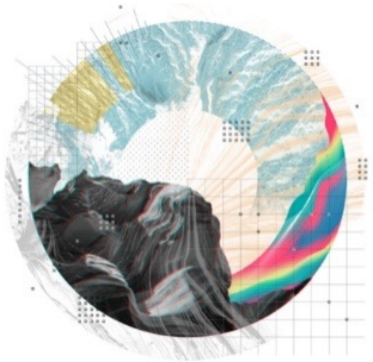
FRC policy paper on competition in the audit market

The FRC has published a policy paper that outlines the regulator's approach to competition in the audit market. The paper sets out the FRC's views on the need for a market that consistently delivers high quality audit and is resilient. It also sets out how the FRC is seeking to progress the Government's seven competition policy proposals, and how it proposes to deliver on the operational objective for ARGA to promote effective competition in the market for statutory audit. The paper is intended to support an ongoing dialogue with stakeholders and feedback on the paper is welcomed to inform the FRC's ongoing work. Comments are requested by 28 February 2023.

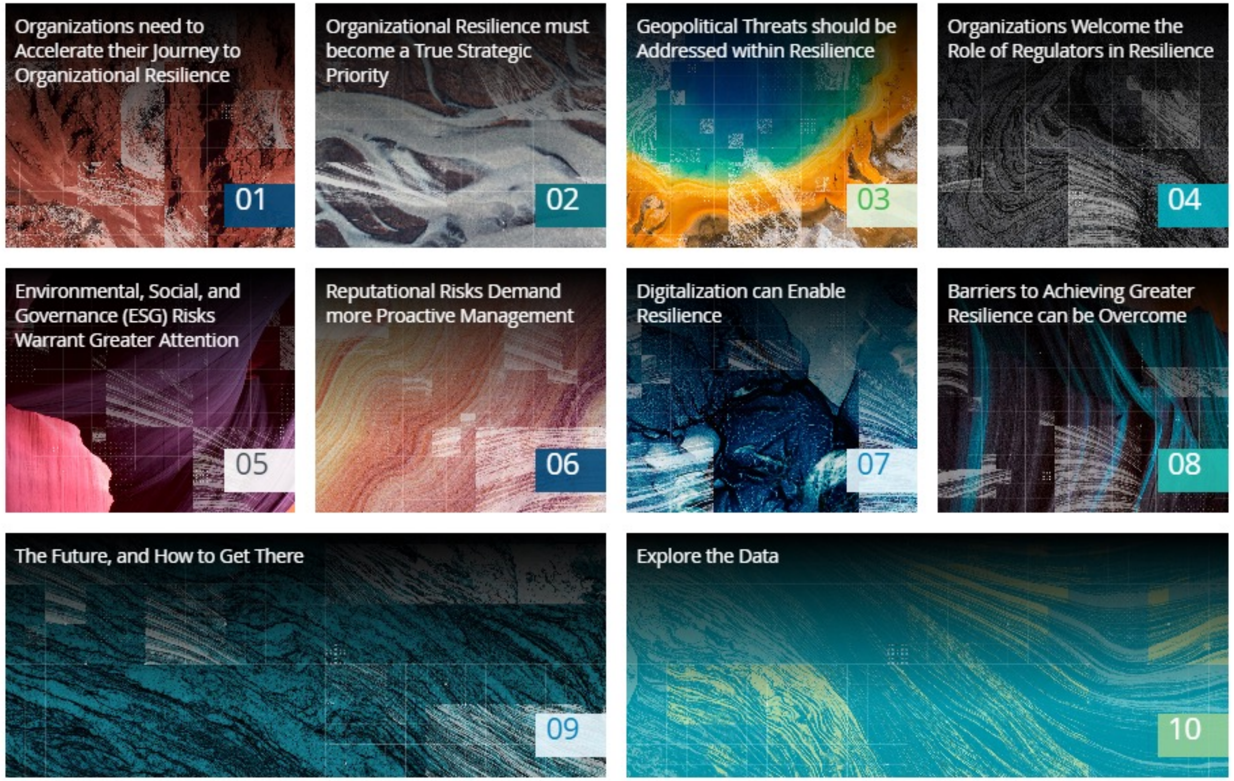
To access the full policy paper click here.

Organisational resilience

Organisational resilience



One aspect of the Government's reform package is the Resilience Statement and further details on this are available from our Newsflash. In advance of this new requirement, for the current reporting season, we are aware that some boards are seeking to make improvements to their reporting in the Viability Statement. Our recent Global Resilience Report provides some interesting observations around the future direction of resilience including how to start the shift from discussion of financial and operational resilience to broader organisational resilience.



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Enhancing your climate reporting

Enhancing your climate reporting

COP27 has closed with a reaffirmation of the commitment to limit global temperature rise to 1.5 degrees Celsius above pre-industrial levels, strengthening actions to cut greenhouse gas emissions and adapt to climate change, as well as boosting the support of finance, technology and capacity building needed by developing countries. However, the UN has warned that the world is currently on track for around 2.5 degrees Celsius of warming by the end of the century.

This is a rapidly changing and difficult area, attracting very significant investor and regulatory focus. UK capital markets regulators have introduced requirements to force companies to report using the TCFD framework (until the finalisation and adoption of the ISSB standards in the UK) and to provide a detailed assessment of their climate-related financial disclosures against the TCFD's recommended disclosures and guidance materials.

This article focuses both on the structure of board oversight of the climate transition and on recent developments in climate-related reporting requirements through that lens. Additional insights on the special role of the chair are available from our recent Chair's Guide to Climate Action publication.

In addition, we draw attention to the EU Corporate Sustainability Reporting Directive, requirements which will become effective in stages, based on the characteristics of undertakings, with earliest application from 1 January 2024 (reporting in 2025 on 2024 data) for those currently in scope of the Non-Financial Reporting Directive (NFRD).

Reporting requirements reminder

For premium listed companies, 2021 was the first year of mandatory TCFD disclosures, with a requirement to include in their annual report a statement on whether they have included disclosures consistent with the TCFD framework and therefore complied with the requirements of Listing Rule 9.8.6R(8) and, if not, explain why not and provide a timeline for compliance.

The area is moving fast and so to help you prepare we have summarised below some key findings and messages from reviews of the first year of mandatory TCFD disclosures undertaken by the FRC and FCA. In addition, in the Appendix we have set out a summary of the different reporting requirements by type of entity and also a reminder of the guidance documents specifically referenced in the Listing Rule.

TCFD disclosures

Over the summer, the Financial Conduct Authority (FCA) and Financial Reporting Council (FRC) published the findings of their first joined up and mutually complementary reviews of mandatory climate reporting under the new Listing Rule requirements. The FCA and FRC reports analyse company reporting against the TCFD framework and provide detailed commentary and regulators' expectations for each of the 11 recommended disclosures.

Enhancing your climate reporting continued

Over 90% of companies surveyed included a recognisable statement in their annual report indicating whether they had made climate-related financial disclosures consistent with the TCFD framework. However, the nature, extent and complexity of disclosures varied considerably. In some cases, companies indicated they had made disclosures consistent with the recommendations, but content was very limited and/or insufficient to be able to determine both completeness and consistency with the framework. Improvements are required, taking into account all relevant guidance such as all sector guidance.

The FRC's key messages for directors to consider for next reporting season are as follows:

- Ensure the disclosures are **granular and specific**. Companies should avoid providing high-level, generic information about climate change that does not adequately explain the potential impact.
- Ensure that the discussion of risks and opportunities is **balanced**, not placing undue emphasis on the opportunities.
- Consider **the interlinkages** of TCFD disclosures with other narrative disclosures in the annual report.
- Clearly articulate how **materiality** was considered in the context of TCFD disclosures when preparing the TCFD statement of compliance.
- Consider **the connectivity between TCFD disclosures and the financial statements** and provide explanations where necessary with regard to judgements and estimates, assumptions and sensitivities applied, and the impact of emissions reduction commitments and strategies on the financial statements.

TCFD Governance pillar

To help directors improve governance-related reporting on climate, in this section we will focus on the findings related to the first TCFD pillar – Governance – which requires companies to disclose the organisation's governance around climate-related risks and opportunities.

Although 98% of companies reported consistency with the Governance pillar of the TCFD recommendations, the FCA's detailed assessment concluded that there was in fact much lower consistency than claimed, with only half of the companies in the sample providing disclosures that were mostly or partially consistent with the relevant recommended disclosure and the Guidance for All Sectors on management's role in assessing and managing climate-related risks and opportunities.

Better reporting suggested by the FRC in this area would include clear and specific disclosure of the governance structures and processes by which the board considers climate-related issues, including:

- the responsibilities of relevant committees or individual management positions;
- agenda items considered by the board or relevant committees or of specific reviews undertaken, frequency of their review;
- what decisions were made at board level;
- responsibilities of other committees, such as the audit and remuneration committees, advisors or working groups informing the board on climate issues;
- how climate issues are integrated into the company's strategic thinking and future planning, like major capital expenditure, acquisitions and disposals.

Enhancing your climate reporting continued

For more information on FCA's and FRC's findings and recommendations, please see our article here.

Net zero pledges and transition plans

Investors and other stakeholders are demanding more clarity on company "net zero" commitments and their strategies to deliver against targets than is currently being provided. The FRC Lab published its report on Net Zero disclosures, where key findings from discussions with investors are summarised.

Progress towards net zero varies between industries and companies, but all companies are recommended to consider enhancing transparency in three fundamental areas:

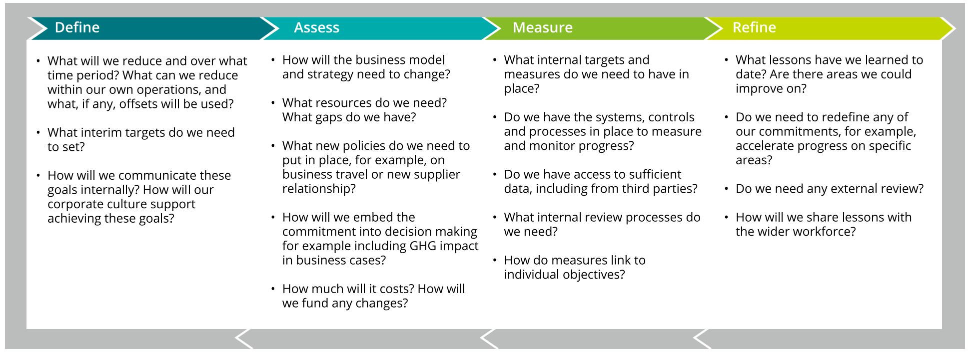
- **Commitments** - the level of ambition, scope, nature and timing of the commitment, together with what is included and what is excluded.
- **Impacts on strategy** - how the commitment impacts strategy and business model, including information on transition plans, assumptions, uncertainties, and risks and opportunities.
- **Performance** – transparency on metrics used in the short, medium, and long term and frameworks (data collection and accountability) set up to measure targets and progress towards those.

Strong and effective governance is fundamental to setting meaningful targets from the top, and integrating these into robust systems and controls this in turn will enable companies to better understand their targets and better establish their teams' roles to achieve those net-zero commitments.

The FRC suggests a four stage approach that is intended to help companies to provide net zero disclosures in their reports:

1. Define the commitment
2. Assess the impact
3. Measure progress
4. Refine the approach

The FRC Lab report provides an illustration of considerations for each stage:



Enhancing your climate reporting continued

Sustainability/ESG Committees

In November, the FRC published their annual review of corporate governance reporting, in which they share findings on governance-related disclosure matters. It was noted that out of 100 companies surveyed, 45 have set up a board-level committee with responsibility for assessing and considering environmental issues, with a higher proportion amongst FTSE 100 companies. The existence of a separate committee was evenly spread across sectors.

Board expertise to oversee climate-related risks and opportunities still remains mainly undisclosed or poorly explained. Companies need to ensure that sufficient expertise and knowledge of climate-related issues at board and senior management levels has been integrated into training and on-boarding materials, to help better navigation of these complex and increasingly material issues.

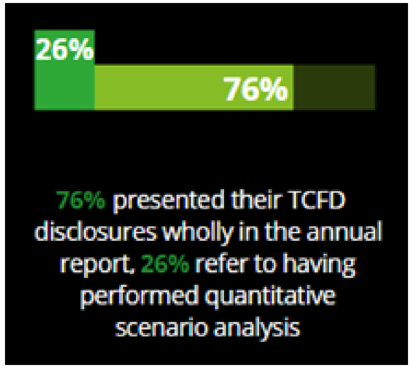
In our half-year 2022 On the Board Agenda we presented you with the results of Deloitte research of emerging practices in the FTSE 350 for board oversight of ESG strategy. Some of the key findings included:

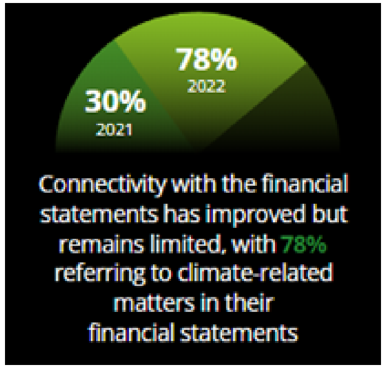
- About 50% of the FTSE 100 and about 30% of FTSE 250 companies had established an ESG/Sustainability Committee.
- Typically, the majority of members are non-executive directors (with input from the CEO and in-house Sustainability/ESG leaders). However, some include the CEO and executive members within the actual committee membership.
- The majority of FTSE 100 committees publish formal Terms of Reference. There are common themes but there is some variation in membership, duties and remit of the committee.

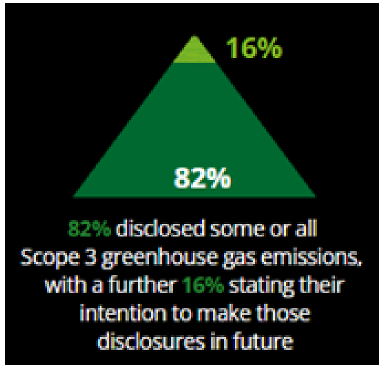
Deloitte Corporate Reporting Insights 2022

We have also published our annual survey of 50 FTSE 350 companies "Corporate Reporting Insights 2022" which included a review of the first reporters' FCA compliance statements and how companies are responding to the more challenging aspects of TCFD.

Some of the key findings included:







Enhancing your climate reporting continued

In light of the updated implementation guidance that companies will now have to consider when making their assessment of whether their disclosures are consistent with the TCFD's recommendations, we highlight the following three areas which we believe also need closer attention in the upcoming reporting season and have proven to be challenging areas for companies to report on:

Considerations for the board	Findings from the survey
Transition planning: Review the climate-related transition plans in place for the business, ensuring that milestones are supported by definitive actions, and report on those measures used to track progress against the plans in place	37% clearly described the strategy by which the company intends to meet its carbon reduction target. A further 34% gave some indication of those plans.
Scenario analysis: Consider how scenario-analysis of climate-related risks and opportunities is being used to understand fully the potential financial impact and the interplay with disclosure in the financial statements, particularly at a segment level	Of the 76% presenting their TCFD disclosures wholly in the annual report, 21% (eight companies) quantified the potential financial impacts of climate-related risks and opportunities in their TCFD disclosures, although these did not all address climate change in their financial statements. Half of the eight provided specific point estimates and the other half provided estimated ranges.

Considerations for the board	Findings from the survey
Metrics and targets: Put in place appropriate oversight to ensure that the business is accounting for its total carbon footprint throughout the value chain, disclosing this information clearly and transparently	It was encouraging to see 82% (2021: 60%) disclosing some or all of their Scope 3 emissions, with a further 16% noting their intention to make these disclosures. For 17% of those disclosing some or all of their Scope 3 emissions (2021: 20%), it was not clear which of the 15 categories of Scope 3 GHG emissions are included or are excluded in their reported Scope 3 emissions.

Assurance

Our survey also explored the level of assurance reported by companies on climate-related disclosures: 68% of companies in our sample obtained some level of internal or external verification or assurance. This, taken with 58% having an element of directors' remuneration linked to environmental performance, reflects increasing stakeholder expectations and demands for accountability and transparency on climate-related matters.

Greenhouse gas (GHG) emissions were most frequently assured, of those companies obtaining assurance 62% included certain Scope 3 emissions within the assurance. However, the calculation and reporting of Scope 3 emissions remain challenging areas for many organisations and the scope of assurance varied in terms of the number and range of Scope 3 emission categories covered.

Enhancing your climate reporting continued

We did not note any examples of "reasonable assurance" on information outside the financial statements. However, it was encouraging to see that 68% did have some form of internal or external assurance, and 48% stated they had obtained "limited assurance" over climate-related disclosures, particularly given some UK companies could be subject to mandatory assurance requirements if they are in scope of the EU Corporate Sustainability Reporting Directive (CSRD) from 1 January 2024 (see below).

The CSRD will directly affect UK companies if they have securities listed on EU regulated markets or if they generate more than EUR 150 million net turnover in the EU (for each of the last two consecutive financial years) **and** have at least one EU subsidiary (large or listed on an EU regulated market) **or** EU branch (more than EUR 40 million net turnover in the preceding financial year). It will also apply directly to EU subsidiaries of UK companies.

For more details and the timing please see our Need to know publication "Worldwide reach of the Corporate Sustainability Reporting Directive".

Further questions for the board to consider:

1. Does the board and management have a thorough grasp of this rapidly developing area? If not, what more is required?
2. Has the company reported consistency with the TCFD recommended disclosures on governance, risk management and recommended disclosures (a) and (b) set out under Strategy pillar?
3. When assessing whether climate-related disclosures are consistent with TCFD Recommendations, is it clear in the annual report how all relevant sector-specific guidance has been assessed?
4. Is there a clear consistency between TCFD and climate-related disclosures in the front half of the annual report and the disclosures in the financial statements (e.g. assumptions, measurement of assets/liabilities), especially in light of the company's net zero transition plans?
5. Has the company considered if it is in scope for the CSRD and does management understand what the additional requirements are?

Further resources for non-executive directors

Chapter Zero's purpose is to build a community of non-executive directors and equip them to lead crucial UK boardroom discussions on the impacts of climate change.

Click here to learn more about being a member of Chapter Zero.

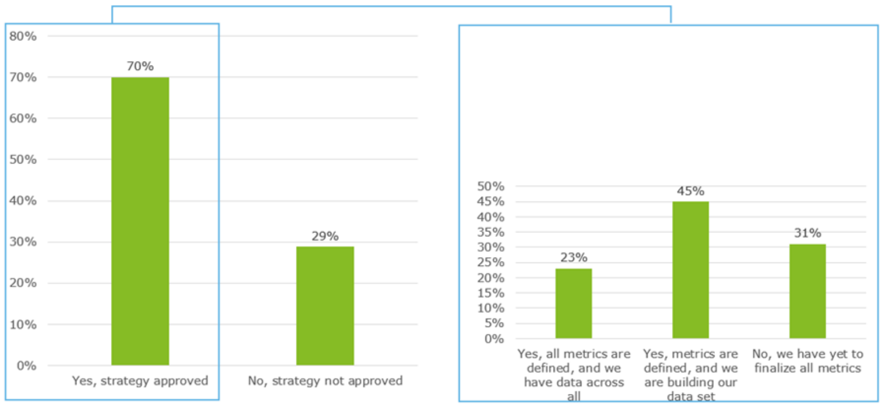
Building effective controls over ESG data

Building effective controls over ESG data

Whilst ESG data and disclosures feature heavily in most annual reports, it is widely accepted that the systems relied upon to produce that data are significantly less mature that those for financial information. This data quality issue could have implications internally and externally – for internal decision making and tracking progress, and for external stakeholders and shareholders who may seek to rely on that information.

Robust, decision-useful information requires robust methodologies with reliable systems and controls. In this article we discuss considerations for ESG reporting and present a framework for assessing the effectiveness of controls and highlight recent Deloitte research on the connection between trust and ESG.

A recent Deloitte Global survey on Trust and ESG asked whether the board had approved an ESG strategy with clearly defined metrics. The results demonstrate that the majority of companies have significant work to do in relation to building their metrics and supporting data sets:



In our publication ‘Internal control and the board: What is all the fuss about?’, to encourage well-documented compliance with the existing UK Corporate Governance Code requirements, we set out a four step framework for boards to use to assess the effectiveness of internal controls over financial reporting. Below we have adapted that four step framework to consider and assess the effectiveness of controls over ESG data – the considerations we have added are shown in italics:

Step 1 – initial assessments and entity level controls:

- Start with a detailed understanding of the business model
- *Identify the non-financial data and reporting necessary for managing the business and monitoring overall performance*
- *Understand stakeholder views of non-financial reporting and consider relevant industry frameworks or regulations*
- *Establish materiality and make an inventory of material external reporting*
- Undertake financial *and non-financial* reporting risk assessments, and fraud risk assessment
- Establish clear and robust entity level controls to ensure the right “tone from the top”
- Define a hierarchy of delegated authorities from the board

N.B. This initial assessment stage is likely to need to be regularly reassessed given that stakeholder needs and reporting expectations in this area are evolving so rapidly.

Building effective controls over ESG data continued

Step 2 – confirmation of in scope systems and identification of material controls:

- Obtain clarity over in scope systems and related general IT controls
- *Generate robust documentation of processes, definitions and methodologies for generating non-financial data, with clear data owners*
- Identify the material controls

Step 3 – establish robust monitoring and review processes:

- Define and evidence a robust process for on-going monitoring of the design and operating effectiveness of material controls, *including testing of methodologies back to supporting evidence*
- Define and evidence a robust process for a year-end assessment of the design and operating effectiveness of material controls, *including testing of methodologies back to supporting evidence*

Step 4 – establish clear reporting protocols and accountability for action:

- Define a significant control failure or weakness that would require detailed consideration and disclosure of remediating actions
- Define reporting processes including remedial action tracking

These areas of focus for the controls over ESG data are reinforced in the FRC Lab report 'Improving ESG data production'. The report suggests that boards should be asking the following questions about the production of ESG data:

- What processes and controls should we have in place to collect and manage ESG data?
- How does our approach compare to that used for financial information?
- Are processes and controls consistently robust across the group?
- Do we have the right systems and tools?
- Do we need to improve training on ESG data issues and methodologies to allow better collection, control and decision-making?
- What is the process in place to periodically review the quality and accuracy of data?
- What is the process for identifying how systems and controls need to be strengthened?
- Do we have a consistent level of maturity of data and systems across the group?

The FRC Lab report mentioned that some companies are voluntarily seeking external assurance over areas such as data processes and controls, as well as the data itself, particularly in relation to emissions data. Deloitte's Corporate Reporting Insights 2022 noted that 72% of our sample of companies had some form of external verification or assurance of information over and above the statutory audit of the financial statements.

The new Audit & Assurance Policy provides boards the opportunity to explain the decisions they are taking in relation to obtaining assurance (from both internal and external sources) and will also provide greater transparency for stakeholders on the extent to which they should feel comfortable to rely on the data provided based on the nature of assurance provided. The FRC currently considers the most appropriate standard to apply when performing assurance engagements on such information is 'ISAE (UK) 3000, Assurance Engagements Other Than Audits Or Reviews Of Historical Financial Information', alongside relevant ethical standards and other ethical pronouncements established by the assurance practitioner's relevant professional body.

Focus areas for year-end reporting

Focus areas for year-end reporting

There is a great deal of regulatory advice to bear in mind when preparing this year's annual report. In this article we pull together the key messages from the FRC's recent bulletin aimed at CEOs, CFOs and audit committee chairs, together with its annual review of corporate reporting and its annual review of corporate governance reporting. We close with some key findings from Deloitte's annual Corporate Reporting Insights survey.

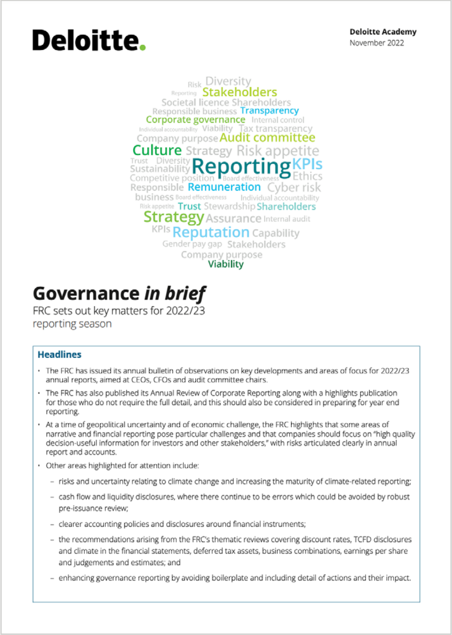
With the global economic downturn and stresses in global supply chains exacerbated by the ongoing conflict in Ukraine, we have covered separately the issues in judgements and estimates in uncertain times. The challenge of reporting on climate change is also covered separately in the Climate reporting section.

The suite of FRC publications for the 2022/23 reporting season

As part of its transformation into a regulator focused on improvements, in October the FRC issued three linked publications setting out corporate reporting expectations and areas of focus for the 2022/23 reporting season:

- Key matters for 2022/23 reports and accounts (Bulletin) –a summary of the most important findings and expectations from the various FRC reports, thematic reviews and Financial Reporting Lab reports published during the past year.
- Annual Review of Corporate Reporting 2021/22: Corporate Reporting Highlights– a summary of the key findings from the Annual Review of reporting and the FRC's expectations for reporting over the year ahead.
- The FRC's Annual Review of Corporate Reporting 2021/22 (Annual Review) – this is the detailed publication which describes the FRC's corporate reporting monitoring activity and findings over the year, case studies and example disclosures.

For information regarding many of the other FRC thematic reviews and Lab reports published during 2022, see our Governance in brief on key matters for 2022/23 reports and accounts.



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Deloitte Academy
November 2022

Governance *in brief*

FRC sets out key matters for 2022/23 reporting season

Headlines

- The FRC has issued its annual bulletin of observations on key developments and areas of focus for 2022/23 annual reports, aimed at CEOs, CFOs and audit committee chairs.
- The FRC has also published its Annual Review of Corporate Reporting along with a highlights publication for those who do not require the full detail, and this should also be considered in preparing for year end reporting.
- At a time of geopolitical uncertainty and of economic challenge, the FRC highlights that some areas of narrative and financial reporting pose particular challenges and that companies should focus on "high quality decision-useful information for investors and other stakeholders," with risks articulated clearly in annual report and accounts.
- Other areas highlighted for attention include:
  - risks and uncertainty relating to climate change and increasing the maturity of climate-related reporting;
  - cash flow and liquidity disclosures, where there continue to be errors which could be avoided by robust pre-issuance review;
  - clearer accounting policies and disclosures around financial instruments;
  - the recommendations arising from the FRC's thematic reviews covering discount rates, TCFD disclosures and climate in the financial statements, deferred tax assets, business combinations, earnings per share and judgements and estimates; and
  - enhancing governance reporting by avoiding boilerplate and including detail of actions and their impact.

Focus areas for year-end reporting continued

Key disclosure expectations for 2022/23

The FRC observes that the overall quality of FTSE 350 reporting has been maintained and in fact there have been improvements in some areas of reporting, including judgements and estimation uncertainty and revenue reporting which have been long-standing areas of concern. However, there is scope for improvement in cash flow statements and in complex areas such as financial instruments and deferred tax.

Out of 252 reviews conducted, 27 companies (over 10%) were required to restate parts of their annual reports, almost double the number of restatements in the previous year, with a high proportion relating to cash flow statements.

At a time of geopolitical uncertainty and of economic challenge, the FRC highlights that some areas of narrative and financial reporting pose particular challenges and that companies should focus on "high quality decision-useful information for investors and other stakeholders," with risks articulated clearly in the annual report and accounts. See Reporting in times of uncertainty.

The FRC also highlights three areas of financial reporting for particular focus based on their findings this year:

- **Cash flow statements** – 15 out of 27 restatements required by the FRC this year related to cash flow statements, where the FRC considers a series of simple consistency checks and robust pre-issuance review (see box below) by both preparers and auditors would identify these in advance of publication. Cash flow statements will be a focus for audit quality inspections in the 2022/23 cycle.
- **Financial instruments** – in some cases queries could be avoided by clearer accounting policies and disclosures. Areas of focus include non-banking companies' disclosures of expected credit loss provisions, financing arrangements and covenants.
- **Deferred tax assets** (also a thematic review) – the FRC noted that in some cases there was again limited evidence disclosed regarding the recognition of deferred tax assets by entities with recent losses and that disclosure in this area must go beyond boilerplate and be entity-specific. The thematic review also identified an area for improvement for companies to explain the specific nature of key judgements and estimation uncertainty relating to deferred tax assets.

Focus areas for year-end reporting continued

Pre-issuance review of cash flow statements – some tips from our experts

The FRC encourages companies to refer to the appendix of their thematic review to review the consistency checks carried out by the CRR team.

Our experts suggest to review by looking down the cash flow statement and asking management questions about any areas that seem unclear or out of the ordinary.


FRC Financial Reporting Council

Thematic review: Cash flow and liquidity disclosures

November 2020

They also highlight the following areas as some of those warranting attention:

- Consider whether the item reported is actually a cash transaction that should be in the cash flow statement.
- Ensure there are adequate disclosures of non-cash transactions.
- Classification of cash flows for unusual, non-recurring or complex transactions – a good start is to look down the cash flow statement and notes.
- Parent company cash flow statements and classification of cash flows with a treasury company – several restatements were based on this.
- Netting of cash flows – for complex financial instruments, this may not be obvious - consider seeking advice.
- If cash outflows classified as investing activities did not give rise to an asset recognised on the balance sheet, they have been miscategorised.
- The FRC expects to see a tabular gross debt reconciliation of liabilities arising from financing activities – leases and preference shares that are liabilities should be included.
- And don't forget cash equivalents – this is sometimes an area that companies gloss over too quickly as, in particular, there are products such as money market funds that can lead to different conclusions.

Annual Review of Corporate Governance Reporting

At the start of November 2022, the FRC published its 'Review of Corporate Governance Reporting' which is based on a review of a sample of 100 companies drawn from the whole premium listed market. The comprehensive report presents the findings from this review and sets out the FRC's expectations for the future application of the Code and governance reporting. Our Newsflash is available here.

Focus areas for year-end reporting continued

The report highlights areas of high quality reporting, but also draws attention to improvement needed in a number of areas: disclosures on workforce and wider stakeholder engagement, diversity and oversight of the effectiveness of the risk management and internal control systems. In particular, the FRC has looked closely for disclosure of actions and outcomes resulting from governance policies, procedures and activities noting that the better disclosures include specific examples and case studies.

To improve in this area, the FRC's expectations include the following:

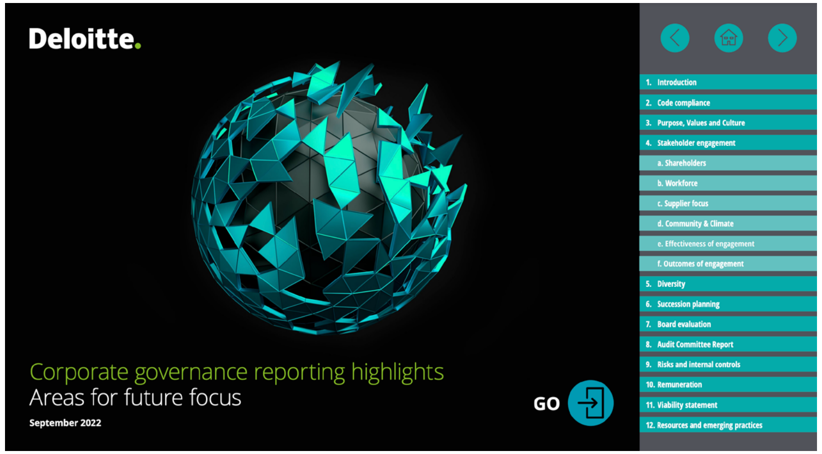
- Moving away from declaratory statements and providing specific disclosures
- Providing clear and meaningful explanations when departing from the Code – the FRC provides an example from Admiral Group PLC
- Demonstrating how the company's culture is aligned to its purpose, values and strategy
- Reporting on engagement with shareholders and stakeholders, and how their views have been considered
- Making clear linkages in the report to policies or disclosures that relate to stakeholder matters.
- Reporting on diversity, including at a senior leadership level beyond the recommended external targets, and showing company objectives and targets.
- Explaining how the board or a committee has reviewed the effectiveness of the risk management and internal control systems (see further detail below).
- Reporting on how the executive remuneration arrangements align with the company's purpose, values and strategy.

In addition, the FRC draws attention to ensuring clarity in the disclosures of:

- not only the outcomes from culture assessment and monitoring activities, but also the impact of any remedial initiatives to assess their effectiveness in the following reporting year;
- the extent to which shareholder engagement activity enabled shareholders to ask questions and present their views and concerns;
- how workforce views obtained from engagement activities are connected to actions carried out by the board;
- management of modern slavery risk including how the company has evaluated the impact of modern slavery on the business and who is responsible for driving strategy on modern slavery;
- the methodology used to calculate energy and carbon data, as well as a discussion of work that is underway to disclose in future, or to enhance current disclosure, and clarity about which of the Scope 3 categories will be included;
- how diversity objectives and initiatives link to company strategy; and
- procedures to identify and manage emerging risks; and following an assessment, an explanation of the emerging risks identified and actions to mitigate them.

Focus areas for year-end reporting continued

For examples of good practices in reporting on those areas that were also covered by the FRC in 2021, see our Corporate governance reporting highlights: Areas for future focus.



Two areas which are expected to receive additional focus this year:

- Provision 4 – the FRC is assessing the level of engagement with shareholders and the **quality and timeliness of reporting following a significant vote against** a board-recommended resolution at a general/annual meeting. This will go beyond the annual report to consider announcements of voting results and update statements. Examples of previous disclosures around votes against are available at the Investment Association's Public Register and the IA guidance is available here.
- Provision 29 – companies are encouraged to include a sufficiently detailed explanation regarding how boards have reviewed the **effectiveness of their risk management and internal control systems**, including confirming the effectiveness of these systems or, where weaknesses or inefficiencies have been found, describing these in the report. This has been raised for attention in letters to companies in the past year and will also be an area of focus for the Corporate Governance and Stewardship team this coming year. It will also feed into the formulation of potential policy options to be included in the upcoming 2023 consultation on the update to the Code.

Examples of actions undertaken by boards and committees:

The FRC sets out the following examples of actions undertaken by the board or a committee to review the effectiveness of the risk management and internal control systems:

- Considering the reports from senior management on their own assessment of controls and risk management
- Receiving assurance from management on compliance with relevant policies
- Receiving internal assurance of the effectiveness of the internal control function
- Reviewing reports from the management risk committee
- Reviewing reports from the internal audit function
- Reviewing reports from the external auditor
- Appraising the company's response to cyber-risks and data protection
- Reviewing instances of whistleblowing and other incidents
- Carrying out an independent external review

Focus areas for year-end reporting continued

Sustainability rising in prominence - Corporate Reporting Insights 2022: surveying FTSE annual reports – Deloitte report issued November 2022

The relationship between purpose and profit has come to the centre ground with the pandemic, the climate crisis, the race for talent and the current economic and geopolitical uncertainty. Many companies now fully integrate environmental, social and governance considerations into their strategic decision making to drive financial returns and respond to stakeholder expectations. Companies are embracing transparency and accountability to increase trust and confidence in this broadening area, supported in selected areas by assurance, internal or external.

This year's report highlights the need for connectivity across the annual report while exploring trends across five key areas– purpose, people, planet, prosperity and assurance. The survey provides insight and inspiration, accompanied by examples of better practice and regulatory hotspots, useful reading for companies preparing for the next reporting season.

The online format allows easy navigation through the chapters pointing boards towards key points to consider and highlighting to report writers 'what to watch out for'. Some highlights of this year's findings include:

- Almost all reports (90%) stated their purpose upfront, a marked shift from 41% five years ago.
- Although 68% clearly explained the link between executive remuneration and strategy, very few (18%) clearly explained the link to company purpose.
- All reports acknowledged the importance of employee wellbeing (as distinct from broader health and safety concerns), up from 96% last year. More than half of these (64%) went further by clearly describing how wellbeing is being assessed by management.
- The majority (88%) described a principal risk related to retention of people, but just 38% gave an employee turnover or retention metric.
- Linking the impact of climate-related risk in the wider annual report to financial statements has improved, with 78% of reports referring to climate-related matters in their financial statements (compared to just 30% in 2021). Just under half of annual reports' financial statements (42%) confirmed that there was no significant impact on the current year numbers as a result of climate-related risks. However, many references to the impact of climate on the financial statements continue to lack specificity and detail.
- Most reports (82%) disclosed some or all of companies' Scope 3 emissions with a further 16% stating their intention to make those disclosures in future. While Scope 3 emissions are recognised as difficult to identify and measure accurately, they frequently represent the largest proportion of a company's carbon footprint and are therefore of great interest to investors and other stakeholders. Given the significance of Scope 3, more than half (54%) included some or all Scope 3 within their carbon reduction target (2021: 30%).

In addition to the links embedded in this article, we would also like to draw your attention to **Closing Out 2022** – this is our one-stop guide which covers the principal narrative and financial reporting issues that are relevant to annual reports for the 2022 reporting season. As well as highlighting key areas of regulatory focus identified in the FRC's 2021/22 Annual Review of Corporate Reporting, the 2022 guide considers other aspects of reporting, including the challenges of reporting in an environment of global economic uncertainty and climate change.

Taxation

Taxation

2022 has been a year of change in taxation approach for individual countries and globally. In this article we flag some key changes that already have taken effect or are soon to do so in the UK, including from the recent Growth Plan statement. We also highlight major changes enacted in the US and changes resulting from collective international action.

UK Corporation Tax rate

On 14 October 2022, the then Prime Minister Liz Truss announced her decision to keep in place the increase in the main rate of corporation tax to 25% from 1 April 2023, reversing the announcement made in 23 September's 'mini budget' that the rate would be maintained at 19%.

The increase in the rate to 25% from 1 April 2023 was already substantively enacted into UK tax law on 24 May 2021 and received Royal Assent on 10 June 2021. This is a big change in rate and therefore careful consideration will be required for companies with balance sheet dates after substantive enactment in order to schedule out the temporary differences that are expected to reverse post 1 April 2023. Any temporary differences expected to reverse before 1 April 2023 will need to continue to be measured at the 19% tax rate.

If there is significant judgement involved in determining the extent to which the temporary differences will reverse pre 1 April 2023 (at 19%) vs post 1 April 2023 (at 25%) then additional disclosure of these judgements may be required.

Banking surcharge

All banking companies in the UK must currently pay an additional tax surcharge on all taxable profits in excess of £25m per annum. This falls within the definition of an income tax and is accounted for in the tax line. The surcharge rate is currently set at 8%.

Following the decision to proceed with the Corporation Tax rate increase to 25% from April 2023, the changes to the Bank Corporation Tax Surcharge which are legislated to take effect from the same point will also go ahead. This means that from April 2023, banks will be charged an additional 3% rate on their profits above £100 million – meaning that they will continue to pay a higher combined rate of corporation tax than most other companies, and a higher rate than they did previously.

Other Budget measures

In October 2022 the newly appointed Chancellor of the Exchequer, Jeremy Hunt MP, announced that further tax policies set out in the Growth Plan statement (or 'mini budget') of 23 September 2022 will no longer be taken forward:

- The basic rate of income tax will remain at 20%, instead of being cut to 19% from April 2023.
- The 1.25 percentage point increases to the rates of income tax on dividend income, which took effect in April 2022, will now remain instead of being reversed from April 2023.

Taxation continued

- The 2017 and 2021 reforms to the off-payroll working rules (IR35), which broadly shifted decision-making from workers to businesses, will remain in place instead of being repealed from April 2023.
- A new VAT-free shopping scheme for non-UK visitors to Great Britain will no longer be introduced.
- Alcohol duty rates will no longer be frozen for a year from February 2023.

However, Mr Hunt stated that certain other tax changes announced in the mini budget will proceed. Reductions of national insurance rates for 2022/23 and the cancellation of next year's 1.25% health and social care levy were both enacted by the Health and Social Care Levy (Repeal) Act 2022, which received Royal Assent on 25 October 2022. A Stamp Duty Land Tax (Reduction) Bill, to permanently enact the changes to stamp duty land tax for residential property in England and Northern Ireland, including the increase in the threshold to £250,000, has had its second reading in the House of Commons on 24 October 2022 and awaits the Committee stage. Mr Hunt also stated that the permanent increase in the capital allowances annual investment allowance (AIA) to £1 million, the next steps of the alcohol duty review, and changes to the Seed Enterprise Investment Scheme (SEIS) and the Company Share Options Plan (CSOP) will also continue as planned.

On 17 November 2022 Mr Hunt delivered the Autumn Statement 2022. The government used inflation to its advantage, freezing thresholds and cutting allowances to raise taxes without raising rates, using the concept of fiscal drag. A number of measures were announced, including:

- The Personal Allowance, Inheritance Tax and Higher Rate thresholds were all frozen;
- There were substantial changes to Capital Gains Tax, with the Annual Allowance halving from £12,300 to £6,000 next year, then halving again to £3,000 from 2024;
- A number of changes to windfall taxes, extending them to 6 years, increasing rates to 35%, and adding a new 45% rate for renewable and nuclear energy producers. This leaves the oil and gas sector facing headline rates of 75%, and energy producers facing 70% on windfall profits;
- The government announced the introduction of a new 15% Domestic Minimum Top-up Tax alongside its implementation of the OECD Pillar Two framework in the UK;
- Significant reliefs from Business Rates totalling £13.6bn, particularly helping the retail and hospitality sectors by increasing rates relief to 75% and extending it until 2024;
- For large companies the R&D Expenditure Credit will increase from 13% to 20%, however the enhanced deduction for SMEs is reducing from 130% to 86%; and
- Electric Vehicle users will now be subject to road tax from 2025, and the benefit in kind tax on company EVs increases by 1% pa to 5% in 2027.

Taxation continued

Global tax reform: Pillars 1 and 2

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting reached political agreement on the key components of the two-pillar approach to international tax reform in 2021 and significant technical work has been undertaken throughout 2022. 2023 will see a move into the implementation phases, particularly for Pillar Two, and most global businesses of any scale are likely to be affected.

- **Pillar One: Nexus and profit allocation rules (Amount A)**
  Amount A targets the largest multinational groups focusing initially on those with at least EUR 20 billion of consolidated revenue and net profits of over 10% (i.e., profits before tax to revenue). Exclusions apply for the extractive sector and regulated financial services. A formulaic approach will be used to allocate a percentage of global profits to market jurisdictions for tax purposes, i.e. countries where customers and users are located. The Amount A rules will take effect in 2024 if agreed by a 'critical mass' of countries, including the US.

- **Pillar Two: Global minimum tax**
  Pillar Two, introduces a minimum effective tax rate of at least 15%, in each jurisdiction calculated based on a specific accounting based ruleset. Groups with an effective tax rate below the minimum in any particular jurisdiction would be required to pay top-up tax in their head office location or in the location of other affiliates. The tax would be applied to groups with revenue of at least EUR 750 million, making it far more widely applicable than Amount A under Pillar One. Countries are also able to introduce domestic rules to tax local businesses including wholly domestic businesses.

With action required in 2023 ahead of a scheduled implementation of the Pillar Two rules starting from January 2024, board awareness of the issues at stake is important, noting the potential implications on the group's effective tax rate and significantly increased compliance requirements.

The tax affairs of large groups have become much more complex: groups should also monitor the timetable for legislative enactment in individual jurisdictions and consider the extent to which disclosures on the future impact of these rules should be included in the financial statements.

Taxation continued

US tax reform

On 16 August 2022, President Biden signed into law the Inflation Reduction Act of 2022, the roughly $740 billion tax-and-spending package that includes a number of measures including:

- A new minimum tax on certain large corporations, generally those with three-year average adjusted financial statement income of $1bn or more;
- An excise tax on share buybacks;
- A significant funding boost for the US tax authority (IRS) enforcement efforts;
- A long-term extension of the Superfund excise tax; and
- Incentives to address climate change mitigation and clean energy, and provisions to promote health care affordability.

The minimum tax (AMT) would broadly impose a 15 percent minimum tax on adjusted financial statement income (AFSI) of applicable corporations over the corporate AMT foreign tax credit for the taxable year. This provision would be effective for taxable years beginning after 31 December 2022.

Resources to help you get ahead:

Tax At Hand is our website providing regular tax news updates

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Remuneration committees and workforce pay: Navigating a volatile environment

Remuneration committees and workforce pay: Navigating a volatile environment

In a challenging economic environment, boards will face heightened scrutiny in the coming year around executive pay decisions and actions taken to support the workforce in light of a growing cost-of-living crisis.

The impact of rising inflation and a volatile macroeconomic environment is being felt both in the UK and across global markets. At the same time, many companies face significant talent challenges, with a recent Deloitte Academy poll citing the ability to attract and retain talent as the top business concern at present.

Changes to the UK Corporate Governance Code in 2018 expanded the remit of the remuneration committee to include oversight of workforce remuneration and related policies. The COVID-19 pandemic and the cost-of-living crisis have heightened external focus on workforce reward decisions, with an increase in the breadth of talent discussions at the remuneration committee, and at the board.

In the coming year, we expect to see particular focus on the following areas:

1. Salary review – executive and wider workforce

While executive salary increases have typically tracked a workforce inflation rate of c.2% in recent years, in a high inflation environment we are seeing remuneration committees take a more considered approach to the annual salary review for executive directors. With continued economic volatility and interest rate rises expected to put continued pressure on household living standards in the coming year, companies are more commonly adopting a tiered approach, with higher percentage increases typically applied to lower paid employees reflecting their proportionally greater exposure to price inflation. We are also seeing salary budgets focussed on talent 'hotspots' such as digital, cyber-security and technology-focussed roles.

"The remuneration committees of those companies that have decided to give employees on low salaries a significant pay increase to help them navigate the current crisis should exercise caution if they plan to use the average workforce salary increase rate when setting executive salaries."
LGIM Principles of Executive Pay, October 2022

Investors are also shifting their expectations in this area. In a letter to Remuneration Committee chairs in November 2022, the Investment Association noted that "in a period of significantly higher inflation, the IA consider that additional restraint should be shown for executive director salary increases. [..] If salary increases are needed, IA members encourage Committees to consider increases below the rate of salary increases given to all employees".

Institutional Shareholder Services (ISS) recently issued draft voting policy changes for the UK & Ireland[3], with a proposed amendment stating that salary increases for executives should be "low and **ideally lower proportionally** than general increases across the broader workforce".

Caution around higher executive salary increases is linked to the multiplier effect on overall quantum where incentives are based on a % of salary, and remuneration committees should understand this impact when setting pay increases for the year ahead.

For March to June financial year ends, executive director increases were typically set lower than the workforce rate, in particular where average workforce salary increases were at or above 4%, and this is expected to continue into 2023 as year-end results are published.

[3] Proposed ISS Benchmark Policy Changes for 2023, November 2022. Consultation period runs from 4 – 16 November. Existing guidance states that salary increases for executives should be "low and in line with than general increases across the broader workforce"

Remuneration committees and workforce pay: Navigating a volatile environment continued

Executive and workforce salary increases - March to June year ends

	FTSE 100 (26 companies)			FTSE 250 (36 companies)		
	CEO	**CFO**	**Wider workforce (average)***	**CEO**	**CFO**	**Wider workforce (average)***
Upper quartile	3.9%	4%	5.1%	4.8%	5.5%	5.4%
Median	**3%**	**3%**	**4%**	**3.5%**	**3.6%**	**4.9%**
Lower quartile	3%	2.8%	3%	2.8%	3%	3.1%

*As disclosed in the Directors' Remuneration Report

Questions for remuneration committees:

- How has the salary budget been allocated across the organisation? e.g. for lowest paid workers; in 'talent hotspots'.
- What is the inflationary impact by country and how do increases reflect the local economic environment? Are there any employees exposed to hyperinflation?
- What is the impact of any proposed executive directors increases on overall quantum (e.g. target and maximum remuneration)?
- How has the CEO: employee pay ratio moved year on year and what are the drivers of this?

2. Cost-of-living actions – supporting the workforce

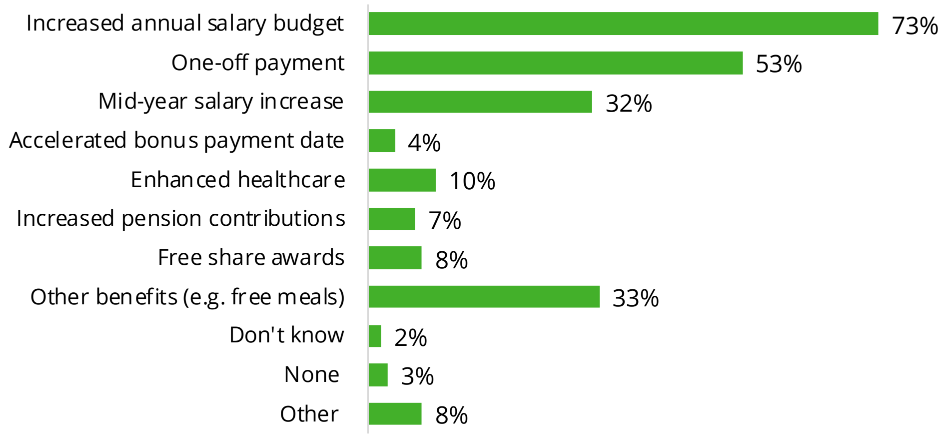
Around c.25% of FTSE 100 companies have published details of specific actions taken to support the workforce through the cost-of-living crisis, and many companies are closely monitoring the external environment and considering their response in this area. To date, published actions have been most common in sectors with significant front-line workers (e.g. consumer goods and retail), as well as banks, insurance and financial services sectors.

In addition to an increased annual salary budget or mid-year salary increases, a recent poll suggested that around one-half of companies have made, or are likely to make, one-off payments to targeted workforce populations to help support with the cost-of-living crisis. Where made, these have been in a typical range of c.£500 - £2,000, and applied below an earnings threshold (e.g. £35k - £75k). Other approaches have included a review of benefits offerings, wage advance arrangements and accelerated bonus payment dates.

In the coming year we expect to see expanded narrative in directors' remuneration reports around wider workforce pay and cost-of-living actions. Based on recent investor guidance and consultation, it is set to be a key area of focus during the 2023 AGM season, with shareholders increasingly looking to understand the relationship between pay decisions for executives and the workforce.

Remuneration committees and workforce pay: Navigating a volatile environment continued

Which, if any, of the following cost-of-living actions have you taken or are you likely to take across the workforce? (Select all that apply)



Poll question - Annual Remuneration Strategy Conference October 2022

Questions for remuneration committees:

- What actions have been taken to support the workforce through the cost-of-living crisis? Are there different approaches by jurisdiction?
- How has the annual salary budget spend been allocated across different earnings levels?
- How do wider reward policies and actions support the broader talent agenda (e.g. return to office/hybrid working)?

3. Engaging with the workforce on remuneration

In the current environment, many boards (and remuneration committees) are increasing their employee engagement activities as they seek to monitor and assess the workforce impact against an evolving economic backdrop.

In November 2021, the Financial Reporting Council published clarifying guidance on the requirements of Provision 40 and 41 under the UK Corporate Governance Code, explaining that companies are expected to effectively engage on workforce remuneration and this should include a two-way dialogue. In the last year we have seen increasing disclosure in this area, with greater regulatory focus on the quality of reporting.

"Provision 40 asks companies to effectively engage with the workforce to discuss their remuneration arrangements. In our 'Improving the quality of 'comply or explain' reporting' publication we explained that 'effective engagement' for the purpose of this Provision means two-way dialogue. [..] Provision 41 of the Code asks companies to explain 'what engagement with the workforce has taken place to explain how executive remuneration aligns with wider company pay policy'. Such engagement could be a two-way direct engagement or one-way." **FRC Annual Review of Corporate Governance Reporting, November 2021**

Remuneration committees and workforce pay: Navigating a volatile environment continued

To comply with Provision 40 in terms of workforce engagement	To comply with Provision 41 in terms of workforce engagement
• Two-way engagement with the workforce during the reporting year • Specifically discuss the company's remuneration arrangements • Opportunity for the workforce to ask questions or raise issues • Explain this engagement and the outcome from it in the annual report	• Two-way or one-way (such as a communications video, report, newsletter) engagement during the reporting year • Explain to the workforce how executive remuneration aligns with wider company pay policy • Describe this in the annual report

The majority of remuneration committees build on existing workforce engagement activities in looking to meet Provisions 40 and 41 of the Code. Examples include the attendance of the remuneration committee chair at workforce forum events or listening group sessions; online Q&A sessions and a dedicated email address to answer queries relating to the decisions of the remuneration committee. Multimedia communications (e.g. video from the remuneration committee chair) have also used to explain the role of the remuneration committee and year end decisions on executive pay.

Questions for remuneration committees:

- How has the committee engaged with employees on workforce and executive pay? How will year end out-turns be communicated?
- What are current workforce 'hot topics' and what supporting data is available (e.g. surveys, external ratings such as Glassdoor)?

Final thoughts

Remuneration committees will need to delicately navigate a challenging external environment when assessing 2022 remuneration outcomes and setting pay for 2023, in an environment of heightened scrutiny and reputational risk. Increasingly, committees are expected to understand, and report on, wider workforce pay and we are seeing growing discussion at board level around the wider people and talent agenda.

Remuneration Committees may well find that setting out some guiding principles would be helpful, such as those set out in the Leaders as Change Agents Guide, to which Deloitte is proud to have contributed.

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Pensions: responding to gilt market volatility

Pensions: responding to gilt market volatility

Recent volatility in gilt yields has had a pronounced impact on liability driven investment (LDI) strategies and the funding health of pension schemes more broadly. With leveraged LDI having risen in the consciousness of policymakers, regulators and even the wider public, even the asset class is being questioned.

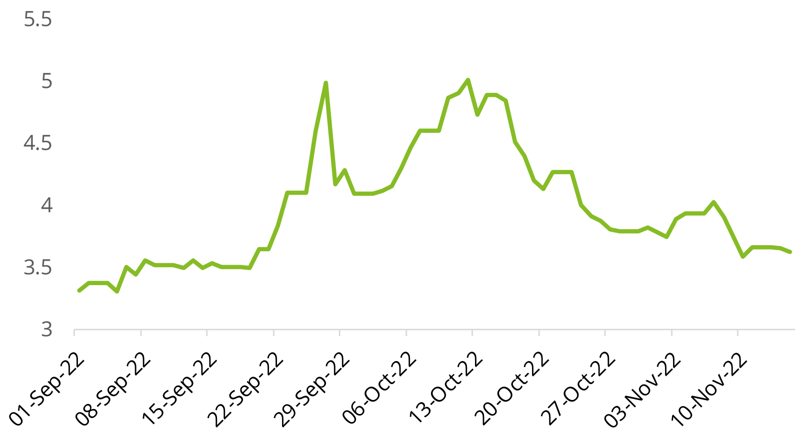
This article explains the background to the issue, the reasons that pension scheme trustees and boards of corporate sponsors are acting quickly to reassess the merits of their investment strategies, and other matters to consider when taking on a new role at a company with a defined benefit scheme.

The state of play: Gilt market volatility

Nominal and real gilt yields have been trending higher for some time and more sharply recently in response to the sustained and historically extreme rise in UK CPI. With gilt investors already pricing in more aggressive policy action from the Bank of England, the new Chancellor Kwasi Kwarteng's "mini-budget" on 23 September 2022 triggered a pronounced sell off. The market moves (which equated to an 1% rise in 20-year spot yields over 3 business days) were accentuated by leveraged LDI portfolios and LDI funds as investment managers were forced to trim hedging exposures in response to a severe reduction in available collateral.

Gilt markets ultimately became dysfunctional and the Bank of England was forced to step in on 28 September to stabilise prices, restore market functionality and prevent a broader crisis. The change in Chancellor and resultant changes to tax and to spending plans appears to have restored calm. Gilt yields have fallen from recent highs but remain elevated, reflecting generally higher inflation concerns.

20 year nominal gilt spot yields (%p.a.)



Impact on pension schemes

UK pension schemes hold gilts and index-linked gilts to hedge interest rate and inflation exposure within their liabilities. Leveraged hedging or LDI instruments, LDI funds and mandates are commonplace, offering an efficient means of reducing volatility in pension scheme funding ratios. As gilt yields rose, the value of these leveraged instruments fell which required pension schemes and their investment managers to post significant amount of collateral.

Pensions: responding to gilt market volatility continued

Many schemes focused throughout this gilt market crisis on maintaining hedging levels, sourcing additional collateral and ensuring LDI managers have clear instructions should additional collateral be required in the future.

However, the material rise in gilt yields has had a significant impact on pension scheme funding positions, asset allocations and possibly also a knock-on impact on the prospects of meeting ultimate funding goals.

Corporate sponsors of defined benefit pension schemes are now taking the time to undertake a high-level review of their investment strategy to better understand:

- Collateral sufficiency testing to understand the ability to withstand future gilt market volatility;
- The current funding health of their scheme;
- Scenario planning for asset allocation positions after possible market moves and any collateral driven transactions. Many schemes have seen a rise in allocation to unlisted assets which may mark to market infrequently and be less illiquid; and
- The expected trajectory of the scheme's funding position under various scenarios and to understand the probability of meeting longer term funding goals.

Some pension schemes may wish to explore the potential to switch from levered LDI into physical, unlevered hedging instruments such as Gilts and Index-linked Gilts.

Areas for directors to consider when speaking with management

- If your company has defined benefit exposure, ensure you understand the exposure and the impact the movement in rates has had on your funding position. Speak with your Trustees and ask for an updated funding position.
- Be prepared to seize opportunities. Work with your company adviser to understand if there is opportunity to reduce risk/cash contributions as a result of the market changes.
- Develop contingency plans and be prepared to take decisions. Wargaming is a useful way to prepare for various scenarios including how decision making can be made in situations of market volatility.

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Pensions: responding to gilt market volatility continued

Financial reporting perspective – pensions in the annual report

Volatility in gilt yields and reassessment of defined benefit scheme investment strategies will have knock-on effects to financial reporting around defined benefit schemes. There are two areas to bear particularly in mind when reviewing disclosures this year end, which we understand are also areas likely to receive regulatory focus.

Disclosure objectives: with a volatile environment it is important to bear in mind that IAS 19 expects an entity to disclose "information that… explains the characteristics of its defined benefit plans and risks associated with them…" [IAS 19.135(a)] and "a description of the risks to which the plan exposes the entity, focused on any unusual, entity-specific or plan-specific risks, and of any significant concentrations of risk…"[IAS 19.139(b)]

Sensitivities: the graph earlier in this article shows that a reasonably possible change for the discount rate may now be significantly higher than the rate that has been used for sensitivities over the past several years. The requirement in IAS 19 is to disclose "a sensitivity analysis for each significant actuarial assumption as [at the year end], showing how the defined benefit obligation would have been affected by changes in the [assumption] that were reasonably possible at that date", along with "changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses, and the reasons for such changes." [IAS 19.145]

Appendix

Appendix

Summary of climate reporting requirements

	Premium- and Standard- listed companies	Regulated businesses (asset managers, FCA-regulated pension providers, life insurers)	LLPs and other companies (AIM companies with more than 500 employees, private companies with more than 500 employees and a turnover of more than £500m, companies with more than 500 employees and have transferable securities admitted to trading on a UK regulated market, banking and insurance companies with more than 500 employees)
Requirements	LR 9.8.6R(8)/LR 14.3.27R: a statement setting out whether the company had included in its annual report climate-related financial disclosures consistent with the TCFD Recommendations and Recommended Disclosures and if not, state the reasons for not including such disclosures and steps taken to disclose those in future, which became effective for accounting periods on or after 1 January 2021. An entity should also consider the implementation guidance in LR 9.8.6BG to 9.8.6EG and LR 14.3.28G to 14.3.32G which includes updated 'TCFD Annex' entitled "Guidance for All Sectors", newly added TCFD Guidance on Metrics, Targets and Transition Plans for accounting periods beginning on or after **1 January 2022.**	The FCA published PS21/24, introducing a new Environmental, Social and Governance (ESG) sourcebook with rules and guidance for disclosures consistent with the TCFD framework effective for accounting periods beginning on or after **1 January 2022.** This will be effective from 1 January 2023 for firms with less than £50 billion in assets under management and asset owners with less than £25 billion in assets.	The Department for Business, Energy & Industrial Strategy (BEIS) will require mandatory climate-related financial disclosures in the strategic report in line with the four overarching pillars of the TCFD recommendations for accounting periods beginning on or after **6 April 2022.**

Appendix continued

Reminder of relevant guidance referenced in the Listing Rules

For the 2022/23 reporting season (for periods commencing on or after 1 January 2022), the FCA published implementation guidance in LR 9.8.6BG to 9.8.6EG and LR 14.3.28G to 14.3.32G which clarifies that for the purposes of LR 9.8.6R(8)/LR 14.3.27R, in determining whether climate-related financial disclosures are consistent with the TCFD Recommendations and Recommended Disclosures, companies in scope should undertake a detailed assessment of those disclosures which takes into account:

1. Section C of the TCFD Annex entitled "Guidance for All Sectors";
2. (where appropriate) Section D of the TCFD Annex entitled "Supplemental Guidance for the Financial Sector"; and
3. (where appropriate) Section E of the TCFD Annex entitled "Supplemental Guidance for Non-Financial Groups".

Further to this, under LR 9.8.6C the FCA considers that the following documents are relevant for the compliance statement considerations:

1. the TCFD Final Report and the TCFD Annex, to the extent not already referred to in LR 9.8.6R(8) and LR 9.8.6BG;
2. the TCFD Technical Supplement on the Use of Scenario Analysis;
3. the TCFD Guidance on Risk Management Integration and Disclosure;
4. (where appropriate) the TCFD Guidance on Scenario Analysis for Non-Financial Companies; and
5. the TCFD Guidance on Metrics, Targets and Transition Plans.

For boards to make their management aware of the reporting requirements, please refer to our Need to know.

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