Annual reporting in 2015:

evolving communication in a changing world

September 2016 | Third edition

EY

Building a better working world

Foreword

Welcome to our third annual review of annual reports and accounts (ARAs) published by FTSE 350 companies.

We have been tracking developments in annual reporting for the last few years, with our findings captured in two publications: *Out with the old, in with the new* (September 2014) and *Reflections on the past, direction for the future* (September 2015). In these reports we set out our views on the hallmarks of good disclosures and provided examples of leading practice reporting we observed.

For this year's report we reviewed 100 2015 ARAs of FTSE 350 companies and we focused on five key themes, encompassing current hot topics in the corporate governance and reporting world:

- **Clear and concise**
- **Business models, risk and viability**
- **Culture and people**
- **Broader societal impacts**
- **Looking ahead**

We interviewed the Financial Reporting Lab and investors to gather their views on how reporting can be made most useful. We hope preparers find this to be a helpful practical input as many companies tell us they find it difficult to get feedback on their reporting. We also spoke to key executives from BT on their approach to reporting on broader societal impacts and the effect this has on business practices. Once again we have included case studies, an 'acid test' and an aide mémoire, which we believe are all useful tools to help preparers enhance and evolve their reporting. Also, where we have made reference to company reports, we have highlighted the text with a yellow line on the left hand side.

Company reporting must reflect the business environment, which is changing at an increasingly rapid pace and is also now characterised by uncertainty following the EU referendum result. The last few years have seen stronger calls for transparency on a range of issues and the themes covered in this report reflect these developments, centring around new and growing areas of interest such as cyber-security, viability reporting and tax transparency. Preparers need to think about how annual reports can best provide assurance to shareholders on issues that matter to them most whilst at the same time keeping a focus on what is material to their company.

The findings detailed in this report show that many companies have adapted quickly to the evolving demands on their reporting and we have included case studies of leading examples. However, there is variation in the quality and specificity of disclosures, risk reporting being one example.

I would like to extend my thanks on behalf of the team to all those who took the time to be interviewed for this report. We hope that these interviews, alongside our findings, will be of interest to preparers, investors, regulators and other stakeholders.

We look forward to hearing your feedback and views.

Ken Williamson
Head of Corporate Governance
EY UK & Ireland

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Introduction

Q&A with Ken Williamson, Mala Shah-Coulon and Andrew Hobbs of the EY UK & I Corporate Governance team

From left to right
Ken Williamson
Mala Shah-Coulon
Andrew Hobbs

Q Why have you structured the report under five themes this year?

A: This is our third report on annual reporting trends and we want to keep focusing on the most important issues of the day. However, we continue to draw on our past research. Our previous report, *Annual reporting in 2014: reflections on the past, direction for the future*, included our hallmarks of what we believe to be leading practice in specific areas of reporting. Preparers and boards told us they found these hallmarks useful, so they are contained in the aide mémoire provided in Appendix A. For areas that we have looked at in more detail this year, we have provided hallmarks within this report for the first time. We have also provided an updated 'acid test', which summarises the key questions we expect to be able to answer after reading the narrative disclosures in an ARA and that should also serve as a practical tool for preparers to test the quality of their narrative disclosures.

Turning to our five themes, this is the first time we've looked in depth at 'clear and concise' reporting. We often encounter excess information that muddies the overall narrative and flow of an ARA, so this annual review is an opportunity to share our thinking on what improvements could be made.

Last year we identified business model reporting as a key area in need of improvement, so it's a natural area for further examination. So too is viability and risk reporting, because of the recent changes to requirements. Companies in our sample continue to struggle to connect all the elements of their story, especially with the viability statement, which is often treated as a standalone element within the risk section.

Culture was the watchword of the corporate and regulatory world last year. We recently published *Governing culture - practical considerations for boards and committees* (June 2016), which inspired us to explore companies' disclosures on culture in this review. We recognise the difficulty in articulating company culture, but for many businesses this underpins their success or failure. While most companies mention culture in some way, few discuss it meaningfully, especially with reference to its impact on business model or strategy.

We also wanted to look at how companies are reporting on their broader impacts on society, before finally looking ahead to consider how reporting will be impacted by upcoming regulatory changes and may continue to evolve in future to meet changing investor expectations.

Q What are your overall observations about the quality of reporting?

A: The quality of annual reports has improved again this year and we are encouraged by examples of companies being innovative with their disclosures. Many companies have improved their Strategic Report, although the quality of governance reporting continues to lag behind somewhat. Governance reports are still largely process rather than outcome oriented. Other examples include nomination committee reporting and shareholder engagement disclosures which continue to be areas for potential improvement.

The pace of improvement in overall reporting quality has slowed, however, which suggests that we may have reached a plateau. It's three years since the introduction of the Strategic Report and Directors' Remuneration Reports and, following the changes to the UK Corporate Governance Code in 2014, we are not expecting further substantive regulatory changes to reporting in the next year or so. So it's up to companies and users of accounts (shareholders) to keep the momentum up. Rather than keeping things the same, we encourage companies to consider the needs of their users and continue to evolve and improve their communication through annual reports. We would also encourage investors to provide companies with feedback on their reporting.

Q What are the stand-out findings in this year's report?

A: The biggest change this year is the requirement for companies to report on their long-term viability. In January 2016, we looked at how the first companies affected had responded and published our report *Rising to the challenge: a review of risk and viability disclosures in September 2015 annual reports*. We found that companies had made an encouraging start. However, having now reviewed a broader set of reports, we see substantial potential for improvement.

It may be that companies were being conservative in their first year of viability statement reporting, but we hope they will be bolder in year two. We also think it vitally important for investors to engage with companies in order to prevent these disclosures from degenerating over time (for example, becoming generic).

We know from our interactions and meetings with a number of FTSE 350 companies that a lot of work went into their viability statements behind the scenes. We feel companies should get the credit for their efforts, so encourage them to explain more meaningfully what was done, the judgements made and the sensitivities considered.

A few areas identified last year as in need of improvement have only fractionally improved this year. These are the business model and nomination committee disclosures. Companies should continue to strive to do better.

It was also interesting to note that 25% of companies in our sample included disclosure on the potential impact of Brexit. Following the UK's vote to leave the European Union, and with the benefit of hindsight, we wonder whether more companies would have provided disclosures on this issue, particularly those in the FTSE 250 for whom the impact has not been insignificant. Next year we will look at whether there are more disclosures on how Britain's exit from the EU impacts each business and what it means to their business model and strategy.

Q What is your advice to companies preparing their annual report?

A: We encourage companies to continue to talk to investors to find out what they are most interested in. We have included interviews with some investors and the Financial Reporting Lab in order to help companies think about what users want to read. We have also included an interview with BT showing a preparer's perspective.

Companies should look at their annual report as a communication opportunity, providing a coherent message by focusing on an overarching narrative. This should help to determine relevant content and create a more accessible and readable report. Good quality disclosures create linkages across the annual report, from the business model to strategy, risks, the viability statement, key performance indicators (KPIs) and remuneration. We only saw a minor increase this year in the number of companies making successful links across all these areas in their annual report. We also suggest that companies continue to use our 'acid test', as shown below, which we have updated this year to reflect the evolving nature of reporting. This will help preparers ensure that they have covered the core foundations of an effective annual report.

Our ‘acid test’: a practical aid

These are the key questions we believe a reader should be able to answer after having read the narrative report. We have updated these in line with changing requirements:

Business model:
- How does the company make its money?
- What are the key inputs, processes and outputs in the value chain, and how are the company’s key assets (including its physical assets, IP, people, culture technology, etc.) engaged in the value chain?

Strategy:
- What is the company’s competitive advantage?
- How does the business model help deliver and sustain this over time and how is the company’s business model different from other companies in their sector?

Key performance indicators (KPIs):
- What are the key metrics the board uses to measure progress against its strategic objectives?
- How has the company performed against these metrics over time and how has this influenced the remuneration of key executives?

Risk appetite:
- What levels of risk are the board willing to take in pursuit of its strategy and how is this monitored by the board?

Principal risks:
- What are the key risks to the successful delivery of the strategy and operation of the business model?
- What are the risks that pose the greatest threat to the viability of the company i.e., solvency and liquidity risks?
- How might these risks manifest themselves in the company?

Risk management and internal control disclosures:
- How are the principal risks mitigated and controlled by the company’s systems of internal controls and risk management and how does the board monitor these controls?
- What did the board’s review of the effectiveness of these systems encompass?
- Has the board identified significant failings or weaknesses?
- What was the basis for determining what is ‘significant’?
- Is it clear what actions have been or will be taken to address significant failings or weaknesses?

Viability statement:
- Over what timeframe has the board considered the viability of the company and why?
- What process did the board use to assess viability?
- Does the board understand which, if any, severe but plausible risks (or combination of risks) would threaten the viability of the company and has appropriate disclosure been provided?
- What assurance did the board obtain over relevant elements (e.g., stress testing)?
- What assumptions did the board use in reaching its conclusion?

Governance:
- What did the board and its committees actually do in the year to govern the company – what specific governance issues arose and how were they addressed?
- What, if any, changes were made to governance arrangements during the year and why?
- What areas for improvement were identified from the board evaluation and what progress was made against actions from the previous evaluation?
- How is board composition and succession planning being managed, giving due regard to the evolving strategy of the group, skills, experience and diversity?
- How did the board seek to understand the views of shareholders during the year and what, if any, action was taken as a result of feedback?

Key findings

1 Compliance with the UK Corporate Governance Code

Have all provisions of the UK Corporate Governance Code been complied with?

70%

30%

Have all of the provisions or all but one or two been complied with?

95%

5%

2 Clear and concise

Average length of ARAs

148 *pages in 2012*

163 *pages in 2013*

167 *pages in 2014*

181 *pages in 2015*

Has a supplementary approach been used?

46%

(last year 37%)

Linkages

50% clearly show link between KPIs and strategy (same as last year).

42% show link between risks and strategy (up from 33% last year).

24% show link from strategy to remuneration (up from 20% last year).

12% link all the way through from strategy to KPIs, risks and remuneration (up from 9% last year).

3 Business models, risk and viability

Most common principal risks identified:

72% Regulatory / Legal / Compliance

62% HR / Talent / People / Succession planning

52% Technology / IT

41% Market / Industry conditions

36% Macro economic activity

36% Competition

36% Health and safety

31% of reports included cyber-security as a principal risk (up from 17% last year).

42% of business models clearly explain the competitive advantage of the company.

Time period chosen for the viability statement:

5% 4 years

21% 5 years

74% 3 years

25% of companies explicitly mentioned Brexit in their annual report.

4 People and culture

9%

91%

Was there a clear indication of how the board measures culture?

31%

69%

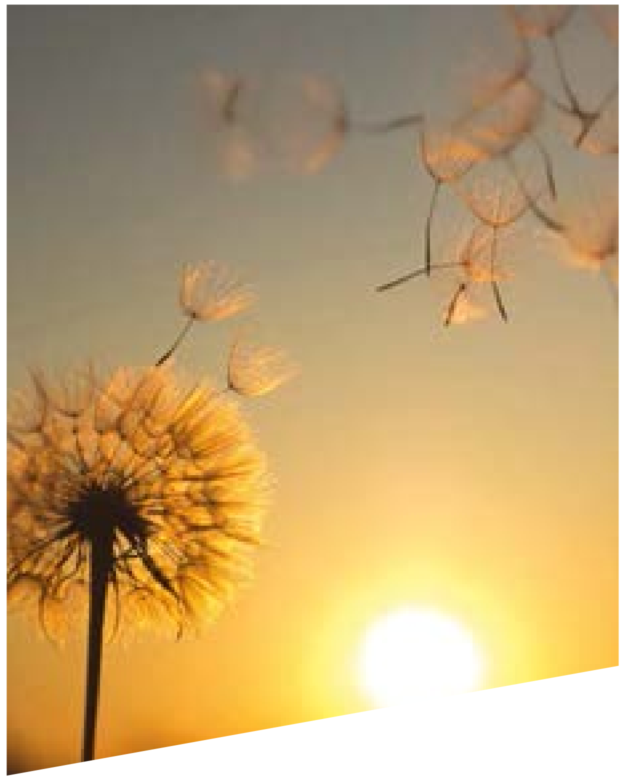
Does the nomination committee specify that it has a role in oversight of the talent pipeline at lower levels in the company?

13% of companies successfully align all of their annual bonus performance metrics with the company's KPIs.

5 Broader societal impacts

17% of companies reported on wider energy consumption data.

19% mentioned tax policy or tax strategy in the front half of the accounts.

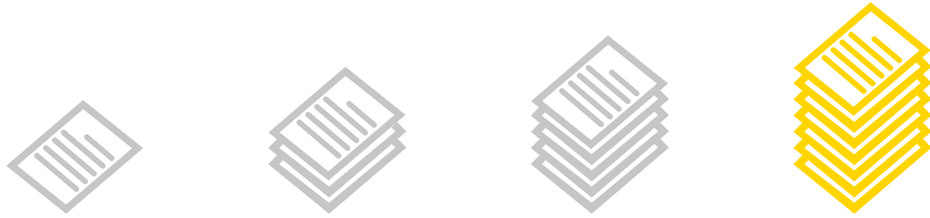


1. Clear and concise reporting

In our report[1] last year we described the tension that exists between reporting in a clear and concise manner at the same time as meeting increasing regulatory requirements. This challenge continued in 2015 with the introduction of new requirements such as the viability statement, and companies continue to struggle to achieve clear and concise ARAs.

The Financial Reporting Council (FRC) is aiming to ensure that annual reports provide relevant information for shareholders through its Clear and Concise initiative.[2] The Code encourages 'fair, balanced and understandable' reporting and the Companies Act 2006 makes reference to providing a 'fair review' and a 'balanced and comprehensive analysis' of the company's business. Beyond this, companies face no specific requirements around clear and concise reporting, but should be focusing on it as they seek to continuously improve the quality of their annual reports.

Average length of ARAs



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The length of annual reports

While the length of annual reports is a crude measure for analysing the extent to which companies are producing clear reports, it can be an indicator of the clarity and accessibility of the narrative. However, we also understand that sometimes a company may need to use a lot of text to describe something well.

This year, as in the preceding three years, annual reports have increased in length. This year's average increase was just over 8%, driven partly by the new statutory requirement to disclose all subsidiaries, associates, joint ventures and joint arrangements.[3] Additionally, increased pressure from the public and some investors has led to some remuneration disclosures increasing in volume, if not always in substance.

We propose a challenge for preparers. When a new disclosure requirement is introduced, they should try to offset the inevitable increase in ARA length by looking for opportunities to streamline reporting elsewhere in the ARA. It is often possible to reduce word count while retaining the material content and meaning. We suggest reviewing draft reports with this challenge in mind.

[1] EY, *Annual reporting in 2014: reflections on the past, direction for the future*, September 2015.
[2] Latest report: Financial Reporting Council, *Clear and Concise: Developments in Annual Reporting*, December 2015.

[3] The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 repealed the previous s410 concession which allowed reduced disclosure of related undertakings. The repeal was in part, a wider drive for transparency and accountability. Previously the information could be omitted if the directors of the company were of the opinion that such disclosures would result in accounts being excessive in length and provided the relevant disclosures were made in the Company's annual return instead.

Has a supplementary approach been used?

46%

(last year 37%)

Despite the average upward trend, some companies have managed to reduce the length of their ARAs this year. This was typically done by annexing or removing (regulation permitting) standing information that had not changed in the year. 46% of companies used a supplementary approach, up from 37% last year. Encouragingly, we found some cases where detailed board biographies, committee terms of reference and extensive sustainability reports were provided by reference to the company's website but not reproduced in full. Additionally, some companies' efforts to address corporate responsibility and sustainability issues throughout their reports, rather than in a separate section, have resulted in more concise ARAs.

Companies should focus on communicating information without clouding key messages with too much detail that can be provided elsewhere. As the FRC explains in its *Guidance on the Strategic Report*, "comprehensiveness reflects the breadth of information that should be included in the Strategic Report rather than the depth of the information."[4] Divisional, business unit or geographic performance are examples of areas where companies can go into too much detail rather than providing an overview of group performance across segments.

Case study

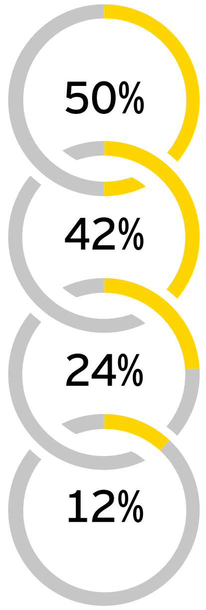
Aggrekko plc

Aggreko plc reduced its annual report by 28 pages. Our analysis found that changes to achieve this reduction included:

- Shortening the statement from the CEO
- Including the Chairman's statement in the Governance section only (removing an additional Chairman's statement from the introduction to the Strategic Report)
- Removing the performance review breakdown by region
- Reducing the sustainability report by cross-referring to relevant sections throughout the ARA instead, thereby reducing repetition and better integrating information within the overall narrative
- Significantly reducing the remuneration report by cross-referring to the previous year's report for the full policy and providing an overview only, using visuals and concise summaries throughout

[4] FRC, *Guidance on the Strategic Report*, June 2014, pg17.

Linkages



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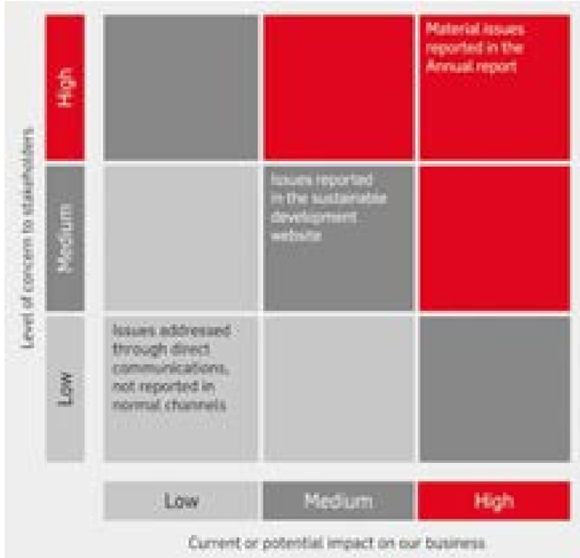


Figure 1. Rio Tinto plc (page 22)

Reducing duplication and creating linkages

Some companies have found innovative ways of reducing duplication in their reports. For example, Hammerson, as in previous years, includes only one statement from its Chairman at the front of the governance section, rather than having two statements from the same person. Other companies use effective signposting in order to reduce replication. Better referencing of information between and within different sections can help avoid duplication while achieving both a clearer and a more concise report.

Materiality should help companies determine what to include in the ARA, with information that does not meet this test excluded. Rio Tinto plc explain their process for identifying and assessing sustainability issues including the rationale for reporting these either in their ARA or Sustainable Development Report based on materiality. Their approach is summarised in their materiality matrix as shown in Figure 1.

Such a 'filtering' approach could be considered by preparers more broadly in relation to the content in their narrative report.

Narrative also becomes significantly clearer when companies make effective links between strategy, KPIs, risks and remuneration. For example, CLS Holdings plc provides a table connecting all these sections of its report (see Figure 2), with asterisks showing which KPIs were used in determining remuneration. Such tables can be highly effective ways to provide these connections, but companies can alternatively use keys, signposting and narrative. St. Modwen Properties plc (see Figure 3) has a section for each strategic pillar, outlining the company's objectives and giving links to KPIs, risks and remuneration. Our analysis this year found a slight increase in the number of companies that create effective linkages between sections.

BUSINESS MODEL	STRATEGY	KPIs	ACHIEVEMENTS IN 2015	PLANS FOR 2016	RISKS (See details on page 28 & 29)
Investments Invest in high-yielding properties, predominantly offices, with a focus on cash returns	We target modern, high quality, well-let properties in good non-prime locations in key European cities We maintain and add value through an active rolling refurbishment programme We create extra value through developments at the appropriate time in the cycle, after largely mitigating letting risk and financing risk	To achieve a return on equity of over 12%* To achieve EPRA NAV growth of over 7.5%*	Return on equity was 19.3% EPRA NAV growth was 17.4% 6 properties acquired for £57.8 million at an average net initial yield of 7.3% 8 properties sold for £34.8 million at an average net initial yield of 2.8%	To continue to reposition the portfolio through acquisitions and selective disposals We expect to continue to see the better investment opportunities to be in the UK and Germany To progress the development plans on Vauxhall Square in anticipation of gaining vacant possession of the main site in late 2016	Property Investment Risks Development Risk
Diversify market risk by investing in geographical areas with differing characteristics	We invest in the UK, France, Germany and Sweden, and in sterling, the euro and the Swedish krona				

Figure 2. CLS Holdings plc (excerpt from page 4-5 showing just one of the objectives)

Objectives	Progress	Next steps
Build our land bank to deliver future opportunities and secure planning gain, with a focus on brownfield renewal and sustainable development. Adapt our asset strategies over the long-term to meet changing market demands. Employ highly-skilled and motivated people to deliver our asset strategies and future growth.	We continue to acquire brownfield sites at low cost and prepare for development through remediation and securing planning permissions which in turn realises value. We have completed a number of strategic acquisitions during the year, predominantly in the North West, including Kirkby Town Centre for £35.8m and our appointment as development manager on the 200 acre MoD Ashchurch site. In this way, we have added value to the portfolio in terms of securing immediate rental income and presenting good future development potential. The business has grown throughout the year, expanding each regional team and St. Modwen Homes through a number of senior appointments. The Group's management team has grown by 5% to 63 (2014: 60), with all having completed a comprehensive development programme during the year. The CSR Steering Group is now established and all 10 objectives set at the start of the period either exceeded, achieved or on target to achieve.	Selective and capital efficient acquisitions. Continue to adopt the latest, most sustainable, development and remediation techniques. Continued recycling of assets with limited opportunity for further significant added value. Capitalise on heightened investor interest. Continue to retain, recruit and motivate highly-skilled people throughout the business and implement an ongoing programme of staff training and management development.

Principal risks		Link to remuneration
Unforeseen or failure to manage long-term environmental issues relating to brownfield or contaminated sites. Inability to recruit, develop and retain staff with the right skills and expertise, resulting in disruption/loss of intellectual property. Employment of inadequate practices to remediate contaminated sites results in reputational damage.		Executive directors' individual objectives for the year's annual bonus arrangements included people-related targets and CSR activities.

Key performance indicators

Figure 3. St. Modwen Properties plc (page 19-21)

Boilerplate information

The governance report is the section that contains the most boilerplate information. This seems largely due to the requirement under the Listing Rules for disclosure of how the company has applied the Main Principles of the UK Corporate Governance Code (the Code), in a manner that would enable shareholders to evaluate how the principles have been applied. Some companies, such as Hammerson, have moved this information to the back of the Directors' report, which allows the narrative of their governance report to flow more clearly. CRH has moved recurring information on its committees and governance to the governance section of its website and then provided a reference in the Annual Report to its "Governance Appendix".

Infographics and plain English

The increased use of infographics and other visual representations has made many reports more accessible, particularly within the Strategic Report. A joined-up approach that visually links the business model, principal risks and overall strategy can add clarity without an increase in page length. Companies just need to take care not to remove important contextual information, especially around the business model, such as key points on competitive advantage and how the business model differs from others in the industry.

Recommendations for clear and concise reporting:

- Focus the narrative and key messages on actions and outcomes rather than recurring processes
- Create clear linkages between strategy, business model, KPIs, risks and remuneration
- Move extra detail (not required by regulation) or standing information to the website or to an annexe and provide a cross-reference
- Provide signposting between sections to avoid duplication
- Remove jargon and ensure that messaging is clear and direct
- Use diagrams to create concise overviews and help user understanding

Interview with Carl Renner and Thomas Toomse-Smith, the Financial Reporting Lab

Carl Renner
Project Director

Thomas Toomse-Smith
Project Director

Please see Appendix B for full biographies of all interviewees.

Q What are your tips for helping companies make their annual reports clear and concise?

A: Continual improvement is needed with annual reports. This requires drive and buy-in from the top. With so many individuals at a company involved in contributing to the annual report, there needs to be someone with authority to ensure a focus on being concise.

The fundamental priority for companies when preparing the annual report is the audience and their needs. Companies need to articulate their story in a way that an outside reader can understand. Good reporters ask people outside of the annual report process to check the flow and understandability of the report.

This is the third year in which companies have prepared a Strategic Report, so they are getting into their stride. However, the incremental change year on year has not been as great as expected. Investors have also told us that reports are not currently meeting their expectations. We want companies to take the opportunity of a lull in regulation to make changes to their reports.

Q How else can companies improve their reporting?

A: Companies are less constrained than they think. It is for the company to determine which method best suits its audience, for example, whether they could make the report more online friendly. We find a lot of users prefer a PDF format as they can see the start and end of the document. Companies should think about the experience of someone using their document. Consistency with other outputs and the ease with which users can find information is crucial.

Investors we speak to tell us that the risks reported are too high level and generic. They are also not linked to the business model. It is important that everything is connected to the key drivers of the business. We also often find that the remuneration report indicates different drivers of the business to those identified in the Strategic Report.

Finally, we are hoping that dividend policy reporting will improve following our report on this topic.

Q What are your early views on the viability statements you have seen?

A: Early reviews have shown that many companies have taken a low risk approach rather than looking holistically and linking the viability statement to the rest of the annual report. There has not been much variation between companies in what they disclose. In many cases it is unclear how they reached the conclusion for the statement. The end goal is that it should form part of the connected story.

In a similar way to audit committee reporting, we've seen a tendency for viability statements to focus on what companies do rather than specific issues addressed. It may be that companies didn't want to disclose too much the first time around. It's interesting that boards are taking long-term decisions with business planning but not with the viability statement.

Q What do you think about the quality of business model disclosures?

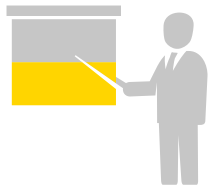
A: We will be publishing our project on business models in October 2016. Companies are unsure of the value of business model disclosures. They tend to be used for the annual report and then not utilised elsewhere. Because of this business model disclosures don't get appropriate challenge from the board. However, investors do see the business model as a fundamental part of their investment decision. They may limit their investment or decline to invest if the business hasn't clearly articulated the business model.

Some companies find it difficult to get agreement on the business model, especially where businesses are very complex, but taking the time to do this brings benefits. The business model description can be used in multiple outputs. Good business model disclosures reinforce the company's message, which should be connected throughout the business and all the outputs that investors see.

Company values statements should be treated as internal information. They should only be disclosed and related to a business model if they form a part of it and help drive the company's competitive advantage.

Integrated reporting comes up in conversations we have relating to business models. There is a danger that companies follow the <IR> Framework to the letter, rather than determining which inputs are material. Just because a report is integrated doesn't mean it is a good report. We do not want all reports to look the same and encourage companies to approach their reports in the way that best suits the company.

2. Business models, risk and viability



42%

of business models clearly explain the competitive advantage of the company.

Business model reporting

In our report[5] last year, we highlighted the need to improve business model disclosures and, in particular, ensure that they clearly articulate how the company makes money. We found that the number of business models which do this effectively (59%) has not materially increased (58% last year). However, there has been an increase in business models that clearly outline the inputs, processes and outputs of the business, which we recommended as a leading practice last year. This move towards using inputs, processes and outputs to describe the business model may also be a result of the growing influence of the Integrated Reporting <IR> Framework, which we discuss in Section 5: 'Looking ahead'. The <IR> Framework looks at the six different types of capital used as inputs and also the ways in which a company creates value for a range of stakeholders, rather than focusing on shareholder value alone.

As discussed in their interview for this report, the Financial Reporting Lab has also been exploring how business model disclosures can be improved. Their initial findings[6] indicate that investors want more detailed information on how value is created and what differentiates a company from its peers.

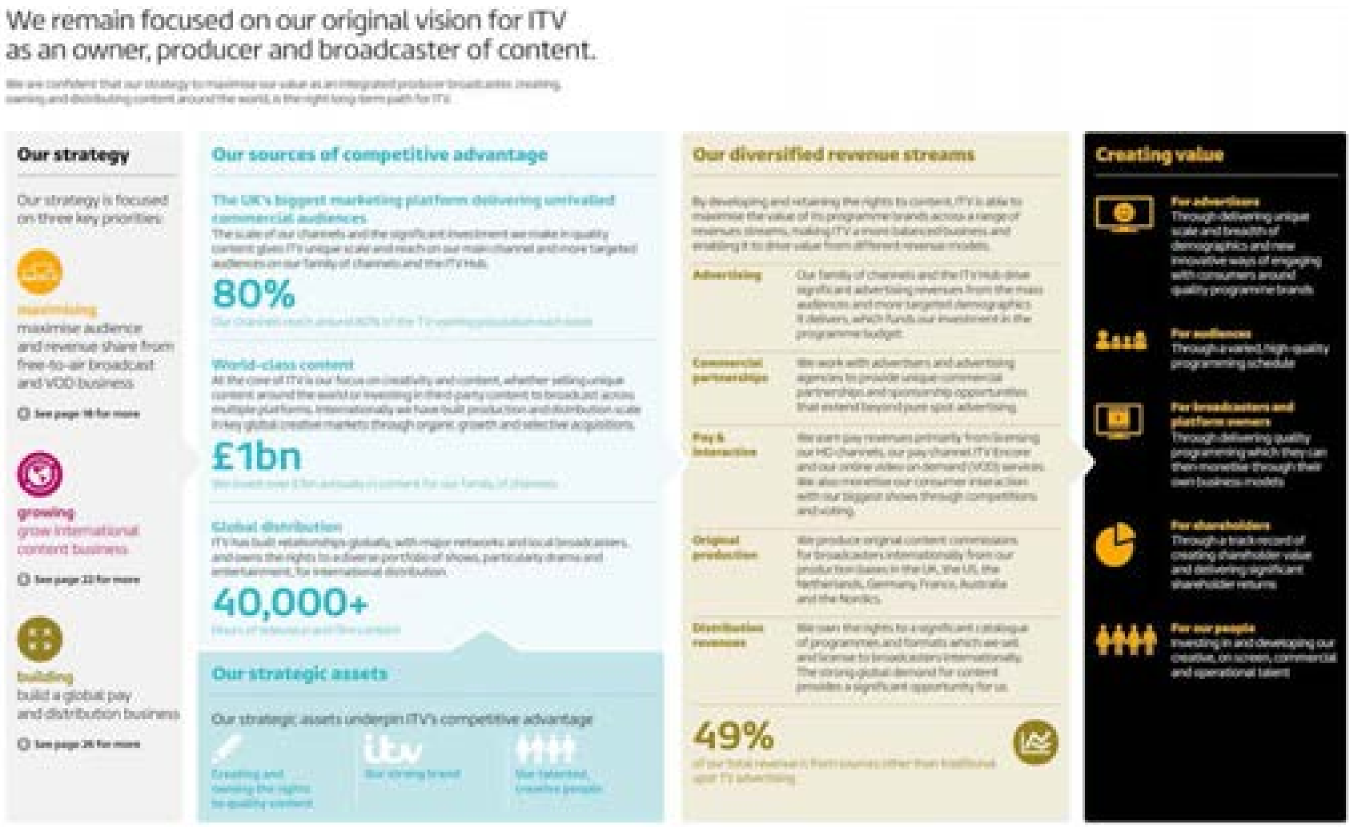


Figure 4. ITV plc (page 10-11)

During our reviews, we particularly looked for useful disclosures on the competitive advantages of the business model and how it differs from other companies in the industry. Only 42% of reports explain this effectively, so it remains a key area for improvement. An encouraging example is the annual report of ITV plc, which includes a useful business model section (see Figure 4) with a clear explanation of competitive advantage, revenue streams and value creation for different stakeholders.

Principal risks

Having established how the company makes its money, principal risk disclosures should identify what events could threaten this and the future survival of the business. We have previously stated that leading practice principal risk reporting should include risks that are specific to the company, a description of relative impact and likelihood, an indication of the change in individual risks since the prior year and quantified risk appetite. Leading reporters clearly link their principal risks to the strategic objectives. This was the case in 42% of our sample. Companies should also link the principal risks with the business model, particularly in light of the viability statement.

For example, if certain key resources or assets are disclosed as inputs to the business model, there should be a follow through (in the risk section) on specific key risks to those resources or assets. This then links up with the viability statement.

The average number of risks disclosed remains stable at 11. The risks within our sample vary according to the size, sector, and geographic spread of company operations, but the most common categories of risk noted in our review are shown in Figure 5.

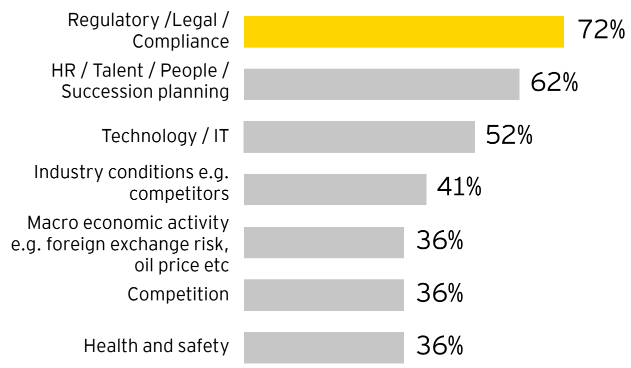


Figure 5. Most common principal risks disclosed

[5] EY, *Annual Reporting in 2014: Reflections on the past, direction for the future*, September 2015.
[6] Financial Reporting Lab, *Current projects*, 2016.

31% of reports included cyber-security as a principal risk (up from 17% last year).

This is a very similar 'top five' to last year with all of the risk types consistent with at least the top ten from last year, with the exception of technology and IT related risks which did not feature in the top ten last year, so this is a significant increase. We re-iterate that the descriptions for each risk must be sufficiently specific to the company to make them meaningful.

Cyber and disruption risks

Cyber-security was listed as a standalone principal risk by 31% of companies, up from 17% last year. However, more companies included it within the over-arching category of technology and IT-related issues. We previously expressed concern that many companies may be failing to fully appreciate the cyber-security threat, especially those reliant on e-commerce. However, this issue has moved into the spotlight with two thirds of large British businesses having experienced a cyber-attack or breach in the 12 months to May 2016.[7] Investors have also expressed growing interest in this area. Sacha Sadan, Director of Corporate Governance at Legal and General Investment Management (LGIM), explained in the 2015 LGIM Stewardship Report[8] that cyber-security has risen much higher up the agenda this year. LGIM has been engaging with boards to make sure they have the right skills and time to focus on this issue.

The new EU General Data Protection Regulation is also "a game changer for organisations".[9] It comes into force in the spring of 2018 and introduces new compliance challenges and fines of up to 4% of total annual worldwide turnover or €20 million (whichever is greater) for non-compliance.

25% of reports which mentioned the upcoming EU referendum

- **13** included the discussion within the principal risks section
- **9** included the discussion in the future outlook section
- **2** included the issue as part of the considerations for the viability statement
- **1** company said it had considered this issue and determined that there would be no impact on the company irrespective of the outcome

There is also a requirement to notify supervisory authority of data breaches 'without undue delay' or within 72 hours, unless the breach is unlikely to be a risk to individuals. EY's guidance *EU General Data Protection Regulation: Are you ready?* covers what organisations should be doing to prepare for these changes, which despite Brexit, are still set to come into effect. With this backdrop, boards need to consider cyber-security risks facing the company and, from a reporting perspective, assess whether disclosures provide sufficient assurance to investors that measures are in place to mitigate both the reputational and legal risks as well as the monetary impact from revenue loss and fines.

Business model disruption has also been a key concern for big business this year. With the rise of fast-growth technology companies in particular, whole industries have been turned upside down in short spaces of time. Our review found that most reports include fairly comprehensive sections on overall market and economic trends, but most disclosures cover conventional market trends rather than potential disruptions from 'left-field' and potential changes that are highly specific to the company and its business model. Some companies did show that they are thinking more broadly in terms of potential disruption. For example, Domino's

> Pizza Group plc (page 12) provides assurance that it is keeping at the forefront of technology in order to meet the new needs of today's "on-demand" society. It shows a recognition of the need to change and adapt. Aviva plc (page 14) provides a horizon review identifying six long-term trends, one of which is the "age of disruption". Next plc (p11) outlines how the way that customers buy from the business has changed between 2010 and 2015.

Brexit implications for risk

Another key issue for boards to consider in 2015 was whether and how the company would be impacted by the outcome of the referendum on the UK's membership of the European Union. Our review found that only 25% of reports mentioned the referendum. This number of EU referendum disclosures seems surprisingly low, which raises the question of whether some boards failed to appreciate the potential likelihood of a majority vote to leave. What we cannot tell from these disclosures is how many boards duly debated the implications and made a considered judgement that no disclosure was needed versus those that may have just sleep-walked into Brexit. We note that the UK market is not material for a lot of companies, particularly those in the FTSE 100. Although the breakdown of those that mentioned the referendum is 15% in FTSE 100 reports and 10% in FTSE 250 reports.

Of the 25% of reports which mentioned the upcoming referendum, 13 reports included the discussion within the principal risks section, two included the issue as part of the considerations for the viability statement and others included it in the future outlook section. One company mentioned the referendum to say that it had considered this issue and determined that there would be no impact on the company irrespective of the outcome. For those that did include it within their principal risks, or as part of their viability statement (particularly the one case where it was included as an assumption), it will be interesting to see how this is followed up in next year's reporting.

[7] BBC, *Cyber attacks: Two-thirds of big UK businesses targeted*, 8 May 2016.
[8] Legal and General Investment Management, *Active ownership: positive engagement to enhance long-term value*, 2015.
[9] EY, *EU General Data Protection Regulation: Are you ready?*, 2016.

Viability statement

The viability statement represented the single biggest new reporting challenge in 2015. It is important to ensure that this new disclosure complements and aligns with existing business model, strategy and risk disclosures.

Together, these disclosures should illustrate how a company makes its money, what the risks are to its business model, strategy, solvency and liquidity in severe but plausible scenarios and using this information to make a judgement on the period over which the board feel it is appropriate to make a viability statement.

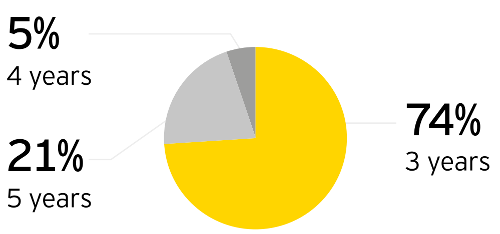


Figure 6. Time periods chosen for viability statements

In our view the best viability statements were provided by the September year-end companies. Some of the later year ends provided good viability statements but the proportion of leading practice statements was lower than those in the sample we reviewed in January.[10]

From our analysis it appears that companies have erred on the side of caution in their first disclosures, with December reporters seeming even more cautious than the trailblazing September ones we reviewed in January. The majority of companies in our ARA review (74%) chose a time period of three years and the others chose either four or five years (Figure 6).

The disclosure and quantification of specific scenarios and assumptions remains the key area for improvement. We believe it is this information, rather than the period, that is of most interest to investors. 45% of reports we reviewed provide some explanation of the scenarios or risk areas that were tested against, but only 7% of companies quantify the scenarios tested. 22% of companies disclose assumptions, but only 5% quantify those assumptions (although it is important to note that, in many cases, the assumptions are not quantifiable).

It is now time for investors to give feedback on whether the first round of viability statements have delivered what they expected and, if not, what changes are needed. Otherwise, there is a danger that the viability disclosures will degenerate to the lowest common denominator and simply tick a compliance box.

We hope that in the second year of compliance, boards have time to reflect on what worked in year one and what can be enhanced in year two. This is not only for the sake of compliance and good reporting. What's more important is that boards and management use the viability statement requirement as a trigger for identifying potential improvements to their risk processes and, where relevant, new opportunities.

Case studies

Fresnillo plc
(page 48-49)

- Clearly outlines the seven different scenarios tested
- Lists the principal risks considered the most important for assessing viability
- Mitigation options in the event of scenarios arising are disclosed

Domino's Pizza Group
(page 23)

- Process of assessing viability is clearly outlined and scenarios tested are quantified
- Key assumptions are disclosed

Grainger plc
(page 29)

- Two scenarios are clearly outlined and quantified
- Key assumptions are disclosed

Rio Tinto plc
(page 16-17)

- Principal risks are shown with an indication of whether they have a potential impact on viability, HSEC and reputation (see Figure 7)
- An explanation of potential upside impact (opportunity) associated with each risk is also provided

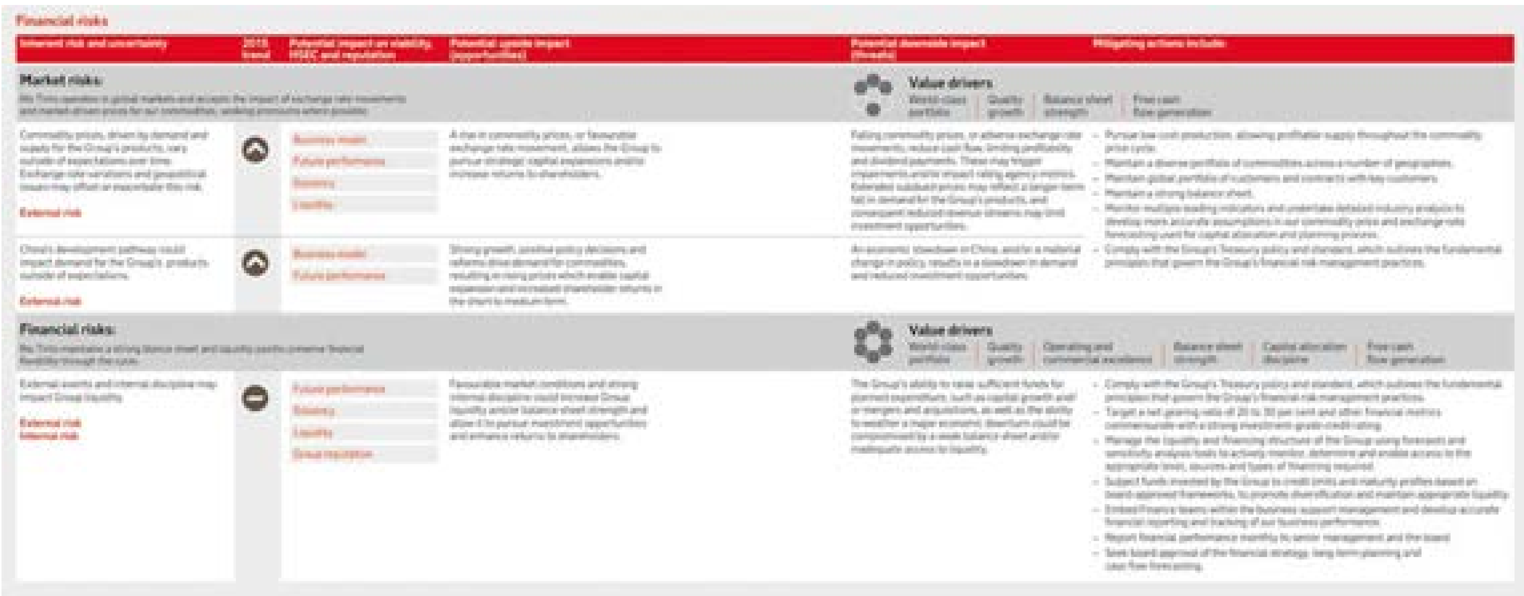
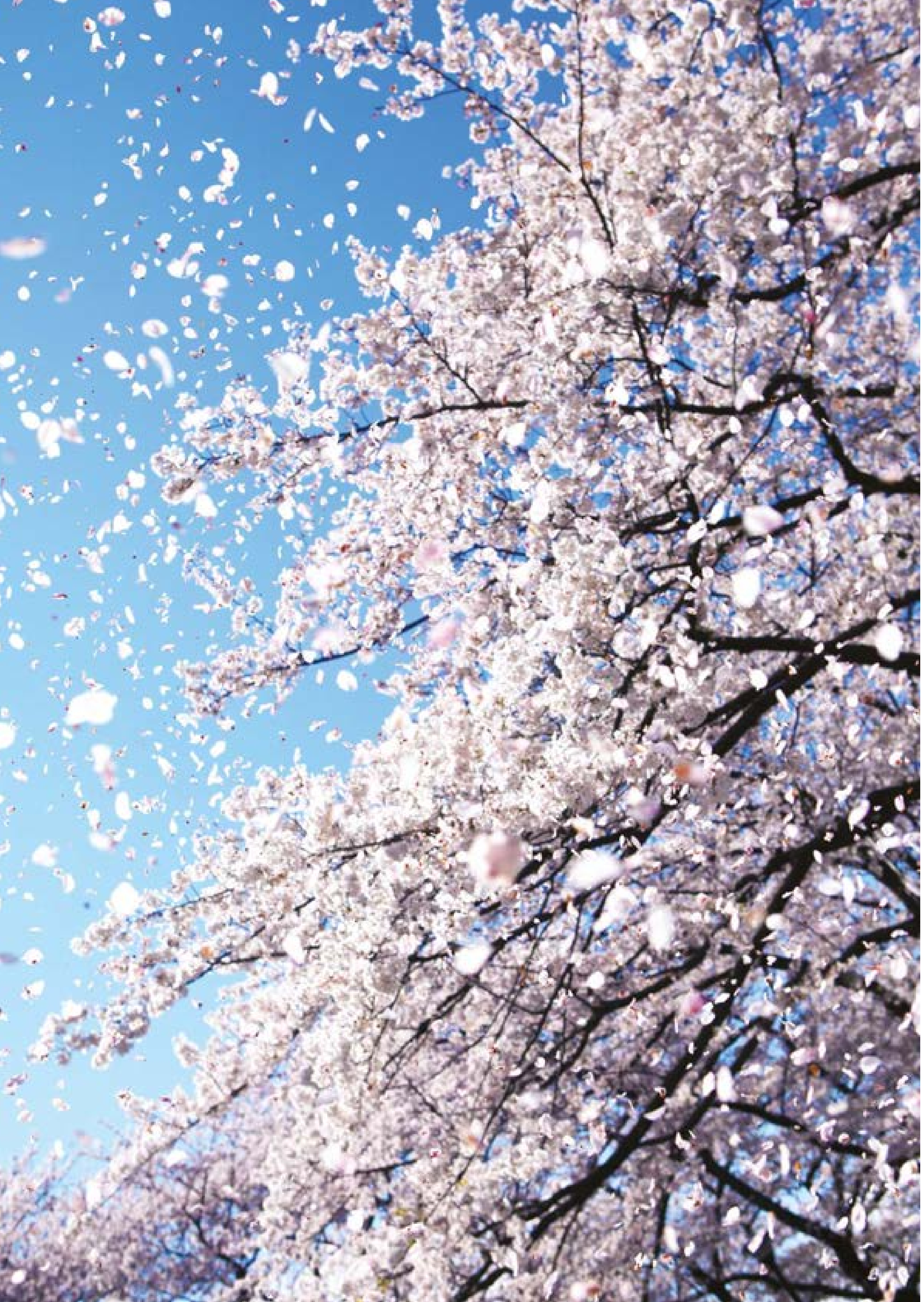


Figure 7. Rio Tinto plc (page 16-17)

[10] EY, *Rising to the challenge: a review of risk and viability disclosure in September 2015 annual reports*, January 2016.



Risk management and internal control

The updates to the UK Corporate Governance Code in 2014 also included changes on risk management and internal control, some of which have an impact on reporting. As we found in our January review, all reports included confirmation that the board has conducted a robust assessment of the principal risks, but very few took the extra step of explaining specifically what that process comprised.

The Code also now states that "the board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report" (Provision C.2.3). Again, we have found generally little qualitative detail on the process or findings of the review or ongoing monitoring.

The FRC Guidance[11] recommendation to explain actions taken to remedy any significant failings or weaknesses in the system of risk management and internal control during the year has been referred to in only 32% of reports, details of which are shown in Figure 8.

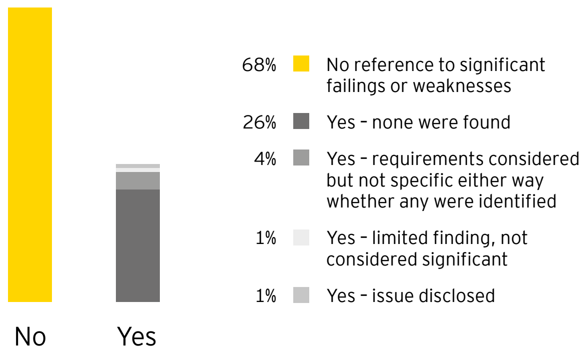


Figure 8. References to significant failings or weaknesses in the risk management and internal control systems

Dividend policy reporting

Last year, the Financial Reporting Lab focused on disclosures of dividend policies and how they can be improved. It found: "Good disclosure relates the policy to the company's strategy, explains how it will be implemented; and makes clear the associated risks and judgements."[12] Dividend policies are important as they contribute to demonstrating the investment case and the board's stewardship. Through its work, the Lab learned that investors seek dividend disclosures which answer the following questions:

- Why this policy?
- What does the policy mean in practice?
- What are the risks and constraints associated with this policy?
- What was done in practice to deliver under the policy?

Our review found that 14% of companies provide an explanation of why they have adopted a certain policy and only 6% make any reference to risks associated with that policy. Dividend policies tend to be short and uninformative, only stating, for example, that the company 'aims to offer a progressive dividend'. It is of course difficult to predict future payments, but companies should disclose the key benchmarks used in assessing whether or not to pay a distribution. Given the timing of the Lab's report, we would hope that 2016 annual reports are more expansive in this area and encourage companies to use the Lab's report as a guide to making their disclosures more informative.

[11] Financial Reporting Council, *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, September 2014.
[12] Financial Reporting Lab, *Lab project report: Disclosure of dividends – policy and practice*, November 2015, pg3.

Interview with Mike Everett, Standard Life Investments

Mike Everett
Governance & Stewardship Director

Q How should companies approach their reporting?

A: Companies should use the annual report as a way of communicating what is important about their business to shareholders. The annual report should be an explanation of how the board/CEO looks at the business and what they think about. Companies should only include information that is material. This should help companies in ensuring they are clear and concise in terms of their narrative.

Standard Life likes annual reports to be integrated. The <IR> Framework is useful, particularly since it is a global framework. We recognise that integrated reporting is beyond reporting; it involves integrated thinking, which makes it a big project for companies. However, we do believe it is a worthwhile process for companies to go through.

Q What do you think about the quality of annual reports?

A: The Strategic Report has improved over time. Companies are getting better at disclosing their KPIs as they often include some non-financial ones alongside the financial. Business model reporting is also improving. When it comes to these disclosures we are interested in how the company differentiates itself from other companies.

The Governance report remains largely boilerplate and often does not provide the reader with a feel for how the board operates. Regulations dictate that certain items have to be disclosed but governance reports have become too boilerplate.

Audit committee reports also contain a great deal of boilerplate; they often do not give the user a good sense of what is important and why committees are doing things. In particular we would like to see more colour in regard to their engagement with the auditor. This report should change each year and provide an opportunity for the committee to explain what it has done.

Q How can companies make their annual reports more clear and concise?

A: Companies could be better at explaining what they do in a concise way. The key is to communicate what the board or a committee did and how they did it. What is important to the committee is important to us as shareholders.

Both the narrative and the numbers should communicate relevant information. It is important that fund managers can easily locate explanations of numbers in the report. This is why signposting is important and notes should be designed to help user understanding. Where it is difficult to follow notes to accounts, analysts come to the conclusion that the business it trying to hide something.

Remuneration reporting is one of the main contributors to increasing annual report lengths. We have seen more reporting with increased detail but it is questionable to what benefit. We want companies to explain why the remuneration is appropriate and how it will be used to retain and attract talent and incentivise individuals in the right way – linked to strategy. It is also important to understand how the remuneration committee has considered how executive management's pay fits within the overall remuneration within the business. We would like remuneration committees to consider societal views on pay, including a consideration of quantum.

When it comes to nomination committee reports, they are fairly uninformative. Disclosing a skills matrix of the ideal board and what the committee is doing to try to fill any gaps would be a good place to start. This gives shareholders a mechanism for understanding the succession planning process.

Q Should companies consider moving information into an annexe or the company's website?

A: The sustainability report doesn't need to be part of the annual report. Environmental aspects can be put in separate reports but it is important to get the information to shareholders. Companies should consider why each disclosure is there and the benefit of having it in the annual report.

Business models are unlikely to change year-on-year but they are an important part of the narrative report and should always remain in the front part. However, if there are other items that are boilerplate and do not contribute to the overall narrative of the company, these could perhaps be put into an appendix or on the website. Many companies put their committee Terms of Reference on their website, which is good for reducing clutter.

Q What do you think about the quality of viability statement reporting?

A: For us it is important for the viability statement to be part of the risk section and the two should connect. The link to business planning is also important and there should be a flow between business planning, risk and the viability statement.

Some investors have been disappointed with the periods disclosed by some companies. However, in my view companies report their view and speak to investors about any concerns they may have.

Some risk reporting is currently a long list of everything without a view on primary risks and the likelihood of them occurring. It is also important for the risks to be linked to the business model.

3.
Culture and people

Culture

In recent years, corporate culture has become a key area of focus for regulators, boards and other stakeholders. In 2014, the UK Corporate Governance Code was updated to reinforce the board's responsibility for establishing culture, value and ethics[13] and a recent survey conducted by EY and the FT (*Is your board yet to realise the true value of culture?*, 2016) found that 83% of FTSE 350 board members believe that shareholders factor culture into their investment decisions. So in our review we looked to see how this focus on cultural issues has been reflected in annual reporting and whether such a qualitative issue can be meaningfully reported on to provide a clear picture of company culture.

Organized for success

In pursuing our purpose of enabling people with life-altering conditions to lead better lives, we are transforming ourselves into a leading global biotech developing and delivering best-in-class therapies for patients with rare and specialty conditions.

Our culture plays a key part in our success. We have a strong patient-focused, performance-based culture:

- We have the courage to lead the way — to anticipate and act on what's next.
- We are agile and adaptable, shaping a better future for patients.
- We keep our promises.
- We fearlessly innovate to address unmet patient needs.
- We do the right thing in the right way.

Our business model is also fundamental — supporting our focus on our four strategic drivers: growth, innovation, efficiency and people.

Inputs

- Our talented, passionate and committed people.
- Our unique high performance, patient-focused culture.
- Our experienced, dynamic leadership.
- Our nimble and efficient manufacturing and sales networks.
- Our ongoing reinvestment.
- Our strong governance.

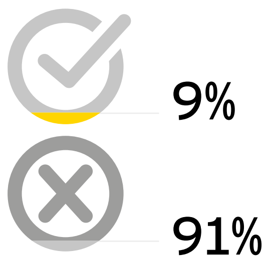
Investment in Non GAAP R&D' in 2015

$884m

Figure 9. Shire plc (page 12)

> We believe it is vital that companies don't just treat culture as a reporting buzzword to be mentioned in their ARA, but see it as an area for action which their reporting appropriately reflects.

From a word search we found that 97% of companies mention corporate culture in their annual report in some form. However, this is often a statement that the company considers culture to be important, without really explaining the link to strategy or the business model. Only 10% include culture as part of the strategy or business model, explaining the importance of getting culture right in order for the business model to work.



Was there a clear indication of how the board measures culture?

Case studies

Aviva plc
(page 9 and 20)

- The strategic framework includes culture as a core element of how the strategy will be delivered
- It describes the key elements of the culture as: Create legacy, kill complexity, never rest and care more

Shire plc
(page 12)

- The business model section (see Figure 9) explains how the culture supports the company's success
- Culture is framed as one of the inputs to the business model and the 'patient-focused and performance-based' culture is then referred to consistently throughout the report

Vesuvius plc
(page 3 and 56-57)

- Board responsibility for culture is affirmed in the Chairman's statement
- A clear framework for business integrity is set out
- Further meaningful information on culture in action is included in the Safety, People and Community sections within the Strategic Report and the language used allows a reader to get a feel for their culture and its importance

[13] Financial Reporting Council, *UK Corporate Governance Code*, September 2016, pg2.

Figure 10. Responsibility for culture

As well as understanding the impact of culture on the business, it is also important to be clear about who is responsible for culture. Our June 2016 report[14] on culture demonstrated the responsibility for culture is spread as shown in Figure 10.

If companies choose to communicate to investors about culture, they should outline the characteristics of the culture they are trying to achieve or maintain and to be consistent on these cultural aims. The next step is to explain how management has embedded that culture and how the board has obtained assurance on this. Relevant board committees should explain their actions in relation to culture. For example, in overseeing the executive talent pipeline, the nomination committee should gain some assurance on how senior talent 'live' the culture and values and, where there are issues, how these affect an individual's progression. Audit committees should consider how culture impacts risk and risk mitigation strategies and ensure that cultural issues are considered as part of any root cause analysis of internal control issues conducted by management.

Significantly, only 9% of reports in our ARA review provide any explanation of how the board monitors and gets assurance on culture. Usually this is through employee surveys. Companies sometimes refer to the use of particular indicators for culture, but the indicators are not disclosed.

"Where it is important to strategy, culture disclosures would be more useful if they included some data which would provide evidence of the culture rather than bland statements and claims about the working environment or inclusiveness. For example, it could be useful for companies to provide employee turnover ratios which could be monitored over time. An important element is to also ensure consistency year on year in terms of statistics provided."

Jed Wrigley
Fund Manager, Fidelity International

[14] EY, *Governing Culture: practical considerations for the board and its committees*, June 2016, pg3.

We recognise that reporting on culture is not easy. The FRC's *Report of Observations on Corporate Culture and the Role of Boards*[15] provides a useful starting point for boards looking to increase their focus on culture, providing some indicators that can be used to assess culture. Our recent report *Governing Culture: practical considerations for boards and committees* also gives examples of the ways that boards and committees can define, shape, monitor and gain assurance on culture. The results of this analysis can be shared in annual reports to provide investors with some assurance.

The work of analysing, auditing and gathering data on culture can be performed by internal audit.

> For example, the audit committee report for BAE Systems (page 67) states: "One key value-add in recent years has been to include the audit of our culture as a part of the internal audit process. The feedback from this latest evaluation will be incorporated into the next phase of the function's continuous improvement plan."

As the FRC's report affirms, "simply adopting formal values statements is not enough". The FRC is seeking feedback on its report and will take this into account when updating its Guidance on Board Effectiveness during 2017. We encourage companies for which culture is either a significant performance driver or risk to report meaningfully on this topic by explaining how culture relates to the business model and strategy and how it is monitored.

Nomination committee reporting

The need for improvement in nomination committee reports has been highlighted over the last year. At the start of 2016, EY conducted a series of roundtable discussions with board chairmen, nomination committee chairmen and members, and company secretaries from over 40 listed companies (predominantly FTSE 350) to discuss the role of nomination committees and how their impact can be improved. The findings were published in our May 2016 report, *The nomination committee – coming out of the shadows*, produced in partnership with ICSA: The Governance Institute.

On the subject of reporting, roundtable attendees saw a need for 'better' rather than 'more' reporting. We do not expect nomination committee reports to become longer, but we believe they can be made more informative.

For example, they could include more specific disclosures on succession planning and skills management. Other areas of discussion during our round-tables earlier this year included how often the nomination committee should meet and who should be the chair. Through this review, we learnt that nomination committees met three times on average during the year, while the chairman of the board acted as the chair of the nomination committee in 87% of companies.

[15] Financial Reporting Council, *Corporate culture and the role of boards: report of observations*, July 2016.

Our ARA review also found that the length of nomination committee reports has increased slightly, to an average of two pages. Some companies have begun to improve their disclosures, but there is still work to do. Although we noted increasing use of skills matrices for the board, only 30% of companies include a skills matrix or provide useful discussion of skills in director biographies. In leading practice reports, the discussion of skills is linked to strategic plans in order to provide assurance that the board has the appropriate skills to oversee the implementation of the strategy over the coming years.

31% of nomination committees state that they have some oversight of internal talent pipelines. The recent FRC paper on succession planning suggests that companies should consider "including information [in annual reports] on the quality of the internal pipeline, as well as what the company is doing to improve it".[16] In general we did notice an increasing depth of discussion on talent development initiatives. For example, accelerated development programmes, senior executive reviews of internal talent, and presentations on the role of the board for rising talent. This is encouraging but we would expect such disclosures to be more widespread given that people risk is considered a principal risk by 62% of our sample.

More clarity on gender splits within the talent pipeline may also likely to be required in future. For example, in February, as part of a broader look at narrative reporting in the UK, the Department for Business, Innovation & Skills[17] (within its consultation on the EU Non-Financial Reporting Directive) questioned the clarity of the definition of 'Senior Manager'. It may change to help companies provide more meaningful information on female representation in the talent pipeline.

Case studies

Weir Group plc

(page 81)

- A skills matrix for the full board is shown on the same page as a graph on appointment and tenure of each director, which aids the succession planning discussion

Barclays plc

(page 61)

- An explanation is provided of board activities and a range of practical measures put in place in relation to succession planning and talent management during the year
- For example, committee members agreed to partner with high potential senior management to support their development

Vesuvius plc

(page 81)

- An explanation of a skills review is provided as well as assurance that the skill sets available match the current near-term strategic requirements of the Group
- Useful information on oversight of senior management succession is included

Diversity and gender pay reporting

Under the Code (provision B.2.4) companies have to disclose "a description of the board's policy on diversity, including gender; any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives". With this and other calls for greater female representation, e.g., the Davies review, boards have inevitably been focused on gender representation. While we are not advocating for this to reduce, we encourage boards to also consider and comment on how they are thinking about diversity more broadly and perhaps expand their focus to include other measures of diversity. The view that other types of diversity should be considered is supported by the Local Authority Pension Fund Forum in their Policy Guide on ESG Issues.[18]

This is an area which will come under greater attention for large PIEs with securities traded on a regulated market in light of the requirements of the EU Non-Financial Reporting Directive (see Section 5: Looking ahead for more information).

As well as the board, there is a focus on diversity of the employee population. Again the focus has initially been placed on gender, with the introduction three years ago of the requirement to report the number of men and women at different levels in the company. Subsequently, in February 2016, the UK government issued draft regulations requiring organisations with at least 250 employees to publish their gender pay gap, on their website, on the premise that increasing transparency will enable the impact of interventions promoting gender equality to be measured and prioritised. Although the recent EU referendum result casts some doubt over the proposed timeframe, the Government Equalities Office has indicated that it remains committed to enacting the regulations. These require employers to take a snapshot of their data in April 2017 and publish it by April 2018.

The draft regulations require organisations to publish annually a range of gender pay gap calculations on their website, which must be accessible to both employees and the public. Employers will also be required to send evidence of compliance to a government website. As the draft regulations stand, organisations are not required to include this information in their ARA. However, persistent interest in human capital reporting, with organisations continuing to measure the value driven by their workforce, suggests reporting on employee pay may become commonplace in the near future. Along with the risks to employee engagement, talent attraction and a potential rise in equal pay claims, the main current concern for organisations appears to be the impact on their reputation, heightened by the government's intention to publish industry league tables.

As well as meeting these new disclosure requirements, it is important to focus on the underlying cause of any gender pay gap and sustainable measures to address it to ensure equality and fairness in the workplace.

[16] Financial Reporting Council, *Feedback Statement: UK Board Succession Planning Discussion Paper*, May 2016, pg14.

[17] Replaced by the Department for Business, Energy & Industrial Strategy in July 2016.

[18] Local Authority Pension Fund, *Policy Guide on Environmental, Social and Corporate Governance Issues*, 2016, pg8.

Culture and people

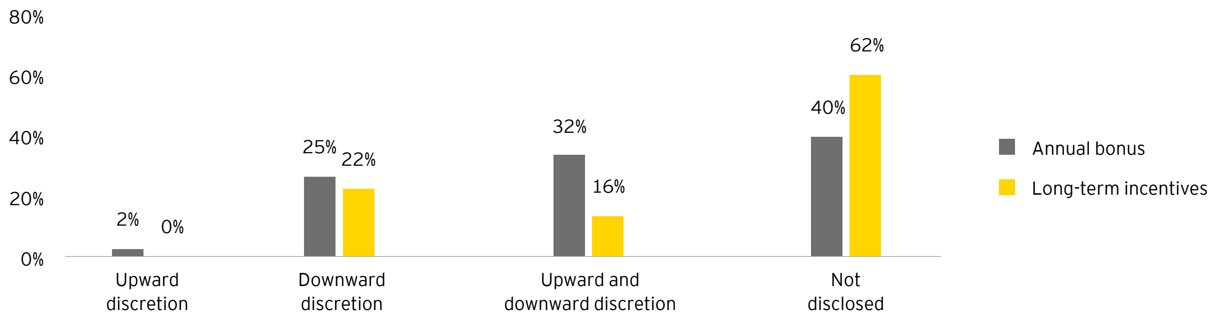


Figure 11. Remuneration committee's discretion to adjust vesting outcomes

Directors' remuneration reporting

Remuneration reports provide a prime opportunity to convey the value of people and culture and explain how executives are remunerated in a way that drives performance in line with strategy. They should be clear, concise and provide transparent disclosure without unduly increasing the overall length of annual reports. In 2015, directors' remuneration reports (DRRs) maintained a consistent length of approximately 18 pages. This is, mainly because companies have included their remuneration policy either in full or as a detailed summary and policy table, even in years where the remuneration policy is not being put to shareholder binding vote. We see this trend continuing, given that many readers of DRRs treat them as standalone documents.

Annual incentives: The majority of companies did not clearly articulate the link between the performance metrics used in the annual incentive plan and the company's KPIs, with only 13% of companies successfully aligning all of their annual bonus performance metrics with the company's KPIs. Of these companies, only one third have both financial and non-financial performance metrics, whereas the remaining two thirds measure annual performance against financial metrics only.

Given that the DRR is often used as a standalone document, by clearly articulating the link between KPIs and bonus payout metrics (see Berendsen plc's 2015 DRR, page 95) companies will improve readers' understanding of how their executives are incentivised to deliver the company's long-term business strategy.

Remuneration committee chairs can also do more to improve their articulation of this link in their annual statement. We feel this is missed opportunity for improved communication with investors and broader stakeholder groups by setting out upfront the context in which remuneration decisions are being made.

Long-term incentive plans: We continue to see companies making changes to their remuneration policies in order to meet investors' expectations and link executive remuneration to long-term company focus. We have observed an increased prevalence of post-vesting holding periods. Almost half of the companies we reviewed require executives to hold shares following vesting (which occurs after a median performance period of three years) for a period of typically two years.

Additionally, there continues to be an increase in prevalence of non-financial performance metrics in long-term incentive plans, with over 10% of the companies in our sample now measuring performance against strategic metrics. Typical non-financial performance metrics include safety and sustainability, balanced scorecard, R&D leadership and project implementation. We expect this trend to continue as companies pursue the stronger alignment of executive performance-related pay with long-term company objectives.

Powers of discretion: The use of discretion by remuneration committees, not clearly defined in DRRs, has been a continued area of focus for investors. Our review found that there is still a lack of disclosure about the circumstances in which remuneration committees may apply discretion to adjust vesting outcomes of incentive awards, as shown in Figure 11. As most companies are reviewing their remuneration policy prior to putting it to shareholders' vote in 2017, they will need to consider the role that positive and negative discretion should have in their short and long-term incentive plans, as well as the appropriate disclosure of how this discretion can be used, including limits and circumstances.

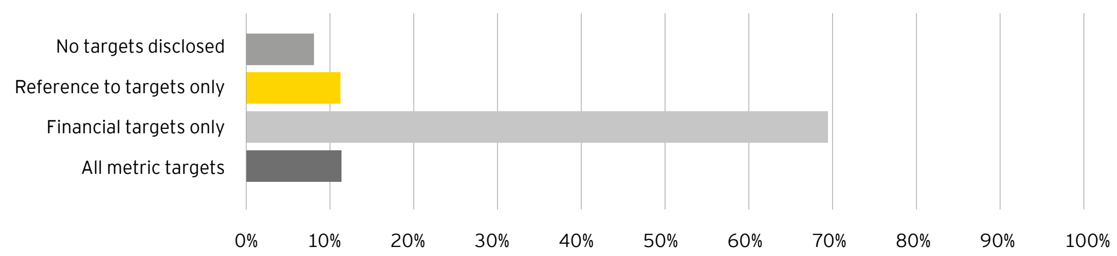


Figure 12. Retrospective bonus target disclosure

CEO salary increases: Amidst a back-drop of public concern over rising overall pay levels, we nonetheless observed another year of limited increase in CEO base salaries and expect this trend to continue given investors' increasing focus on executive pay levels. Companies must communicate clearly to investors the reasons for any significant increases that are not in line with other employees. In the longer term, given the impact salary increases have on total remuneration awarded to executives, companies may wish to consider including a salary maximum when putting their policy to the shareholders' vote.

Malus and clawback provisions: 93% of the long-term incentive plans now have a clawback policy in place, compared to 89% of annual bonus plans. A significant number of companies still do not disclose the period over which clawback applies; where disclosed, clawback typically applies for two or three years following vesting. Improving clawback and malus disclosure would help companies demonstrate to stakeholders the circumstances and timeframe in which executive remuneration may be withheld or recovered.

Annual bonus target disclosures: Following calls from investors and their representative bodies, including the Investment Association and Aviva Investors, for better disclosure of bonus targets, we now see around 80% of companies reporting bonus targets and actual performance retrospectively for the year under review. Of these, 69% disclose financial targets only and 11% provide disclosure for both financial and non-financial targets (see Figure 12). Prospective targets were disclosed by only 3% of companies.

Investors' voting power at AGMs: During this 2016 AGM season, a number of companies faced significant votes against their remuneration policies or reports. There appears to be a general trend towards opposition to excessive boardroom pay. Whilst in some cases this follows poor performance it is not limited to those companies that are not performing well. However, only one company in our sample had their remuneration policy opposed and 90% of companies had their annual reports on remuneration approved by more than 75% of their shareholders. Companies should bear in mind the Code requirement to explain the actions they intend to take to understand the reasons behind a vote result when a significant proportion of votes have been cast against a resolution at any general meeting.

Following the recent publication of the Investment Association Executive Remuneration Working Group's final report (see page 51 for more detail) and in light of the experience gathered over the three-year cycle of remuneration policies, GC100 and Investor Group published a revised version of their directors' remuneration reporting guidance on 15 August 2016. The new guidance replaces the 2013 version and includes changes related to disclosures on use of discretion, comparator groups, maximum opportunities and more. We note that many of these align with our findings and recommendations from our review.

Overall, we are witnessing improvements in reporting on remuneration. We expect this to continue as preparers seek to improve the clarity and conciseness of remuneration reports and stakeholders continue to improve their understanding of the link between strategy, performance and pay across FTSE 350 companies.

Interview with Jed Wrigley, Fidelity International

Jed Wrigley
Fund Manager

Q How do you think companies can make their annual reports more clear and concise?

A: There are many bodies globally looking at the issue of clear and concise reporting, for example, the FRC's Reporting Lab, EFFAS group and METI Japan and some progress has been made. However, the annual report is increasingly moving away from an explanation of how the board acted as a custodian and now often includes information that is less relevant to assessing the performance of the company. The annual report should only contain information that is material to the company. For example, environmental issues can be highly relevant and, where this is the case, should be included – we would expect a lot of information on this for oil companies but almost no reference to this from an advertising agency.

Annual reports should be understandable by anybody, so they must be simple and straightforward – with numbers tabulated or presented in graphs wherever possible.

Q What are your views on remuneration reporting?

A: As it stands remuneration reporting is adequate but I am uncomfortable with the increased use of non-GAAP measures. In particular, where such non-GAAP measures are used I believe there should be specific linkage to the audit committee report, which should consider their use. The audit committee should explain why non-GAAP measures, whether used for remuneration measurement or not, are a better representation of economic performance. As an example some companies add back share-based compensation, only count the cash contribution of the pension, and add back 'wasting' intangibles.

We are concerned about how remuneration KPIs can be manipulated and that individuals can act in a way to maximise pay. For example, non-GAAP measures/ratios may be used that don't necessarily deliver value. One large retail company used return on capital employed (ROCE), which we would normally support, but in this case management were effectively incentivised to do significant sale and lease-back of properties to reduce capital employed to increase the ROCE ratio. Long term analysis of the company performance indicates that this did not create any real economic value. Now the company has a remuneration policy which makes the buy-back of real estate somewhat beneficial in the long term – effectively repurchasing the same sites that were sold before at a premium. Serious capital allocation decisions are being driven by compensation rather than long-term shareholder value.

Q Do you think nomination committee reporting can be improved?

A: There is not a lot of information in annual reports on nomination committees and diversity. As an example, it is difficult to disclose information about succession planning without giving away too much sensitive information. Nomination committee reporting is a rare area where the investment community needs to rely on large institutions who can have discussions with the Chairman and NEDs behind closed doors to achieve the best outcome for all.

While diversity is very important, current reporting on this issue is adequate. If a company wants to provide more information, it should go on the website. Those wishing to access the information, e.g., prospective employees or suppliers, will look on the internet.

Q How could culture be reported in a way that demonstrates its value to investors?

A: How people are nurtured should be described, provided this is a key part of the strategy. Where it is important to strategy, culture disclosures would be more useful if they included some data providing evidence of the culture, rather than bland statements and claims about the working environment or inclusiveness. For example, companies could usefully provide employee churn ratios which could be monitored over time. An important element is to also ensure consistency year-on-year in terms of statistics provided.

I don't look to understand culture through reading the annual report but through meeting management teams. Metrics around how individuals are incentivised are important to see what matters from a delivery perspective. How much of the pay is due to qualitative or quantitative factors? How far down do share plans go?

4.
Broader societal impacts

Over the last few years, companies have started to disclose more information on the broader impacts of their business, on people, communities and the environment. This is in part due to increasing pressure from a wider group of stakeholders calling for more information on issues such as tax, equality and discrimination, gender diversity and carbon emissions.

The question is, where should these disclosures go? Other than mandatory disclosures required under law irrespective of materiality, companies must consider whether information is material and meets the Companies Act test – "to the extent necessary for an understanding of the development performance or position of the company's business". In other words, if the information has an impact on the business model, strategy or risks, it should be placed in the annual report. If it does not, companies should consider whether it should be on the website or in other documents. Refer back to Figure 1 to see how Rio Tinto determines placement for their sustainability information based on materiality. It is encouraging that some newer and upcoming disclosure requirements don't have to be contained in the annual report, such as the modern slavery and gender pay gap disclosures.

Sustainability reporting

The vast majority of companies in our sample include a dedicated sustainability section within their ARA. Only a small number embed sustainability information throughout their reports rather than in a standalone section. Companies that include discussion of sustainability within their narrative on business strategy include ARM Holdings plc, AstraZeneca plc, Kingfisher plc, Reckitt Benckiser plc, and Unilever plc.

Around half of all organisations report on performance against sustainability metrics and targets. However, a much smaller proportion of these companies include this information alongside KPIs, or attempt to make linkages between non-financial KPIs and the business strategy or financial performance in their reporting.

There are still 13% of FTSE 350 companies that do not include any non-financial KPIs. However, of the 87% that do, many only disclose non-financial KPIs in the sustainability report, rather than integrating them within the main body of the ARA.

Reporting on sustainability is becoming increasingly important as climate change rises up the agenda. Sacha Sadan, Director of Corporate Governance at Legal and General Investment Management (LGIM), emphasises the importance of disclosure on how companies will operate, and explore opportunities, in a world facing the challenge to limit global temperature rise to 2°C.[19] The importance of this issue to investors was also demonstrated by the recent shareholder resolutions at BP plc, Glencore plc, Anglo American plc, Rio Tinto plc and Shell plc, all calling for increased disclosure on a range of climate-change related issues, including emissions management, low-carbon investment strategies and resilience in a world of rising temperatures. They were all passed with 96% support or more.

Hallmarks of leading practice sustainability reporting:

- Integrates sustainability content throughout the report
- Uses the business model to articulate how the organisation creates financial and non-financial value
- Articulates how managing sustainability issues supports business performance
- Identifies stakeholder groups and the material sustainability issues of interest to them

[19] Legal and General Investment Management, *Active ownership: positive engagement to enhance long-term value*, 2015.

Energy consumption

Under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, all UK quoted companies are required to report their annual greenhouse gas emissions in their annual reports. Additionally, up until the scheme ends in 2019, companies registered on the Carbon Reduction Commitment Energy Efficiency Scheme are also required to report (outside of the ARA) on their emissions from their energy consumption in the UK to the Environment Agency, increasing the onus on organisations to make public their emissions data. All other information on energy is voluntarily disclosed.

The annual report can be a good place to provide a snapshot of a company's environmental position, which is of interest to a wide variety of stakeholders, but reporting in this area should be explained in the context of relevance to strategy and business model.

This view is supported by many investors, including the Local Authority Pension Fund Forum.[20] Reporting on progress on energy use reduction can also be of interest to shareholders due to the benefits of reducing the costs of energy to the organisation.

17%

of companies reported on wider energy consumption data.

Of the companies in our sample, 100% of UK-incorporated companies report on Scope 1 emissions (direct) and Scope 2 emissions (indirect). For companies considering expanding their disclosures to include Scope 3 emissions (these are indirect emissions from the activities of another company, such as in the supply chain) it is interesting to note that only 32% currently report on these. However, for many companies, the majority of emissions come from outside of their own direct operations and, even if not disclosed, it can be useful to be aware of Scope 3 emissions in order to identify further cost reduction opportunities as well as resource risks in the supply chain.[21]

Reporting on energy consumption is also less common, with only 17% of companies including energy data in their reporting. However, where it is included, this content is becoming more extensive and companies are increasingly setting more ambitious targets. They do this through registering with organisations that promote the decrease of carbon emissions or increase in use of renewable energy, such as RE100.[22]

However, many reports only include carbon emissions targets and do not incorporate targets for energy consumption. The level of energy consumption and the source of energy supply are the two main drivers of a company's carbon emissions. Therefore, a report with only carbon emissions targets suggests the company is setting targets without the underpinning energy plan required to achieve it.

It is important that companies clearly explain their overall approach to carbon reduction and energy usage strategies, the link to the overall business strategy and the benefit to shareholders and stakeholders. This will enable ARA readers to understand the relevance of information on energy to the company.

[20] Local Authority Pension Fund Forum, *Policy Guide on Environmental, Social and Corporate Governance Issues*, 2016.
[21] Carbon Trust, *What are scope 3 emissions, how can they be measured and what benefit is there to organisations measuring them?*, 2016.
[22] The RE100 is a collective, global initiative of influential businesses committed to 100% renewable electricity. They aim to increase the demand and delivery of renewable energy globally. Since its launch in 2014, the number of companies registered has increased from 53 to 68, highlighting the desire of companies to publically display their commitment to renewable energy.

Hallmarks of leading practice energy reporting:

- Discloses the extent of carbon emissions, energy consumption and energy cost
- Provides a breakdown of Scope 1, Scope 2 and Scope 3, as well as a breakdown of CO2 emissions across different areas such as operations, transportation, manufacturing, and offices
- Includes a breakdown of the different types of energy sources, including renewable energy
- Discloses targets for carbon emissions, energy consumption, renewable energy and energy cost reductions
- Provides a clear narrative explaining developments and performance during the year and a clear articulation of trends in performance over previous years
- Includes clarity around whether targets are absolute (e.g., total carbon emissions) or relative (e.g., carbon emissions per square metre) as this creates a mechanism for driving behaviour internally within the organisation
- Provides insight into investments in energy efficiency projects or renewable energy

Tax and tax transparency

As highlighted in our report last year, the Organisation for Economic Co-operation and Development's (OECD's) measures in relation to Base Erosion and Profit Shifting (BEPS) are having an impact on businesses' approach to tax risk and planning and accordingly on financial statement disclosures. In 2015 13% of companies in our sample (2014: 4%) single out BEPS and related developments as an area they are focusing on. In particular, they comment on how BEPS measures may affect their effective tax rate or the tax payable in future years. Such comments aside, given that the BEPS measures are largely yet to be implemented, the narrative continues to be general and refers more to the need to continually monitor developments. For further background information on BEPS, see our report from last year, *Annual reporting in 2014: Reflections on the past, direction for the future*.

Of the 100 companies in our sample, 55% include tax risk, in particular in relation to tax authority enquiries or cross border transactions, within their audit committee reports (a 10% decrease from last year).

FRC's thematic review

This year the FRC initiated a thematic review of tax reporting within financial statements. Previous efforts to enhance tax disclosures and improve tax reporting, in the form of the Exposure Draft on IAS 12 and the European Financial Reporting Advisory Group's (EFRAG's) discussion paper *Improving the Financial Reporting of Income Tax*, did not gain support. Nevertheless, it appears that investor feedback, among other factors, prompted the FRC to act. The thematic review is focused on the quality, and not a greater volume of, tax disclosure. It is looking for less boilerplate statements and more examples of best practice disclosures that explain in plain English a company's tax situation. Areas of interest are the sustainability of the reported effective tax rate, the clarity of the tax reconciliation and clear explanations of uncertain tax positions. With the tax reconciliation being a key disclosure, the FRC wants to establish whether material reconciling factors are being identified and if the disclosure allows a reader to understand one-off factors affecting the effective tax rate or those that affect the sustainability of the effective tax rate in future years. Preparers who go beyond the requirement for a numerical reconciliation, providing additional narrative where necessary, are also of interest.

Looking at these factors in relation to our sample, the majority of companies (84%) include a reconciliation of the total amount of tax, while only 5% include a reconciliation of the tax rate. 11% include both. Only 21% provide additional narrative to explain specific line items within the tax reconciliation, in particular when explaining certain one-off events or exceptional items such as a restructuring or the settlement of a prior year tax position. For example, Vodafone plc provides an explanation of how key non-recurring items affect its effective tax rate: "the Group's underlying tax rate for the year ended 31 March 2016 was 28.8%. Certain non-recurring items had a significant effect on the adjusted effective tax rate in the year, which was 15.1%. These include a benefit of 18.4% following the restructuring and simplification of our Indian business, partially offset by a tax cost of 4.6% due to the reduction in the UK corporation tax rate (which resulted in a decrease in the value of our UK capital allowances)".

Lloyds Banking Group plc provides an explanation of recurring and non-recurring items and links this to the sustainability of the effective tax rate: "The effective tax rate was higher than the UK corporation tax rate largely due to the introduction in 2015 of restrictions on the deductibility of conduct related provisions which resulted in an additional tax charge of £459 million. Adjusting for this charge, the effective tax rate would have been 14 per cent reflecting a number of positive one-off items including non-taxable and relieved gains and a small prior year adjustment. Going forward we do not expect these positive one-off items to continue and now expect a medium-term effective tax rate of around 27 per cent, including the forthcoming 8 per cent surcharge on banking profits. This is lower than our previous guidance of around 30 per cent, reflecting actions on PPI."

Of the companies surveyed only 3% include a clear narrative explanation of items that are recurring compared to items that will not recur.

A number of companies do, however, provide an alternative measure of the effective tax rate in the form of an underlying or core effective tax rate. These measures largely exclude the impacts of one-off transactions or restructuring, exceptional items and foreign exchange movements to arrive at a normalised and more predictable measure of the tax paid by the business.

One item worth considering in the context of multinational companies with significant international operations is the use of the UK rate in the effective tax rate reconciliation. This often results in a large item for 'effect of foreign tax rates', while some companies give a blended starting rate with some explanation. A number of companies in our sample apply the UK tax rate and include a single line item for the impact of overseas tax rates. None choose the option in IAS 12 of showing the tax reconciliation split by jurisdiction.

In relation to uncertain tax positions, disclosure explaining the nature and the amount of the uncertainty is regarded as best practice. For 35% of companies 'uncertain tax positions' or 'tax contingencies' are mentioned as an area of focus in the front half of the ARA. But only 10% quantify the amount of the tax provision held for these positions, this quantification being either by category of tax risk or by jurisdiction. Where companies mention uncertain tax positions in the front half, 31% do so within the audit committee report. In 20% of cases where uncertain tax positions are highlighted, additional narrative is included as part of the note on significant accounting estimates or judgements. The narrative is focused on how the uncertainty arises and how the group obtains comfort that the position has been appropriately measured. In the majority of cases the uncertainty arises due to cross-border transactions or transfer pricing positions, where it can be difficult to predict the outcome of tax authority enquiries.

A number of companies comment on the method used in arriving at the amount recorded for uncertain tax positions, with some citing the 'most likely outcome' method or commenting that a provision is made when the likelihood of tax outlay is 'more likely than not'. This is interesting given that the International Accounting Standards Board's Interpretations Committee is currently considering publishing new guidance to clarify how uncertain tax positions should be measured.

Tax strategy

The requirement to publish the group's tax strategy in relation to UK companies including commentary on tax risks and how the group interacts with HMRC will be mandatory from 2017 onwards. Of the FTSE 100, 40% currently mention tax policy or tax strategy in the front half of the accounts, with a notable minority already producing a separate tax strategy or policy document.

Where tax strategies are included within the accounts the general principles within these commonly include:

- Compliance with local tax laws and regulations in each relevant country
- Having open and co-operative working relationships with tax authorities worldwide and engaging in proactive discussions with them
- Supporting the business strategy of the Group by undertaking efficient management of tax affairs in line with the Group's commercial activity
- Transacting on an arm's length basis for exchanges of goods and services between companies within the Group

In a number of cases there is an emphasis on not engaging in tax planning and paying a fair share of tax. For example AstraZeneca plc (page 76) states: "We draw a distinction between tax planning using artificial structures and optimising tax treatment of business transactions, and we engage only in the latter".

Publication of tax strategy

Who: Groups with a turnover in excess of £200m or a balance sheet total in excess of £2bn in the previous year will need to publish a tax strategy. UK subsidiaries may have to publish a tax strategy if the turnover of the global group to which they belong is in excess of €750m.

What:

i. Approach to tax risk management and governance

ii. Level of risk in relation to tax that the Group is prepared to accept

iii. Attitude to tax planning

iv. Approach toward dealings with tax authorities.

Where: The tax strategy should be available free on the internet; it can be part of a wider document.

When: Before the end of your first financial year commencing after Royal Assent of Finance (No. 2) Bill 2016, so for a December year end, by 31 December 2017.

A number of the FTSE 100 already publish a separate documents, available on their websites, outlining their approach to tax.

Interview with Richard Marsh and Jenny Harrison, BT plc

Richard Marsh
Reporting and Insight Director for Sustainability

Jenny Harrison
Director, External Reporting

Q Why does BT choose to report so extensively on environmental and social impacts of the company?

A: We believe that by creating value for our customers and society, we grow our business and reward our shareholders for investing in us. We don't report on these issues just to be – or to be seen to be – 'nice' or 'helpful'. Investors want to invest in a company that is growing and is therefore a good investment, but also a company in which that growth is created in a sustainable and responsible way. We demonstrate this through our reporting and our key stakeholders expect this.

There are also risks to the business in ignoring social and environmental impacts, such as climate change, human rights and scarcity of resources. It's important for us to be transparent about what we're doing about these and to demonstrate that we're going to be here in the long term.

Q How does a focus on these outcomes translate into every day practice within BT?

A: It provides a relevant and measurable link to help guide people across the company. For example, through supporting an energy and emissions reduction programme by using our technologies such as conferencing and travelling less, or looking at supply chain efficiencies and carbon reduction opportunities. We've saved over £200m from reducing worldwide energy consumption since 2012.

Our new ideas scheme is also currently focused on inspiring our employees to develop and submit ideas of how we can help customers reduce their carbon emissions through our products and services.

Our product/proposition development teams also use design checklists to consider and 'design in' environmental benefits wherever possible.

We're consistently working to create more sustainable revenue streams that are both innovative and create social and environmental benefits at the same time. As an example, within our Business and Public Sector line of business, we're extending our initiative to support digital inclusion for social housing, a shared internet service that enables housing associations to offer low-cost connections and devices to tenants with no upfront installation cost and no need for credit checks. This has helped 10,875 properties in 11 housing associations get online in our 2015/16 financial year and means the tenants are able to access the many benefits that being online can bring – in support of education, employment and many other areas. It also provides BT with an additional revenue stream that would not otherwise be accessible.

Q Have there been any particular outcomes or benefits experienced from reporting publicly on societal impacts?

A: Communicating our aims publically has sparked creativity, innovation and leadership at all levels within the organisation. Our line of business CEOs actively develop and drive initiatives to support our '2020 ambitions' and in a way that is relevant to the nature of their business. There are benefits from this in terms of drawing in and motivating talent.

Our reporting has also created opportunities to share and work with other organisations, particularly in areas such as the social return on investment. We've also gained good PR from receiving awards for the quality of our reporting.

Q What feedback has BT had from shareholders and stakeholders on how it reports on broader societal impacts?

A: We've seen growing interest in our reporting and a three-fold increase in the number of downloads of our *Delivering our purpose* report (compared to the same time last year). The feedback on our reporting from Socially Responsible Investors (SRIs) is excellent. SRIs have been particularly impressed with the social return on investment case study we produced and the various innovative ways to help inclusion such as our work with housing associations, but also the simple 'bottom of the pyramid' concepts such as BT Basic. We have found that French and Dutch SRIs are particularly focused on societal themes, while UK, German and US-based SRIs are more focused on governance and environment.

We track all of our main stakeholders closely and carry out a materiality analysis each year to inform what we report on. This analysis comes from around 100 different sources, including employee surveys, customer feedback, social media, and stakeholder reviews. Our most material themes in the last review – which we used to shape our reporting – were privacy and data security, network investment, customer experience and energy/climate change.

Some of our larger customers are also focused on environmental impacts. Some draw this information from the Carbon Disclosure Project but we've also seen a growth in requests for this kind of information from our business customers. Information on broader societal impacts can also be requested as part of 'request for proposal' (RFP) processes, particularly in the public sector.

Q How has BT responded to the recent changes in relation to tax transparency in reporting?

A: During 2015/16 we undertook a review of our tax disclosures in the light of the FRC's focus in this area. We also discussed this with our Board and our Audit & Risk Committee and implemented changes which can be seen in this year's report. Additionally, BT has been engaging with the UN PRI (Principles for Responsible Investment) on the best practice tax guidance which acts as a blueprint for SRIs to engage with companies on tax. By participating in the steering group for this project with the UN PRI, we are ensuring that BT has a say in the way this is scrutinised by investors.

Q This is the second year BT has applied the Integrated Reporting <IR> approach. What prompted BT's decision to move to this format of reporting?

A: We take the view that <IR> is aligned with the legislative changes in the UK which introduced the Strategic Report and we felt that it allowed us to communicate in a more compelling and joined-up way. <IR> encourages a focus on outcomes, rather than just outputs.

When the UK Companies Act 2006 was updated to include consideration of environmental impacts within the Strategic Report, it helped us progress as we had already been slowly moving toward this approach for a few years. We raised <IR> in 2013 and 2014 with our Board and Audit & Risk Committee and then received Board and CEO endorsement to evolve our reporting in this way for 2014/15. We consider it an ongoing journey as we continue to challenge ourselves to improve the integration of broader societal and environmental impacts into our reporting, thinking and decision making.

Interview with Abigail Herron, Aviva Investors

Abigail Herron
Head of Responsible Investment Engagement

Q What do you think of the quality of disclosures on broader societal impacts (by this we mean sustainability, CSR reporting, energy and tax reporting) at present?

A: Things are moving in the right direction, having started from a low base. Reporting is getting better overall but some companies are stalling. The most encouraging sign is integrated reports. Even if companies don't produce a fully integrated report in compliance with the <IR> Framework, we are encouraged by those who are taking steps to integrate their reports – and in fact, from a UK standpoint, producing a good Strategic Report is a great start.

Environmental impact and climate change disclosures need to focus more on the link to strategy as well as outlining future plans and mega trends, rather than providing a philanthropic overview of a company's activities. Mitigation strategies also are important. There are enough companies striving ahead in this area to encourage other companies to follow suit.

The main challenge for businesses is to get across the culture of the company through their reports. They tend to err on the side of caution because of legal risk. Companies need to be brave to say what they have done and not yet tackled. Gender diversity is an example where no one has the perfect answer, so companies should feel comfortable to say they are trying different approaches.

Q When considering a company's broader societal impact, where do you look for this information?

A: We definitely look at the annual report for this information alongside various other sources, including what NGOs say, to form a rounded view.

As long as information on sustainability is accessible we are open to how and where we receive it. There is a 'holy grail' that we look for in reports – imagine a triangle with sustainability, strategy and incentives, all linked together. When this is done it is fantastic.

Investors are poor at feeding back on how we take this information into portfolio construction but we absolutely do read and use it.

Q What could companies do better to meet the needs of investors in relation to non-financial information?

A: What we look for might seem obvious but it is amazing how few companies achieve it.

Firstly, a company should identify the material environmental, social and governance (ESG) issues that have potential to affect its operation, financial health or perception by critical stakeholders. These choices should be justified and related to the health of the business as a whole.

Reporting of ESG issues should be integrated into the main narrative text within the annual report.

A simple example is the way that a power company might report its emissions intensity alongside EBITDA.

Companies should create relevant KPIs to track progress and then establish targets that are stretching, but achievable. They should include these metrics as targets in the executive annual remuneration schemes and report on progress against targets over time. KPIs should remain consistent for at least five years – ARAs should explain notable changes (positive and negative) in performance and justify re-basing/alterations where these become absolutely necessary. We encourage companies to seek independent verification of any data which might be considered material. Platitudinous policy statements or narrative that can't be backed up by evidence should be avoided.

Q Do you look to see how mega trends such as resource scarcity/technological advances impact the long term sustainability of a company?

A: Yes, it is fundamental to how we do things at Aviva; we compliment this with our engagement with companies. For example, as part of our engagement on climate change issues we have spoken to companies which have 30% revenues derived from coal. We want to know how their business models are impacted.

5.

Looking ahead

When embarking on this project we anticipated little regulatory change over the next few years. However, with the UK voting to leave the EU and a new government administration in place, this does not seem as certain. Although unlikely, the repealing of the Transparency Directive and other EU legislation could lead to a reshaping of the UK reporting framework in the medium term. While the previous business secretary had committed to a freezing of regulation on companies, including the Code, Theresa May has begun her premiership with comments about board room excesses, business accountability and trust.

Companies may need to think about how they articulate the impact of Brexit in their narrative reporting, for example, if it has an impact on the strategy or business model. This is particularly the case for companies that referenced the EU referendum as a principal risk or assumption as part of their viability statement. Remuneration is another area that may need to be considered, for example, if remuneration policy changes need to be made in response to Brexit, if targets are impacted by the economic environment and the impact on the retention and attraction of talent. Remuneration committees may also want to consider Theresa May's recent calls for more regulation and transparency over executive pay, particularly the full disclosure of bonus targets, the publication of the ratio between the CEO's pay and the average company worker's pay and the simplification of the way bonuses are paid so that the bosses' incentives are better aligned with the long-term interests of the company and its shareholders.

Notwithstanding this backdrop, in the next 12 months we expect relatively few changes to the reporting regulations and encourage companies to consolidate and improve their reports during this time. As we outlined in *Reflections on the past, direction for the future*, companies should engage with their shareholders in order to get feedback on the annual report and what can be improved for the following year. There are three main areas in which we think style of reporting is set to incrementally evolve over the coming years, which we discuss below, followed by a table which outlines more specific reporting developments that preparers should be aware of for next year.

The Investment Association Working Group's initiative to simplify executive pay

In the autumn of 2015, the Investment Association facilitated the formation of an independent Executive Remuneration Working Group to assess whether the current structure of remuneration, and in particular its complexity, was inhibiting company management from acting in the best long-term interests of companies and their investors. The final report was published on 26 July 2016. It contains ten recommendations for rebuilding trust in executive pay structures based on five underlying themes, as shown in Figure 13.

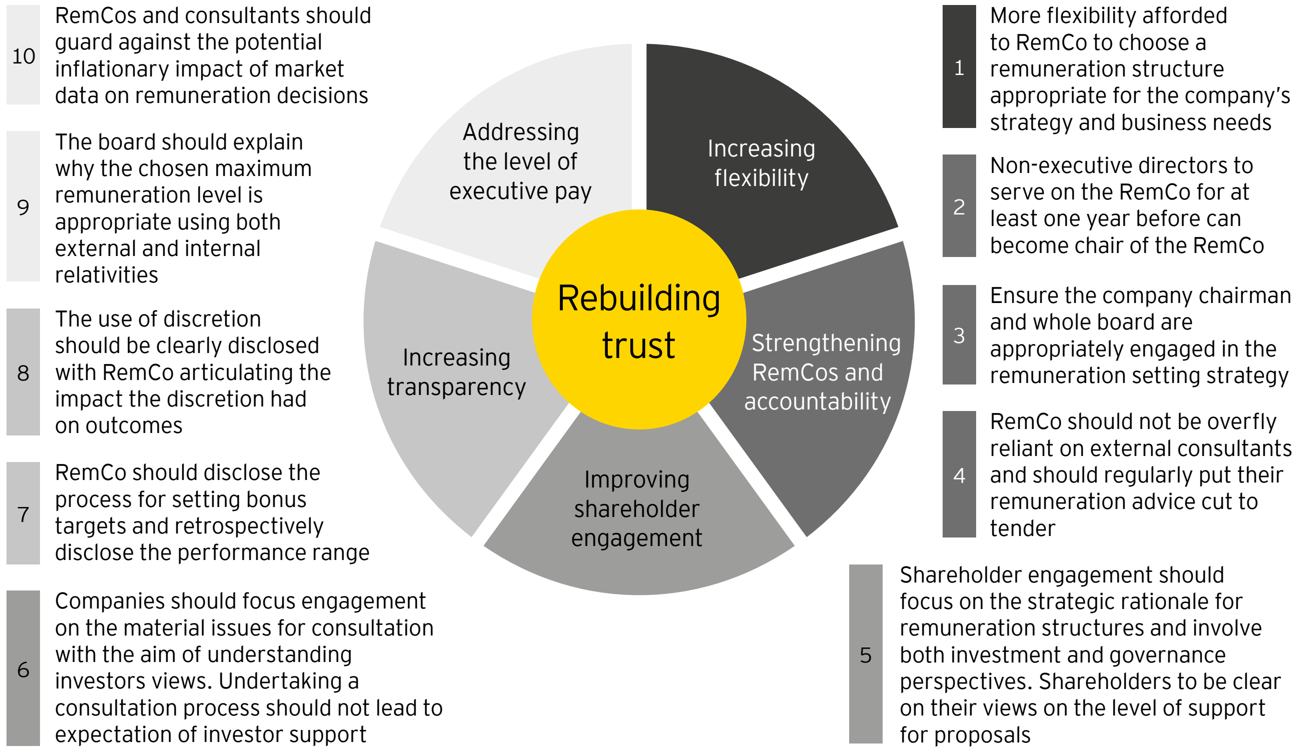


Figure 13. Ten recommendations of the Investment Association Executive Remuneration Working Group.

The Working Group recognises the need for companies to have flexibility in order to create a remuneration structure appropriate for their particular strategy and business needs. It recommends a framework as to how this might operate in practice. We expect companies to review their current remuneration policies in light of this report. However, we anticipate that the late summer publication date will mean that any recommendations are unlikely to be implemented in remuneration policies being put to shareholder vote in 2017. Companies need early and frequent engagement with shareholders when considering any changes to long-term incentives arrangements.

Digital reporting

The Financial Reporting Lab launched its project *Corporate Reporting in a Digital World* in 2014, resulting in the publication of *Digital Present*[23] in 2015 discussing the current use of digital media in corporate reporting. Activity continues, with the Lab's June 2016 call for participation in a project called *Digital Future: Data*[24], looking at how technology trends might drive future changes in corporate reporting and how transformation of reporting formats might be optimised by investors and companies. The Lab expects to publish initial outputs by the end of 2016.

We note that increasing numbers of companies are including web-based versions of their annual report, embedded in their website, with the option to download separate PDFs. Users of ARAs remain divided between those who like to use a hard copy and those who prefer an online version. At present, many UK companies produce both a fully designed PDF and a web-based condensed version of the annual report. Companies in some other countries, such as Germany, are moving toward more web-based versions of their annual report and then creating a simple, text-only full PDF version. It will be interesting to hear the feedback the Lab obtains and to see where this debate takes us in the UK.

Integrated Reporting

While few companies in our sample prepared their ARAs under the <IR> Framework, we saw an increase in companies influenced by or moving towards integrating reporting by, for example, referencing some 'capitals' as inputs to their business models. Investors we have spoken to, including Abigail Herron and Mike Everett in their interviews for this report, view this is as a move in the right direction.

In our view companies do not necessarily have to go the whole hog and report under the <IR> Framework. Producing a Strategic Report that clearly links the business model, strategy, KPIs, risks and remuneration goes a long way to producing an integrated, user-friendly report. Where sustainability and other non-financial measures are vital to the business, they should be appropriately reported and intertwined in the Strategic Report. Most important to us – and commensurate with the <IR> Framework – is that companies adopt integrated thinking and communication, which can lead to better business practices, with better reporting as an ultimate outcome.

[23] Financial Reporting Lab, *Lab project report: Digital present*, May 2015.
[24] Financial Reporting Lab, *Call for participation – your opportunity to get involved in the Digital Future*, June 2016.

Reporting developments

This table is intended to serve as a prompt for companies on the upcoming changes that are likely to affect corporate reporting in the broadest sense (either in the ARA or other channels). It does not contain full detail under each development and we recommend preparers refer to and review source documents for fuller detail and completeness.

Companies need to start preparing for (or should have already prepared for) …

Regulatory development, scope of entities affected and source	Mandatory disclosure within the ARA?	Effective date	Comments and practical considerations
Annual slavery and trafficking statement Entities affected: Organisations with a turnover, or group turnover of £36 million or more which are either incorporated in the UK or carry on a business in the UK. Source: UK Government (The Modern Slavery Act).	No, should be published prominently on the website	Years ending on or after 31 March 2016 Statement must be produced within 6 months of year end	This statement must describe the steps that an organisation has taken to ensure that slavery and human trafficking are not taking place in any of its supply chains or its own business, or it must disclose that the organisation has taken no such steps. Detailed Government Guidance is available from: https://www.gov.uk/government/publications/transparency-in-supply-chains-a-practical-guide. In case of benefit to companies who are yet to prepare and publish their first statement, some March 2016 year-end reporters have already published their first statements. The Business & Human Rights Resource Centre is currently maintaining a public record of companies' statements: https://business-humanrights.org/en/registry-of-slavery-human-trafficking-statements-under-uk-modern-slavery-act
Guidelines on Alternative Performance Measures (APMs) Entities affected: Applicable to issuers of securities on a regulated market and to preparers of prospectuses. Scope includes APMs contained: ‣ Outside the financial statements in ARAs (essentially the front half) ‣ In half-yearly reports and preliminary announcements ‣ In other regulated information e.g. in ad-hoc communications, such as RNS announcements and press releases Source: European Securities and Markets Authority (ESMA).	Yes, to the extent APMs are presented in the front half of an ARA Note that IAS 1 (revised) covers the presentation of non-GAAP measures in financial statements	Documents in scope published after 3 July 2016	The Guidelines replace the previous 2005 CESR Recommendation. They are consistent with the FRC Guidance on the Strategic Report and a Financial Reporting Review Panel press notice issued in 2013 on the presentation of exceptional items. In particular, the Guidelines mandate that: ‣ APMs are presented consistently over time (with any changes in explained) ‣ APMs are presented with no more prominence than GAAP measures. ‣ An explanation for the use of the APM (to allow users to understand its relevance and reliability) is provided ‣ The description of an APM is clear, meaningful and not misleading (e.g. are items truly non-recurring?) ‣ The definition of an APM (including its basis of calculation and key assumptions) is disclosed ‣ APMs should be reconciled to GAAP measures While consistent with previous or other current guidance noted above, a key change is the enforcement of the Guidelines. In the UK, this will be performed by the FCA and the FRC and companies must comply on an every effort basis. As well as the ESMA Guidelines preparers should refer to the frequently asked questions issued by the FRC: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FAQs-ESMA-Guidelines-on-Alternative-Performance-M.pdf

Companies need to start preparing for (or should have already prepared for) …

Regulatory development, scope of entities affected and source	Mandatory disclosure within the ARA?	Effective date	Comments and practical considerations
New audit committee (AC) report disclosures Entities affected: Entities subject to the UK Corporate Governance Code. While boards are not required to follow this guidance, it is intended to assist them when implementing Section C3 of the Code. Source: FRC *Guidance on Audit Committees* April 2016.	Yes	Financial periods commencing on or after 17 June 2016	The FRC updated its *Guidance on Audit Committees* largely to implement the EU Audit Reform. Before companies consider the disclosure aspects, some of the changes necessitate more substantial underlying changes e.g. to AC processes, operation and composition and companies and ACs should plan ahead for these. New disclosures[25]: ‣ How the AC composition requirements have been addressed, and the names and qualifications of all members of the AC during the period, if not provided elsewhere ‣ How the AC's performance evaluation has been conducted ‣ The current external audit partner name, and for how long the partner has held the role ‣ Advance notice of any retendering plans ‣ If the external auditor provides non-audit services, the committee's policy for approval of non-audit services ‣ Audit fees for the statutory audit of the financial statements ‣ Fees paid to the auditor and its network firms for audit related services and other non-audit services, including the ratio of audit to non-audit work ‣ For each significant engagement, or category of engagements, explain what the services are and why the AC concluded that it was in the interests of the company to purchase them from the external auditor ‣ An explanation of how the committee has assessed the effectiveness of internal audit and satisfied itself that the quality, experience and expertise of the function is appropriate for the business ‣ The nature and extent of interaction (if any) with the FRC's Corporate Reporting Review team

[25] Recommended rather than mandatory by virtue that they are contained in the *Guidance on Audit Committees*

Companies need to start preparing for (or should have already prepared for) …

Regulatory development, scope of entities affected and source	Mandatory disclosure within the ARA?	Effective date	Comments and practical considerations
Publication of tax strategy Entities affected: Groups with a turnover in excess of £200m or a Balance Sheet total in excess of £2bn in the previous year. UK subsidiaries if the turnover of the global group to which they belong is in excess of €750m. Source: UK Government (HMRC).	No	Before the end of the first financial year commencing after Royal Assent of Finance (No. 2) Bill 2016, so for a December year end, by 31 December 2017	See page 45 in Section 4 on Broader Societal Impacts for full details.
Extended scrutiny over the Strategic Report A combination of the two factors below may lead to increased scrutiny of Strategic Reports: ‣ A change in the auditor's opinion over the Strategic Report to include an affirmative statement that it has been prepared in accordance with applicable legal requirements ‣ An extended focus on the Strategic Report by the Corporate Reporting Review team (of the FRC) e.g. to consider whether Strategic Reports are consistent with the ESMA Guidelines on APMs.	No	Ongoing	When producing Strategic Reports, companies should be aware of the gradual incremental shifts in regulatory, investor and auditor scrutiny.

Companies to keep a watching brief on …

Regulatory development, scope of entities affected and source	Mandatory disclosure within the ARA?	Effective date	Comments and practical considerations
EU Non-Financial Reporting Directive (NRFD) Entities affected: Any large undertaking that is a Public Interest Entity (PIE), with an average of 500 employees and that: ‣ Issues transferable securities that are admitted to trading on a regulated market in the EU; or ‣ Is a credit institution (a bank or building society, though not a credit union); or ‣ Is an insurance undertaking; or ‣ Is designated by a Member State as a public interest entity (for instance because of its business, size, or the number of its employees) Source: EU, as implemented by UK Government (Department for Business, Energy and Industrial Strategy) and FCA via Disclosure and Transparency Rules.	Yes	Financial years commencing on or after 1 January 2017	Despite the Brexit vote, this will be implemented in the UK. The impact of the EU NFRD depends on how the new government implements the EU NFRD, including its approach to quoted companies with less than 500 employees but which under current UK company law produce an expanded Strategic Report. While the UK is at the forefront of non-financial reporting especially following the introduction of the Strategic Report in 2013, the scope and emphasis in wording of the EU NFRD must be borne in mind. Many of the new disclosures are similar to those required in the expanded disclosures for quoted companies in the Strategic Report although new items potentially include: ‣ Reporting on anti-corruption and bribery issues ‣ Giving information on due diligence processes over non-financial information as part of the description of policies ‣ Explaining why, if the entity does not have a relevant policy ‣ For large PIEs with shares on a regulated market, mandatory disclosure of a board diversity policy including objectives, details of implementation and the results[26] (currently being consulted upon by the FCA[27] as an amendment to DTR 7) ‣ Broader consideration and disclosure by companies of principal risks arising from environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters The former Department of Business Industry and Skills consulted on the implementation of the EU NFRD in February 2016. However following a change in government the timing and next steps are unclear and companies need to keep a watching brief on this.
Gender pay gap Entities affected: Organisations with at least 250 employees. Source: UK Government Equalities Office, The Equality Act 2010 (Gender Pay Gap Information) Regulations (draft)	No	The EU referendum result casts some doubt over the proposed timeframe. However the Government Equalities Office has indicated that it remains committed to enacting the regulations. These require employers to take a snapshot of their data in April 2017 and publish it by April 2018. Companies should keep a look out for the final enacting regulations.	
Payment practices Entities affected: Large private companies, large limited liability partnerships and large listed companies (as defined in the Companies Act 2006). Source: UK Government (Small Business, Enterprise and Employment Act 2015).	No, proposals were for this information to be published on a single central website	The proposals are to require reporting on payment practices including standard and average payment terms semi-annually. Secondary implementing legislation is needed under the Small Business, Enterprise and Employment Act 2015 and progress seems to have stalled. Companies should therefore keep a watching brief on this.	

[26] Currently similar disclosure is required on a comply or explain basis for Code reporting entities, however the EU NFRD requirements cover a broader set of entities and are more detailed.

[27] FCA CP16/17: Quarterly Consultation Paper No. 13

Concluding remarks

Compared to recent years, it seems that preparers will have to contend with a relatively small number of substantial developments for their 2016/2017 ARAs. In our view this provides a window of opportunity for companies to reflect upon and embed some of the more recent reporting changes, for example, risk and viability disclosures.

Furthermore, it is an opportunity to evolve and adapt reporting in a rapidly changing business and economic world. Political, investor and regulator interest in issues such as culture, cyber, digital disruption and the broader societal impacts of business creates a new set of challenges for preparers of annual reports to communicate how they are tackling these issues. We look forward to continuing to track how annual reporting in the FTSE 350 evolves to reflect how companies are addressing the issues of the moment as well as preparing for the future.

Appendices

Appendix A: Aide mémoire

This aide mémoire will help you think about key considerations and challenges as you start planning and drafting your next annual report. These reflect our hallmarks of leading practice as disclosed in our previous report, *Annual Reporting in 2014: reflections on the past, direction for the future*, with some updates to reflect changes following new requirements.

ARA content	Notes and actions
Fair, Balanced and Understandable	
• Structure your ARA to aid effective communication of key messages, reduce repetition and tell a story. Innovate the structure to achieve this • Create meaningful links between the business model, strategy, KPIs, principal risks and remuneration • Disclose the processes or measures used by the board to conclude that the ARA is FBU and the outcomes from that process e.g., resultant changes made to the ARA • Ensure consistency and balance between narrative reporting and financial statements, as well as across different sections of the narrative report • Move 'standing' information in the narrative to the back of the ARA or to the website (regulation and law permitting) • Consider whether the Directors' Report could be placed at the back of the ARA • Ensure that alternative performance/non-GAAP measures are clearly reconciled to GAAP measures and there is balance in how performance is described using these two measures	
Strategic report	

Business model
• Ensure that the business model description:
  • Explains in simple and clear language how the company makes money
  • Clearly explains the key inputs, processes and outputs in the value chain, and how key assets (including its people, technology, etc.) are engaged in the value chain
  • Provides insight into investment and revenue streams in relation to different parts of the business or different phases of development
  • Provides a comparison between the company's business model and those typically used in the sector and articulates why management believe their model is most effective
  • Articulates how the business model will help deliver the strategy	

ARA content	Notes and actions

Strategy
• Ensure that the narrative on strategy:
  • Is company-specific and contains clear expression of how strategy will be achieved and implemented (strategic objectives)
  • Articulates both short and long-term strategic objectives
  • Is clearly linked to strategic objectives, KPIs, principal risks and remuneration
  • Describes how the global environment, market trends or industry context impact the strategy and the strategic objectives
  • Explains what makes and sustains the competitive advantage of the business in relation to others in the industry
• Where additional 'concepts' such as purpose, vision, mission, or values are used alongside the strategy, clarify the way in which they fit together, and are put into operation	

Key performance indicators (KPIs) • Ensure KPIs are company specific and are based on a broad set of financial and non-financial measures • Explain how the KPIs specifically help measure progress against the strategic objectives as well as why each one was chosen • Show which KPIs are linked to executive variable remuneration • Disclose targets for each KPI and report performance against those targets in a balanced and transparent manner • Disclose KPI performance data over a number of years (e.g., 3-5 years) in order to show trends • Explain changes to KPIs or their calculation if relevant • Ensure that the performance review section (i.e. the narrative) provides context for actual performance in respect of KPIs	
Principal risks • Ensure that the principal risks disclosed are specific to the company (e.g., by providing detail on which specific areas of the business are most affected) • Indicate whether the risk has changed from prior year (e.g., increased or decreased) or is new • Clearly explain the principal risks that may affect the ongoing business model, solvency and liquidity of the company and how they are being mitigated • Provide detail on risk appetite for each risk and how this is monitored by the board	
Risk management and internal controls • Explain how the principal risks are mitigated and controlled by the company's systems of internal controls and risk management and how the board monitors these systems • Explain what the board's review of the effectiveness of these systems encompassed • Disclose whether the board identified any significant failings or weaknesses • Define the basis used for determining what is 'significant' • Explain the actions that have been or will be taken to address significant failings or weaknesses	

ARA content	Notes and actions

Viability statement

- Avoid boilerplate. Disclosures should be clear on the:
  - Timeframe that the board considered the viability of the company over and why
  - Process board developed and implemented to assess viability including disclosure of scenarios used to test solvency and liquidity with quantification of those scenarios if relevant
  - Assurance board obtained over relevant elements (e.g., stress testing)
  - Assumptions the board used in reaching their conclusion with quantification if applicable
- Explain how directors assessed the company's prospects, i.e. what the robust assessment of principal risks consisted of not simply that an assessment was carried out
- Consider positioning and flow of linked disclosures i.e. those relating to principal risks, going concern and the viability statement
- Cross-reference disclosures which are related e.g., financial statement disclosures on capital management required under IFRS

Governance report

Explanations for non-compliance

- Ensure explanations for non-compliance with the Code:
  - Are specific as to which element of the Code has not been complied with
  - Illustrate how actual practice is consistent with the underlying spirit of the relevant Code Provision and contributes to good governance and the delivery of business objectives
  - Describe mitigating actions taken to address any additional risks that may have arisen as a result of non-compliance
  - Are clear on when the company expects to be in compliance with the Code Provision (where non-compliance is intended to be time limited)

Board evaluations

- Describe the board devaluation strategy spanning the three-year evaluation cycle, including external evaluations
- Explain the performance evaluation process, any significant recommendations or actions taken and changes or improvements that the board has committed to following an evaluation
- Provide transparent and balanced disclosure on areas for improvement identified in an evaluation

Shareholder engagement

Ensure that descriptions of how the company has engaged with shareholders:

- Provide context e.g., description of the shareholder base in terms of size and geography or the voting record from the last AGM
- Indicate whether the company has been proactive in reaching out to and engaging with shareholders in the year
- Explain what matters were discussed with shareholders and the feedback received
- Detail the actions, if any, that have been taken as a result of engagement
- Specify who (e.g., which board members) met with shareholders during the year
- Describe other methods of shareholder engagement (e.g., surveys or written feedback) in addition to meetings and presentations
- Clearly describe the actions the company intends to take to understand the views of shareholders when there have been a significant percentage of votes against a given resolution at a general meeting

ARA content	Notes and actions

Nomination committee report

- Provide sufficient disclosure on board composition and board succession planning to provide assurance that they are being managed to deliver the long term strategy
- Consider providing an overview of when directors are due to leave the board, and the resultant skills gaps that will need to filled
- Provide insight on the robustness of board level recruitment and selection processes including whether a search firm was used, the skills and experience that were sought and why the successful candidate met the criteria set
- Explain how the committee creates and supports board diversity in practice
- Articulate the skills and experience of each board member and how they will help the company/board, as opposed to a list of previous roles held
- Describe the initiatives that are in place to develop the next cadre of senior management and an indication of whether emergency succession plans are also in hand

Audit committee report

- Consider a separate report within the governance section introduced by the audit committee chairman
- Use active language throughout focussing on activities in the year, actions and outcomes rather than generic process and role descriptions
- In relation to significant issues considered by the committee:
  - Clearly explain what the issue is and how it is relevant to the company and its circumstances (including an amount where relevant)
  - Articulate the audit committee's specific actions in addressing the issues including, e.g., specific concepts that were challenged and debated, resources or points of reference that were used and/or areas in which further information was requested
  - Provide insight as to whether any third-party evidence or assurance was received by the audit committee to address a significant issue
  - Be prepared to explain why the significant issues considered by the committee do not align with the risk areas identified in the auditor's report
  - Consider separating issues which are recurring in nature from those that are specific to the year in question
- In relation to describing how the committee assessed the effectiveness of the audit process:
  - Disclose both how the assessment was undertaken (i.e. the process) as well as the criteria and evidence considered in making the assessment
  - Ensure disclosure describes the how the effectiveness of the audit process was assessed holistically and not just in relation to the auditor
  - Explain any changes in the assessment compared to prior years e.g., new areas of focus

ARA content	Notes and actions
Remuneration committee report	
• Ensure that the remuneration committee chairman's introduction is impactful, insightful and linked to the narrative on performance throughout the rest of report • Ensure that there is a clear link (e.g., by use of graphics) between the KPIs that drive variable executive pay and those that are used to measure the delivery of the strategic objectives • Clearly articulate how the remuneration policy is designed to drive execution of business strategy and long-term performance • Provide context for the variable remuneration rewards in the year clearly describe whether targets were met and what was paid • Highlight key information clearly to minimise excessive cross referencing to various tables and notes • Ensure any changes to remuneration arrangements are clearly described • For the ease of shareholder understanding, best practice guidelines recommend that the remuneration policy table should be disclosed in the remuneration report annually, even when not subject to vote at the AGM.	
Financial Statements	
• Highlight any changes in significant accounting policies • Ensure consistency of judgements and estimates and segmental analysis notes within the financial statements with the Strategic Report • Ensure consistency and balance between the financial statements and the narrative of the rest of the report • In the spirit of FBU, consider re-ordering and/or grouping of disclosure notes • Consider presenting the CFO's review or performance summaries within the financial statements • Review the financial statements for opportunities to cut clutter, e.g., by removing unnecessary policies, or conducting an assessment of materiality • Where judgement is exercised to remove immaterial disclosure items briefly explain the basis for doing so (unless rationale is clear)	
Tax	
• Explain how the company is monitoring the changing regulatory landscape in relation to tax in particular given the forthcoming Actions under BEPS. • Consider explaining the company's overall approach to tax, attitude to tax planning and tax strategy including commentary on tax risks. This particular requirement will become mandatory for accounting periods beginning after Royal Assent of the Finance (No.2) Bill 2016 for companies of a certain size. • In relation to uncertain tax positions, explain the nature and the amount of the uncertainty with particular reference to IAS 1 paragraphs 125 to 129. • Consider drawing upon global tax footprint information to ensure a consistent story is given to all stakeholders in particular in light of forthcoming Country by Country Reporting requirements.	

Appendix B: Interviewee biographies (in order of appearance in the report)

The Financial Reporting Lab

Carl Renner

Carl joined the Lab in late 2013. He has over 17 years of experience in accounting professional services firms in Sydney, Tokyo and for the last 11 years, in London. He has led audits of small to large listed companies in a variety of sectors and due diligence assignments on medium to very large transactions. Carl qualified as a Chartered Accountant in Australia. Carl is currently leading the Lab's series of projects on Business model reporting, Principal risk reporting, and Viability reporting and Clear & Concise reporting case studies. Previously, he led the Lab's project on Accounting policy disclosure and co-led the project on *Disclosure of dividends – policy and practice.*

Thomas Toomse-Smith

Thomas is Project Director of the Financial Reporting Council's Financial Reporting Lab. Thomas led the Lab's 'Towards Clear and Concise Reporting' project and is now leading the 'Corporate Reporting in a Digital World' project looking at how the use of digital reporting might be optimised in the future. Before joining the Lab, Thomas worked in the Corporate Reporting team at a FTSE 100 company for 2 years. Prior to this he worked in insurance audit for 10 years both in the UK and the US. Thomas is a UK Charted Accountant.

Standard Life Investments

Mike Everett, Governance & Stewardship Director

Mike moved to his role as Governance and Stewardship Director in October 2012. In this role he works as part of the Governance & Stewardship team to protect and enhance the value of clients' investments through the analysis and mitigation of governance risk. He also has specific responsibility for addressing the implications of changes to public policy for Standard Life Investments and its clients.

Fidelity International

Jed Wrigley ACA. MA (Oxon.)

Jed joined Fidelity International (FIL) in 1993 as an Equity Analyst covering a number of sectors including industrials and insurance in Europe. From 1996 to 2005 Jed managed UK Equity mandates, investing in all sectors of the market. He became Director of Accounting and Valuation in 2006 and was responsible for implementing a standardised valuation and modelling framework for the equity research team until 2008. He has served on a number of advisory committees as an expert user for IASB, FASB, CBI and EFRAG as well as being an active participant in CRUF.

Jed currently has two primary roles at FIL firstly acting as a fund manager within a team delivering a new range of institutional global equity portfolios and secondly as fund manager for Eight Roads, the proprietary investing division of FIL with assets deployed in property, venture capital, non-financial services businesses and listed equities. He sits on the investment committees for our property holdings and private equity funds invested in Europe, India, China and the USA. He chairs several Quarterly Fund Review meetings where he meets with fund managers to discuss fund performance, structure, process and risk. He has served as one of the pension trustees for FIL since 2008.

BT plc

Richard Marsh

As reporting and insight director for sustainability, Richard is responsible for running the reporting that helps to underpin BT's 2020 ambitions in the focus areas of creating a connected society, supporting charities and communities and delivering environment benefits. Richard's background has spanned a number of operational roles and delivery roles in the telecommunications sector.

Jenny Harrison

As Director, External Reporting for BT Group, Jenny is responsible for accounting policy, global processes and Sarbox compliance across the group. Her role covers the quarterly results release publications and she works alongside corporate governance and investor relations, as well as with colleagues across the business, to produce BT's annual report. Jenny previously spent over 15 years in practice covering roles across audit and advisory, transactions and sustainability and worked closely with government and industry to develop a response to carbon disclosure and integrated reporting.

Aviva Investors

Abigail Herron

Abigail leads responsible investment and corporate governance engagement across all asset classes and markets at Aviva Investors. She compliments this work with public policy advocacy in the UK, EU and UN on a spectrum of issues from capital markets through to the sustainable development goals and green bonds. Abigail sits on the ICAEW Corporate Governance Committee, is a chartered company secretary and a Fellow of the ICSA, a member of the Chartered Institute for Securities & Investment (CISI) and a Trustee of the Chartered Secretaries' Charitable Trust.

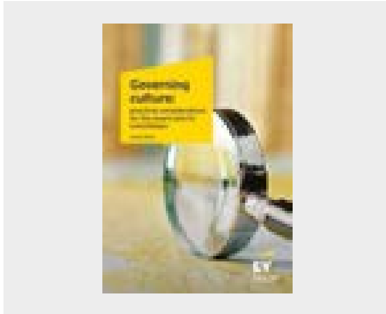
A team of approximately 15 EY professionals, led by the Corporate Governance team and including professionals from our remuneration, tax, climate change and sustainability practices, conducted a comprehensive review of ARAs.

The sample consisted of 100 ARAs of FTSE 350 companies with September 2015 to March 2016 year-ends. The sample was weighted: 43% FTSE 100 and 57% FTSE 250 companies. Our sample covered a range of industries that broadly reflects the composition of the FTSE 350, other than excluding investment trusts and mutual funds.

Our research compiled qualitative and quantitative findings on a broad range of measures and key themes which we present throughout this report alongside recommendations for leading practice. Where we have seen examples of leading practice from outside our sample, we have also included reference to these.

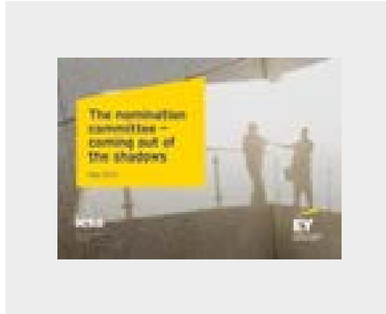
Appendix D: Other recent reports by the EY Corporate Governance team

Contact us for hard copies of any of these reports or visit our website to download them: http://www.ey.com/corporategovernance



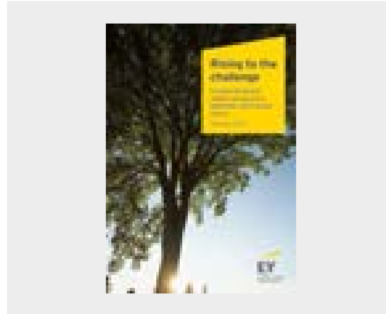
June 2016

Governing culture: practical considerations for the board and its committees helps boards and committees address the impact of organisational culture by providing questions that can be used to ensure that a consideration of culture is embedded in their decision-making and oversight.



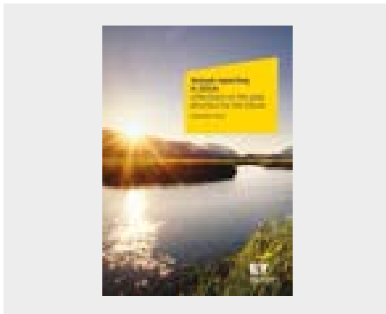
May 2016

The nomination committee - coming out of the shadows, produced in partnership with ICSA: The Governance Institute, focuses on the role of the nomination committee and how boards can improve its work. The report is based on a series of roundtable discussions that we facilitated with board chairmen, nomination committee chairmen and members, and company secretaries from over 40 listed companies (predominantly FTSE 350).



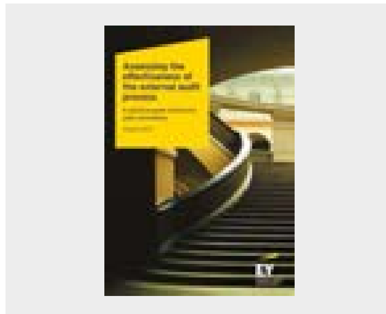
January 2016

Rising to the challenge: a review of risk and viability disclosure in September 2015 annual reports analyses the first batch of annual reports required to comply or explain under the 2014 UK CG Code provisions on risk and the viability statement. The report is based on a sample of 14 annual reports. It provides insight on emerging trends and leading practices.



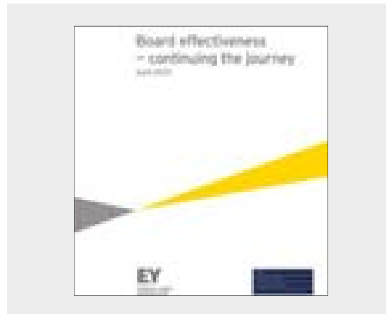
September 2015

Annual reporting in 2014: reflections on the past, direction for the future highlights trends, developments, and opportunities for improving annual reports and accounts in order to better communicate with the investor community. It sets out hallmarks of good reporting and includes case studies of leading practice.



August 2015

Assessing the effectiveness of the external audit process is a guide and tool to help audit committees assess and report on the effectiveness of the external audit process. This tool takes into account the FRC's guide *Audit Quality: Practice Aid for Audit Committees* issued in May 2015.



April 2015

Board effectiveness - continuing the journey is based on a series of individual meetings and roundtables which brought together leading chairmen, board directors and senior investors to debate the issue of board effectiveness. The report draws on the contributions from these discussions and is supplemented by insights and perspectives from EY and The Investment Association.

Appendix E: EY contacts

	If you want to know more about..	EY contacts		
Corporate Governance	‣ Perspectives and trends in governance including the views of investors ‣ Board composition and effectiveness ‣ Leading practices in annual reporting including narrative and governance reporting ‣ Future developments in governance and public policy	**Ken Williamson** **Andrew Hobbs** **Mala Shah-Coulon**	kwilliamson@uk.ey.com ahobbs@uk.ey.com mshahcoulon@uk.ey.com	+ 44(0) 20 7951 4641 + 44(0) 20 7951 5485 + 44(0) 20 7951 0355
Tax Accounting and Risk Advisory Services	‣ Design or review of tax risk management frameworks ‣ Developing or refreshing tax policy or strategy to enhance governance ‣ Design, review and implementation of tax data and technology strategies ‣ Assurance over Senior Accounting Officer certification ‣ Review of tax processes and controls, including over voluntary tax disclosures ‣ Tax accounting and reporting services	**Mandy Pachol**	mpachol@uk.ey.com	+ 44(0) 20 7951 7092
Performance and Reward	‣ Executive remuneration including policy design, governance and reporting ‣ Incentive design for executive, management and all employee populations including equity incentives ‣ Share plan implementation in the UK and internationally, including addressing regulatory and tax matters ‣ Remuneration benchmarking and market surveys	**Isobel Evans**	ievans@uk.ey.com	+ 44(0) 20 7951 3113
Climate Change and Sustainability Services	‣ Sustainability strategy assessment and implementation ‣ Environment, health and safety risk ‣ Sustainable supply chains ‣ Sustainable finance solutions ‣ Integrated reporting and sustainability report assurance	**Doug Johnston**	djohnston2@uk.ey.com	+ 44(0) 20 7951 4630
Energy Optimisation Practice	‣ Delivering energy cost reduction programmes and energy heatmaps ‣ Implementing renewable power purchase agreements (PPAs) or green tariffs with developers and suppliers ‣ Delivering on-site and near-site renewable energy solutions ‣ Sourcing funding for renewable energy or energy efficiency projects and developing implementation roadmaps	**Richard Tarboton**	rtarboton@uk.ey.com	+ 44(0) 20 7951 0490

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