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UK Corporate Reform & The Future of Controls

Monday 26th June 2023



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Our speakers and agenda for today...

1. Welcome and Introductions
2. What we are expecting on the 'Restoring trust in corporate governance & audit' reforms
3. What does this mean in practice
4. Deep dive on risk management and internal controls
5. What questions should boards be asking on internal control?
6. Q&A



Sonya Butters



Tracy Gordon



Ololade Adesanya



The current position on the
'Restoring trust in corporate
governance & audit' reforms



Tracy Gordon
Director, Corporate Governance

Latest on the BEIS reform agenda

Draft reporting regulations circulated to selected stakeholder groups – due to be laid before Parliament in June/July



The draft regulations cover six new reporting elements as trailed in last year's Government Response:

- Resilience statement
- Audit and assurance policy statement
- Distribution policy statement
- Statement of distributable profits
- Distribution confirmation statement
- Material fraud statement

Some key points to be aware of from the draft regulations:

- Introduce a new reporting threshold in line with the Large PIE definition
- Subsidiaries exempted from reporting if part of a Group providing the disclosures
- Phased implementation giving unlisted companies an additional year
- Now aiming for **1 Jan 2025** for listed companies and **1 Jan 2026** for unlisted companies in scope

FRC consultation on proposed changes to the UK Corporate Governance Code

Comment deadline 13th September 2023



Four Key Areas of Change







A new declaration by the board on the effectiveness of risk management and internal control systems

Wider responsibilities and considerations for the Board, Audit Committee & RemCo in relation to ESG objectives and other sustainability matters

Incorporation of forthcoming new requirements for an Audit & Assurance Policy and the Resilience Statement

Strengthened reporting on malus and clawback remuneration arrangements

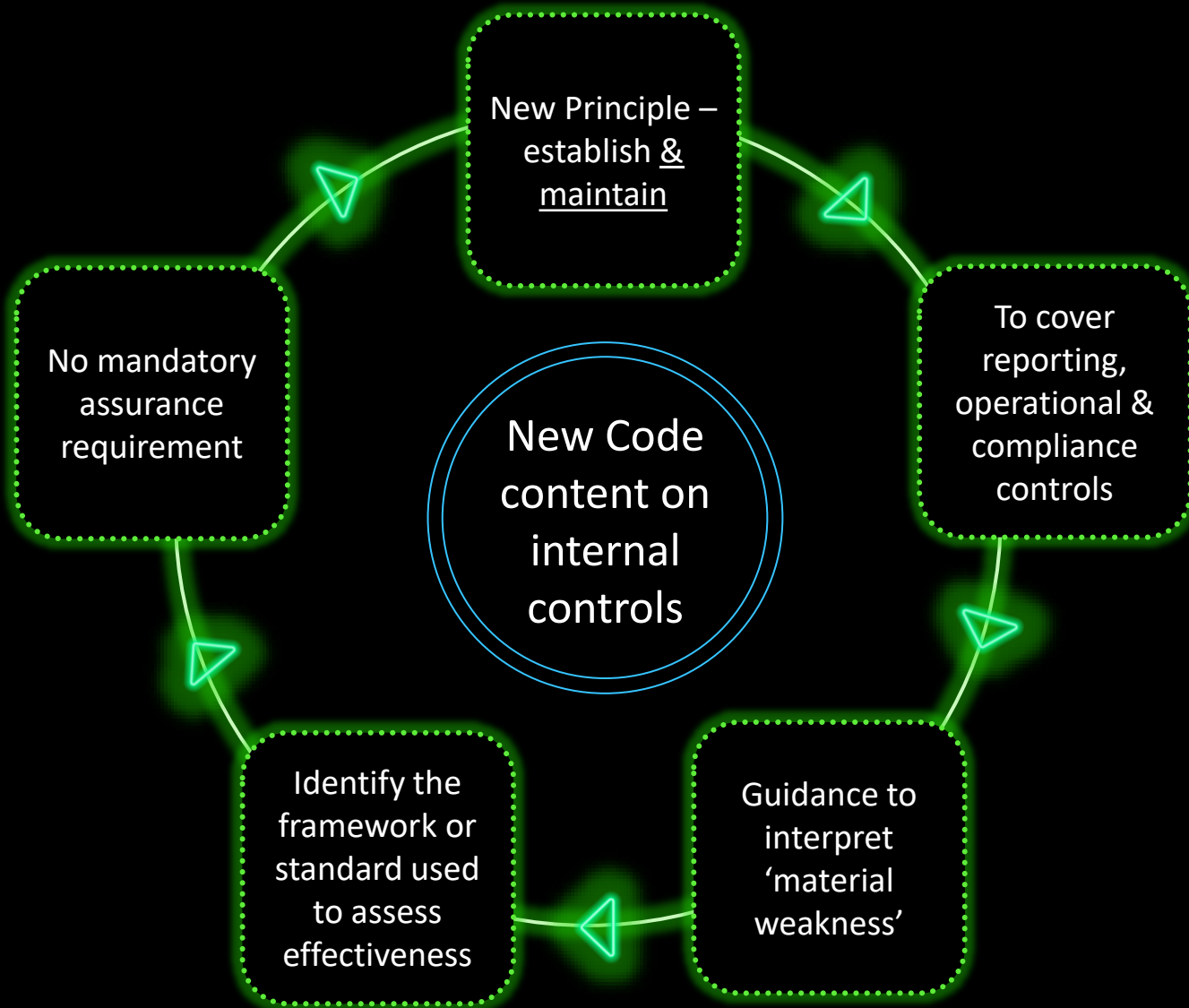
Other Areas of Change

-  Reporting on activities and outcomes
-  Reflecting the publication of 'Audit committees and the external audit: Minimum Standard'
-  Tackling over-boarding
-  Reporting on shareholder engagement
-  Reporting on diversity & inclusion initiatives and targets
-  Clarifying the requirements for the remuneration policy

Intended to apply for periods commencing on or after 1 January 2025

FRC consultation on proposed changes to the UK Corporate Governance Code

A new declaration by the board



A declaration of whether the board can reasonably conclude that the company’s risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report



An explanation of the basis for its declaration, including how it has monitored and reviewed the effectiveness of these systems



A description of any material weaknesses or failures identified and the remedial action being taken, and over what timeframe

FRC consultation on proposed changes to the UK Corporate Governance Code

New responsibilities around ESG and sustainability matters



The Board

Expanding Provision 1 to make clear that environmental and social matters (including climate ambitions and transitions plans) should be considered in assessing the basis on which the company generates and preserves value over the long-term

The Audit Committee

Monitoring the integrity of narrative reporting, including sustainability matters, and reviewing any significant reporting judgements

Reporting on the significant issues that it considered relating to narrative reporting, including sustainability matters, and how these issues were addressed and, where commissioned by the board, the assurance of ESG metrics and other sustainability matters

The RemCo

Considering whether remuneration outcomes are clearly aligned to the successful delivery of the company's long-term strategy includes consideration of environmental, social and governance objectives

FRC consultation on proposed changes to the UK Corporate Governance Code

Incorporating the new requirements for the Audit & Assurance Policy & Resilience Statement



As a reminder – for UK companies with more than £750m annual turnover and 750 or more employees, the Government is planning to issue new requirements, through the Companies Act, for companies to produce an Audit & Assurance Policy and a Resilience Statement

For the Audit & Assurance Policy...

- Decision taken to require all Code companies (regardless of size) to provide one on a 'comply or explain' basis
- Update Code Provision 26 includes the following responsibility for the audit committee: "developing, implementing and maintaining the audit and assurance policy"
- Footnote clearly references the forthcoming regulation as the basis for content

For the Resilience Statement...

- A slightly different approach – overlap with viability
- Going concern provision remains in the Code unchanged
- The provision calling for the viability statement is changed to just focus on describing how the board assesses future prospects and removes the viability statement piece
- Footnote makes clear that companies providing a Resilience Statement (in line with the regulations) will be compliant with the Code
- Companies not required to provide a Resilience Statement (i.e. below the 750:750 threshold) therefore have a choice to provide one voluntarily or report against the provisions



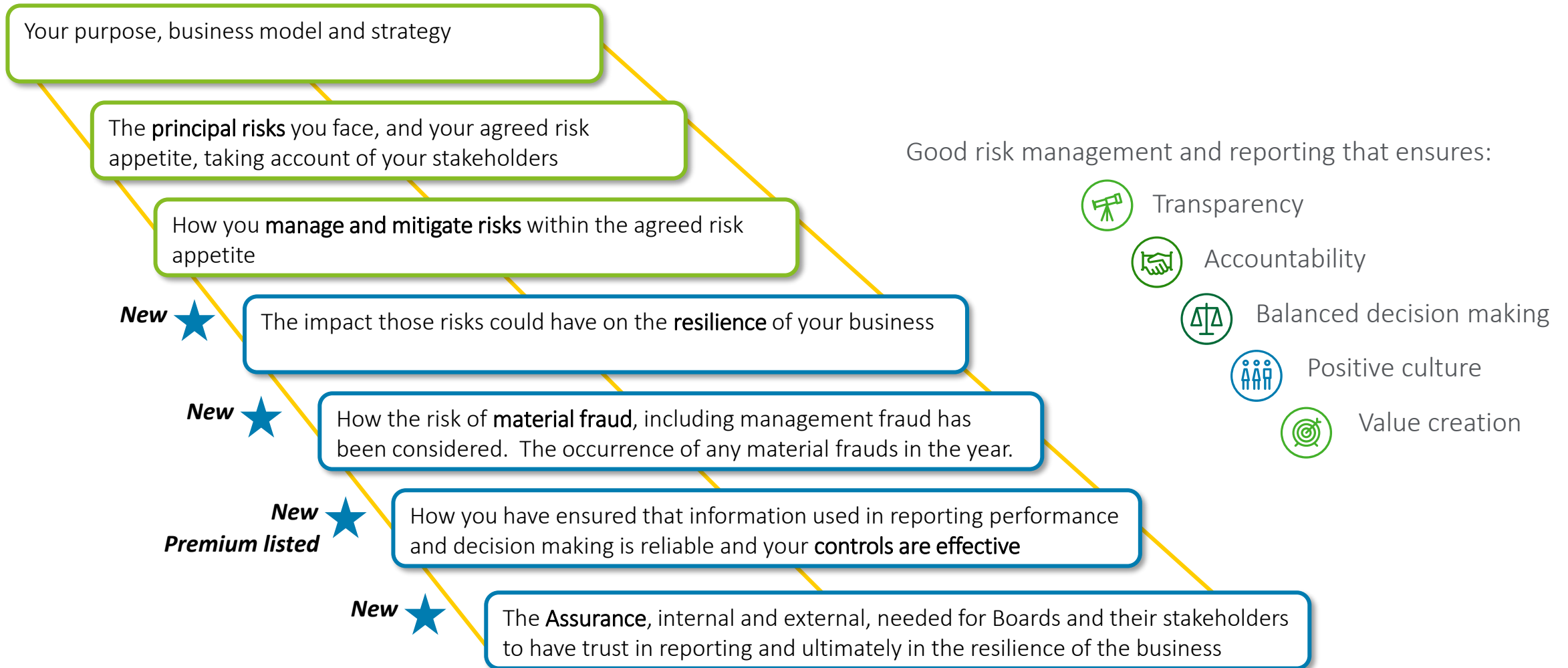
Making sense of the incremental requirements – Tell your story clearly and follow good practice



Sonya Butters
Partner, CFO Advisory, Controls

Linking purpose and business model to risk and resilience

UK companies and their Boards are being asked to enhance their external narrative reporting on risk, how it is managed, how risks might impact and how decisions were taken, and to ensure that narrative is based on substance and internal documentation



There is no right or wrong answer. The "minimum to comply" is to explain your decisions in your year end Reporting, honestly and clearly, backed up by good internal documentation to enable review

Pathway to implementation

Practical Example: Litigation Risk



Your business model and strategy, ERM, Risk Appetite, Investor/Shareholders view

Establish principal risk

- Adverse outcome of litigation
 - Adverse outcome due to pre-litigation
 - Mismanagement of contractual liabilities
- **Assess adequacy of identified level 2 and 3 litigation risks**

Establish mitigating controls

- On an ongoing basis, the Group Legal Team undertake horizon scanning to identify potential litigation, and engage with approved legal firms in advance.
- Controls are established to ensure data and judgements are reported accurately and completely
- **Monitor effectiveness of controls**

Consider impact of risk on resilience

- **Assess whether litigation is a material resilience matter**
- **Assess impact of litigation risks crystallising**
- **Assess adequacy of relevant models and stress tests**
- **Determine appropriateness for reverse testing scenarios**
- **Document impacts and results of resilience testing**
- **Reflect relevant assurance activity in assurance map**

Consider impact on fraud statement

- **Consider impact of litigation risk on the risk of material fraud**
- **Identify and map additional controls to prevent and detect fraud risk due to litigation**
- **Assess the adequacy of relevant assurance activities**
- **Document relevant actual or detected fraud risk and actions taken to address them**
- **Capture result in fraud report**

Map assurance activities

- 2nd Line: Annual review with Finance over major litigation spend to assess future litigation as a function of projected spend.
- **Assess the adequacy of assurance activities across the 3 lines of defence and any external assurance obtained in respect of fraud risk.**
- **Document assurance provider, assurance standard followed and whether assurance is reasonable or limited.**

1

Directors' declaration on internal controls

2

Resilience statement

3

Fraud statement

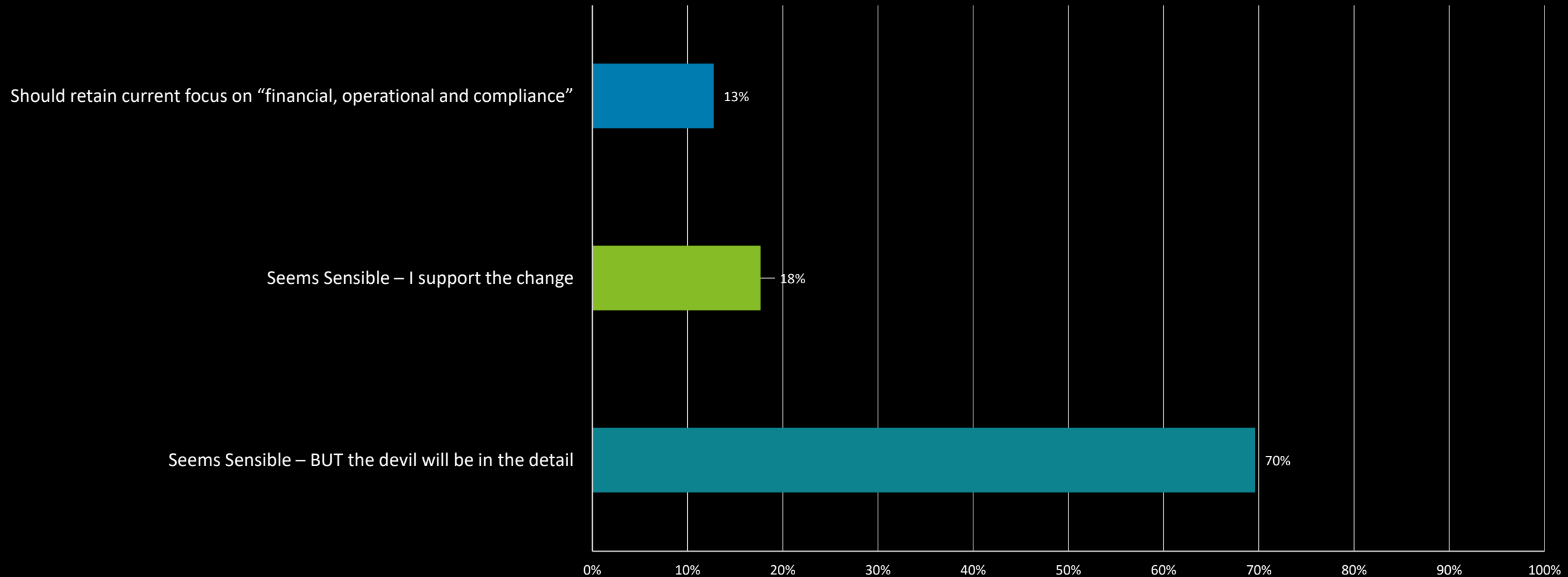
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Audit & Assurance Policy

Polling Question 1



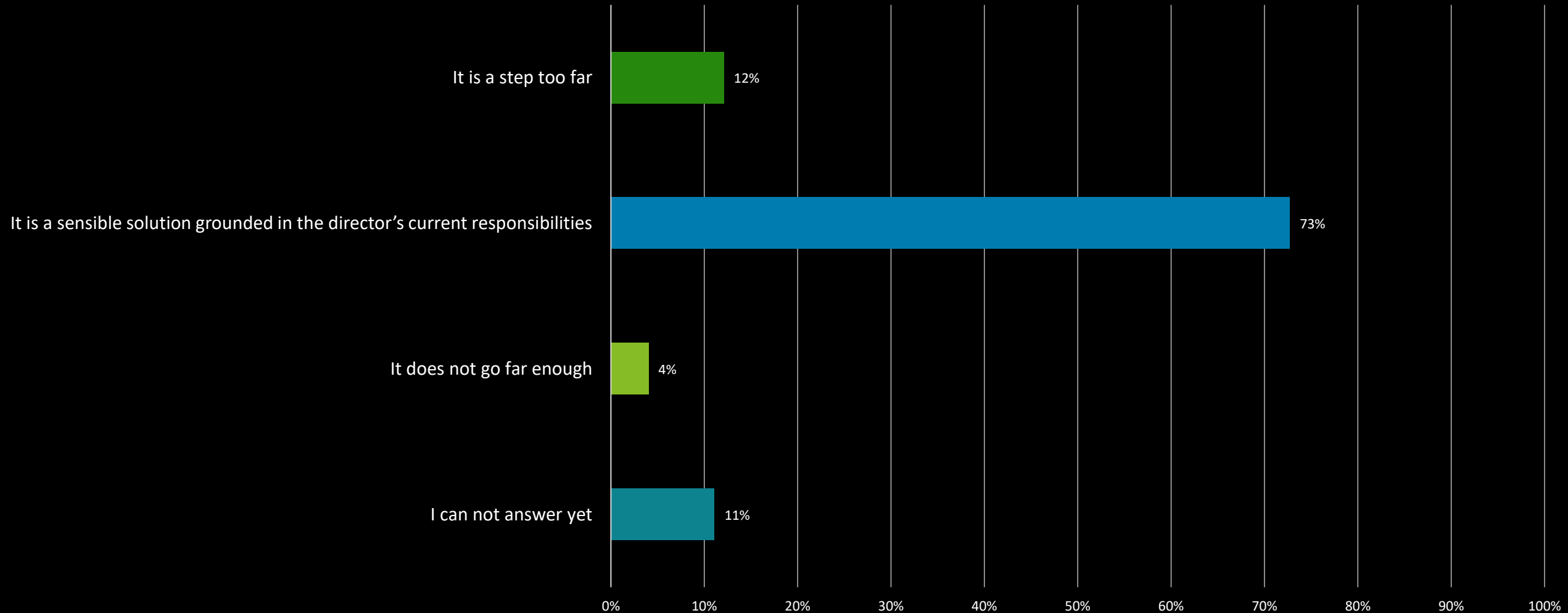
There is a proposal to change the existing categories of material controls from “financial, operational and compliance” to “reporting, operational and compliance”. What is your view on this potential change?



Polling Question 2



What is your view of the proposed suggestion for a board declaration that the framework and systems of risk management and internal control have been working effectively during the year?





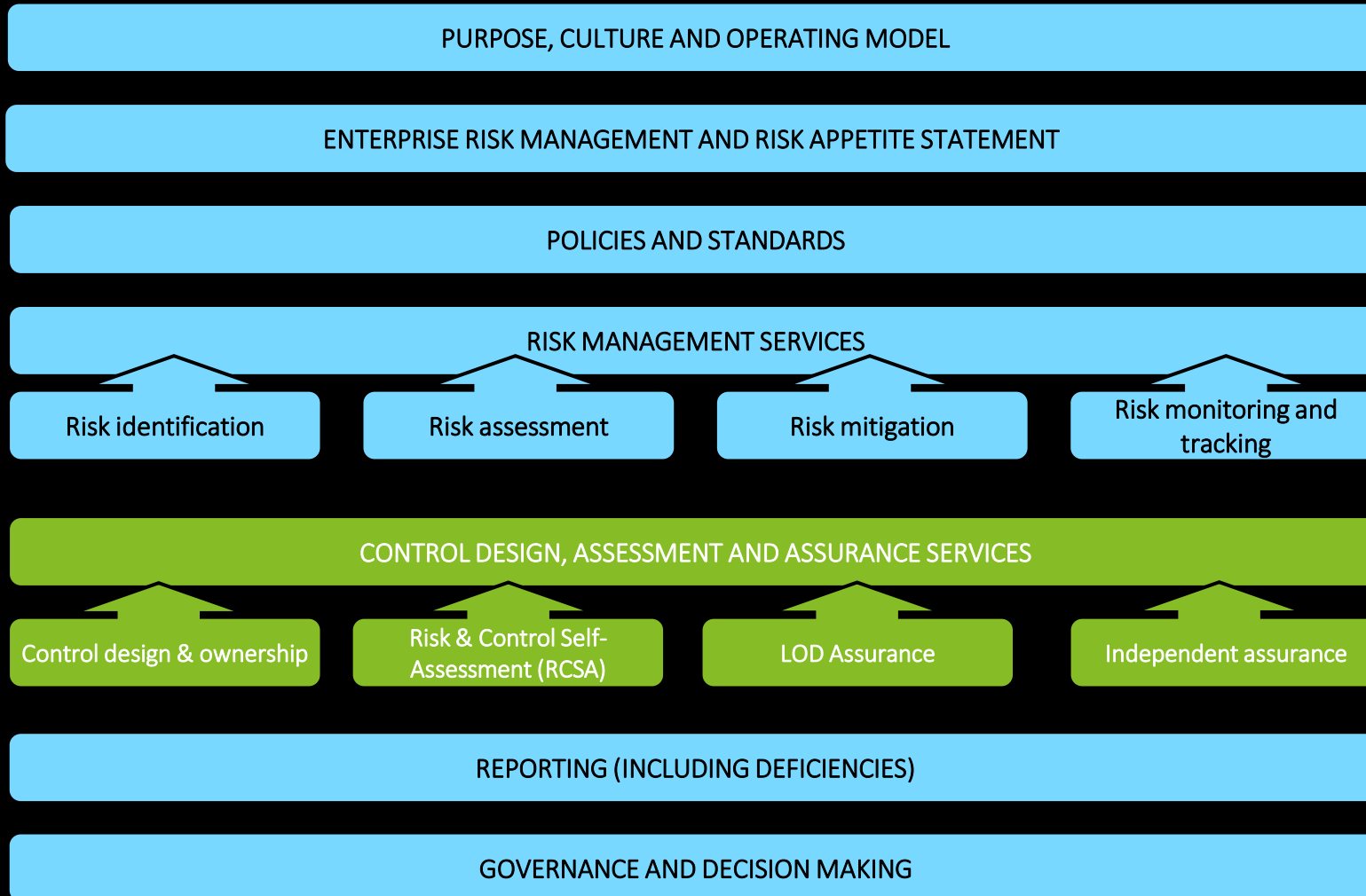
Deep dive on risk management and internal controls



Ololade Adesanya
Director, Financial Services
Controls Advisory

Controls declaration

A holistic enterprise approach



The Risk Universe

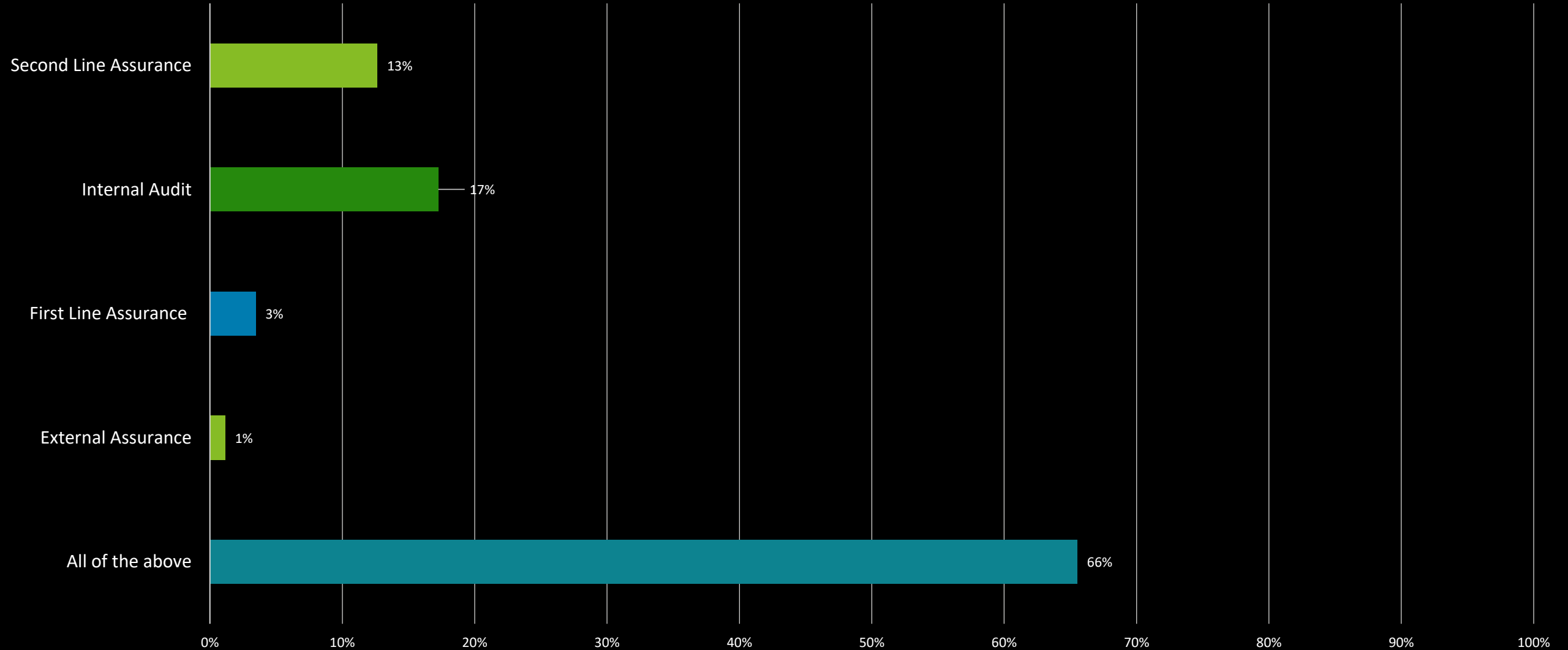
The BAU risk and control services

The accountability and operating model

Polling Question 3



How are you obtaining assurance to attest to the effectiveness of your control environment?





Understanding internal control frameworks – What should your organisation be thinking about?

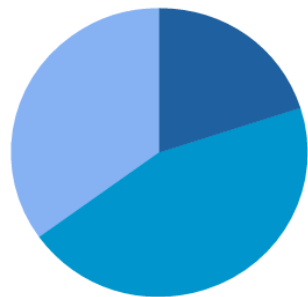


Sonya Butters
Partner, CFO Advisory, Controls

The FRC's expectations under current requirements



However, similar to last year, we were surprised by the high number of companies that did not report on the process carried out for the review.



- **20** Provided specific and/or detailed information
- **45** Only offered brief and vague information
- **35** Did not give any detail on the process

Example of current good practices in the annual review of effectiveness identified by the FRC

- Considering internal assessments by management of controls and risk management
- Reviewing management assurance on policy compliance
- Receiving internal assurance on the effectiveness of the internal control function
- Reviewing reports from the exec risk committee
- Reviewing internal audit reports
- Reviewing external audit reports
- Appraising the company's response to cyber and data risk
- Reviewing whistle-blowing and other incidents
- Carrying out independent external reviews

Key Questions to understand your control framework



What to Control

- Have we re-considered risk appetite as well as materiality including stakeholders' views?
- Have we identified sub-risks and enough detail to enable risks to be managed in the business?
- How often is a periodic re-assessment performed?
- Do we have a history of errors/deficiencies/surprises?
- Have we considered risk of fraud within each risk?
- What systems, tools and spreadsheets underpin each key risk area?



How to Control

- Are our controls mapped to risks and documented in a structured framework?
- Is accountability for each control clear?
- What system(s) are used for controls monitoring?
- How are deficiencies tracked and resolved?
- Does our culture support self-reporting control issues or do we rely on testing?
- Do we want individual objectives linked to controls?
- What is the tone at the top?



How to Assure

- Have we mapped sources of assurance to risks and controls and assessed scope and adequacy?
- What is the right mix of monitoring, self-assessment, testing by the business and testing by internal audit?
- Are roles and responsibilities defined across our three lines?
- Do we have a testing programme or methodology?
- How automated is our testing?
- What reports will the Board receive?



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