Corporate Governance

Key developments

This briefing is the **fourth** in our series of briefings on corporate governance and is designed to provide a synopsis of topical corporate governance matters impacting companies in the United Kingdom. This briefing tracks the development of certain matters identified in our **first**, **second** and **third** briefings and outlines new matters of interest.

This briefing focuses on key matters arising since the last newsletter 6 months ago. If you would like further details on a topic, please contact a member of our Public Company Advisory ("**PCA**") team, whose details can be found at the end of this briefing.

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FRC Annual Enforcement Review

The FRC published its fourth Annual Enforcement Review.

July 2022

On 28 July 2022, the FRC published its fourth Annual Enforcement Review ("**AER**"), setting out its key observations arising from audit investigations carried out by the FRC for the year ended 31 March 2022. At a glance, the AER highlights that:

- there are 47 current investigations;
- 15 investigations into auditors, accountants and/or actuaries were opened during the year;
- 24 cases were resolved through "Constructive Engagement";
- 13 cases were resolved with settlement;
- 1 case was resolved through tribunal proceedings;
- 3 cases were resolved with no further action;
- £46.5 million in financial sanctions (before settlement discount) were issued;
- There was a 23% growth in the FRC's Enforcement Division;
- Recurring themes in investigations included a lack of scepticism and insufficient audit evidence; and
- The tribunal's report on Silentnight highlighted failures to act with honesty, integrity and objectivity.

Overall, the AER highlights that, whilst the number of cases opened during the year was down by 27%, the FRC has shown an increased capacity and willingness to pursue large and complex audit investigations and has applied a more tailored and cooperative approach to the resolution of cases referred to it. In particular:

- Although fewer cases were dealt with during the year as compared with the previous year, more sanctions were issued, and a higher proportion of such sanctions were non-financial, reflecting the FRC's focus on tailoring sanctions in order to more effectively help deter repeat offending:
  - During the year, the FRC imposed 87 individual sanctions, 25 of which were financial (e.g. fines or waivers of client fees) and 62 of which were non-financial (e.g. reprimands or exclusion from membership of professional bodies). This represents a significant increase (more than 100%) for the year when compared with the previous year's eight financial sanctions and 25 non-financial sanctions.
- The FRC has continued to focus on developing the "Constructive Engagement" process as an effective and efficient alternative to the escalation of cases to investigation where appropriate. This process involves cooperation between the firm subject to the referral and an appointed Case Examiner, sometimes with the assistance of an independent team appointed by the firm, followed by agreement on appropriate remedial actions.
- The FRC's Enforcement Division has grown by 23% in order to support its increased investigation activity.

The activity reported in the AER is reflective of the increased oversight and enforcement role that the FRC is adapting itself to in anticipation of its transition to a more active and more empowered regulatory body to be known as the Audit, Reporting and Governance Authority ("**ARGA**"). The growth and increased action by the FRC was signalled in its Three-Year Plan 2022-2025 (see the **third** of our briefings on Corporate Governance Key Developments). Whilst the AER focuses on statistics relating to investigations concerning audit practices, it provides an insight as to the increased regulatory scrutiny that organisations can expect from the newly empowered FRC / ARGA over the coming years.

The FRC also takes the opportunity in the AER to reiterate the fundamental requirements of integrity and objectivity. The AER notes that, out of 12 audit investigations which involved FTSE or AIM-listed companies and which resulted in sanctions being issued, ten concerned auditors who failed to obtain sufficient appropriate audit evidence performed parts of the audits without sufficient professional scepticism and/or failed to document their workings properly. The FRC accordingly reminds us in the AER that the purpose of an audit is to give reasonable assurance to users of the financial statements that the amounts and disclosures contained are not materially misstated, and emphasises throughout the AER the importance of objectivity and integrity in audit.

As for future areas of focus, the FRC flags that it will be paying particular attention to the impact of risks and uncertainties from climate change and geopolitical events on the work of preparers, auditors and actuaries and, in particular, will be focusing on deficiencies in areas where other parts of the FRC have issued commentary and guidance.

Next steps:

- Audit firms may benefit from revisiting the less technical aspects of their training and emphasising the merits of approaching audit with scepticism, objectivity and integrity.
- Preparers, auditors and actuaries should have close regard to the various pieces of guidance concerning auditing, governance and reporting practices issued by the FRC and cross refer to these when carrying out their work to ensure no material gaps or omissions are made which may later be picked up by the FRC's own audit.

Companies House Corporate Plan

The Companies House Corporate Plan 2022-2023 outlines how Companies House intends to achieve the strategic goals set out in Companies House Strategy 2020-2025.

July 2022

On 26 July 2022, Companies House published its Corporate Plan 2022-2023, in which it outlines how it intends to progress during the next year towards the strategic goals set out in Companies House Strategy 2020-2025. This plan marks the beginning of year 3 of the 5-year strategy and sets out the following strategic objectives:

1. **Maintaining registers and data that inspire trust and confidence:** Further improvements will be made to confirmation statement compliance processes, improving data quality, increasing the role of data analytics in enforcement and data sharing where possible and to improve its data accuracy and verification checks.
2. **Maximising the value of the company registers to the UK economy:** Further improvements will be made to search and reporting interfaces for users, including to further enhance 'advanced search' functions. Data will also be made more readily available and proactively shared across other areas of government in order to assist its decision-making.
3. **Combating economic crime through use of analysis and intelligence:** In anticipation of the changes to be rolled out under the Economic Crime (Transparency and Enforcement) Act, Companies House has developed the Register of Overseas Entities (see item 9 of this briefing) and plans to 'step up' its intelligence and enforcement activities (e.g. using data science and digital research to leverage information held through the register and making this available to law enforcement partners through Companies House's intelligence hub).
4. **Great user experience:** Companies House will continue to move existing services to new technology platforms (including to improve systems relating to, e.g. online confirmation submission, director appointment and payments) with a view to continuing to provide good customer service.
5. **A culture which drives high performance:** Companies House intends to fully embed its three-pronged operating model (company filing; company information; and intelligence and enforcement), overhaul its approach to recruitment and retention, including to implement various employee development programmes and introduce profession-specific development interventions and a longer-term talent management approach, and refresh its rewards and benefits package to reflect new ways of working.
6. **Delivering value through efficient use of resources:** Companies House intends to keep expenditure within delegated limits, improve the efficiency of its internal systems and processes, encourage and support flexible ways of working and develop effective working relationships across government and with other stakeholders.

Companies House also recognises that it has a part to play in reducing its environmental footprint and to help contribute to the UK's net zero targets by 2050, noting in particular that it intends to:

- Continue to integrate positive environmental outcomes into its corporate plan;
- Continue to develop government commitments on tackling climate change;
- Implement and report its progress on implementing the Greening Government Commitments ("**GGCs**");
- Monitor and subsequently reduce its environmental impact in line with its strategy; and
- Continue to identify and introduce processes that will significantly improve its own environmental performance, and services that will help customers to reduce the environmental impact of transacting with Companies House.

Next steps:

Companies might wish to check that their recent filings and company information is complete and up to date. Inconsistencies may be queried by Companies House as it tightens its oversight and checks of company registers.

Further information:

- Click **here** for Companies House Corporate Plan 2022-2023.
- Click **here** for Companies House Strategy 2020-2025.

FCA and FRC Reviews of Climate-Related Disclosures by Premium Listed Companies

The FCA and the FRC have each published findings from their respective reviews of climate-related disclosures by premium-listed companies in their annual financial reports.

July 2022

On 29 July 2022, the FCA published its "Review of TCFD-aligned disclosures by premium listed commercial companies" (the "**FCA Report**") and the FRC published its "Report: Thematic review of TCFD disclosures" (the "**FRC Report**"). The FCA and FRC have carried out their reviews in order to assess "*how far [their] regulatory intervention has resulted in a material improvement in both the completeness of reporting and consistency with the TCFD's recommendations, recommended disclosures and accompanying all-sector guidance…*". The FRC and FCA each reported that premium-listed companies had made good progress in the quality of their climate-related disclosures. However, each report identified a number of weaknesses, which in-scope companies should address in their next round of annual report disclosures.

However, the FCA Report also acknowledges that the TCFD Recommendations are not a corporate reporting standard and flags that, in order to deliver the consistency and comparability of corporate reporting, the FCA intends to adapt the current rules on climate-related reporting in order to help develop a common international reporting standard that references the IFRS Foundation's upcoming International Sustainability Standards Board ("**ISSB**") standards.

FCA Report

The FCA Report, which reiterates the requirement for premium-listed entities to make disclosures in line with the TCFD Recommendations in their annual reports and accounts as set out in LR 9.8.6R (premium-listed) and LR 14.3.27R (standard listed), reviewed the annual reports for the year ended December 2021 of 171 companies on a 'high level' basis, and conducted a deep-dive review of the annual reports of 31 companies for the year ended December 2021.

Notable findings from the FCA Report include the following:

- Although 81% of companies noted that they had disclosed consistently with the seven key TCFD Recommendations, the FCA found several of such companies to have provided very limited detail and the FCA noted that it will consider these cases further and whether it will take any specific action against these companies.
- Gaps in disclosures often related to quantitative detail, e.g. scenario analysis, metrics and targets.
- The level of detail and consistency in disclosures tended to correlate within sector, size and risk assessment lines.

The FCA Report provides lots of practical advice to companies on how they might improve their reporting in the next reporting season, including to:

- Follow the guidance set out in the TCFD Recommendations, and the other documents that companies should consider when determining whether their disclosures are consistent with the TCFD Recommendations, as set out under LR 9.8.6, including all-sector and sector-specific guidance.
- When making net zero commitments, consider the TCFD's guidance on Metrics, Targets and Transition Plans, and ensure disclosures are not misleading.
- Continue to deepen familiarity with the TCFD's Recommendations and further improve internal processes to ensure that you are ready to disclose effectively against the ISSB standards. (The FCA intends to adapt the current regime to align with forthcoming ISSB standards on climate-related reporting.)
- Consider the Sustainability Accounting Standards Board ("**SASB**") metrics for the relevant sector when making disclosures against the TCFD's Recommendations and when making wider sustainability-related financial disclosures on other sustainability topics.
- Refer to and apply the FRC's examples of better practice set out in the FRC Report.

Annexes 1 and 2 of the FCA Report provide a useful quick-reference overview of the climate-related disclosure regime, including pointers to specific guidance provisions and publications, and an overview of the TCFD Recommendations.

FRC Report

The FRC Report provides a comprehensive review of the extent and quality of climate-related disclosures contained in the December 2021 year end annual reports of 25 premium-listed companies. It also provides examples of better practice to help companies improve their climate-related reporting in the next round of annual reporting.

The FRC Report found that the companies reviewed had generally 'risen to the challenge' and provided disclosures in line with the TCFD Recommendations as required by LR 9.8.6, and that most of such companies also included reference in their financial statements to climate-related risk, representing welcome progress as compared with the FRC's review of 2020 annual reporting disclosures.

However, the FRC Report also noted several key areas for improvement, including the following:

1. **Granularity and specificity:** Generic or high-level information is not sufficient. The FRC expects specific and granular detail on how climate change may impact a company's business, in terms of business type, sector and geography.
2. **Balance:** Provide more detail on opportunities arising out of climate change, as well as the risks, and include commentary on any links between any climate-related opportunities and any related technological dependencies.
3. **Interlinkage with other narrative disclosures:** Provide greater integration of TCFD disclosures with other ongoing business risks and strategy – do not approach climate change-related disclosures as a standalone or compliance exercise.
4. **Materiality:** Provide a sense of the materiality of the company's TCFD disclosures, and the extent to which the level of materiality of any TCFD Recommendation, metric or guidance in the context of the company's specific business has affected the extent to which the company's disclosures are in line with the TCFD Recommendations. This will help regulators to assess whether a company has indeed disclosed consistently with the TCFD Recommendations as required by the Listing Rules (but take care not to adopt a tick-box narrative).
5. **Connectivity between TCFD and financial statements disclosures:** Provide clearer narrative explanations of the impact of climate-related risks on the financial statements (including as to any judgements, estimates or adjustments that have been applied to the financials). Companies who disclose significant climate risks or net zero transition plans in their narrative reporting but who do not make clear how this is reflected in their financial statements may expect to be challenged by the FRC.

The FRC's detailed expectations by way of commentary and annotation against the climate-related regulatory rules and frameworks are set out in Annex 2 of the FRC Report.

Next steps:

- When preparing climate-related disclosures in line with the TCFD Recommendations, make full use of the various pieces of guidance and technical notes published by the FCA and FRC, as noted in the FCA Report and as set out in the links below.
- Review and, to the extent applicable, follow the FRC Report examples of better reporting in your company's next round of reporting on climate-related matters.
- Increase your company's, and its internal reporting lines', familiarity with the TCFD Recommendations, and alert the same lines to the need to familiarise themselves with the upcoming ISSB standards when published in due course.
- Do not forget the additional Companies Act 2006 disclosure requirements following the enactment of The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/31), which implemented new requirements in relation to the non-financial and sustainability information statement contents, with effect in respect of financial years beginning on or after 6 April 2022.

Further information:

- Click **here** for the FCA's Review of TCFD-aligned disclosures by premium listed commercial companies.
- Click **here** for the TCFD's guidance on Metrics, Targets and Transition Plans.
- Click **here** for the FCA's Primary Market Bulletin 36.
- Click **here** for the FCA's Primary Market Technical Note 802.1.
- Click **here** for a copy of the FRC's Report: Thematic review of TCFD disclosures.

FCA Decision on Carillion Case

The FCA published decision notices censuring Carillion plc (in liquidation) ("**Carillion**") for contraventions of the Market Abuse Regulation ("**MAR**") and Listing Rules in 2016 and 2017, and imposed fines on three Carillion executive directors in connection with the contraventions.

July 2022

In July, the FCA published its decision notices issued in June to Carillion and three former executive directors following respective warning notices issued in September 2020 with respect to proposed action by the FCA in light of Carillion's contravention of MAR and Listing Rule regimes. The three executive directors had referred their decision notices to the Upper Tribunal, and therefore any findings and/or sanctions made in the FCA's notices are provisional and subject to the Upper Tribunal's eventual determination.

In 2016 and 2017, prior to Carillion's entry into liquidation in January 2018, Carillion had published announcements (in December 2016, March 2017 and May 2017) containing misleading and/or inaccurate statements as to the company's financial health. The FCA found that these statements, which did not convey certain significant and known financial deteriorations, had been recklessly published. Further, the FCA found that Carillion's systems, procedures and controls were inadequate and did not sufficiently enable robust accounting judgements to be made, recorded and reported to the company's board and audit committee. The FCA noted that, were it not for the fact that Carillion is in liquidation (such that a financial penalty would be borne by Carillion's creditors), it would have imposed a fine of £37,910,000. Given Carillion's circumstances, the FCA has instead publicly censured the company.

Carillion did not refer its notice to the Upper Tribunal. The FCA found that Carillion breached the following:

- **Article 15 of MAR** (prohibition of market manipulation) – Carillion disseminated information in the Announcements that gave false or misleading signals as to the value of its shares in circumstances where it ought to have known that the information was false or misleading.
- **LR 1.3.3R** (misleading information must not be published) – Carillion failed to take reasonable care to ensure the positive announcements it published about the financial performance of its general business and its UK construction business were not misleading, false or deceptive and did not omit anything likely to affect the import of the information.
- **Listing Principle 1** (procedures, systems and controls) – Carillion failed to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its Listing Rule obligations.
- **Premium Listing Principle 2** (acting with integrity) – Carillion did not act with integrity towards its shareholders and potential shareholders.

The FCA found that the three executive directors recklessly and knowingly partook in Carillion's breaches and have issued the following sanctions (subject to the Upper Tribunal's review):

- Former chief executive, Richard Howson, fined £397,800;
- Former finance director, Richard Adam, fined £318,000; and
- Former finance director, Zafar Khan, fined £154,400.

Next steps:

Consider whether internal processes, procedures and systems need to be proactively reviewed and strengthened in order to ensure robust reporting lines. This is all the more important in light of the incoming reforms to the accounting and audit regimes in the UK, as FCA and ARGA scrutiny will only increase in the pursuit of avoiding a repeat of the Carillion case.

Further information:

- Click **here** for the Decision Notice: Carillion plc.
- Click **here** for the Decision Notice: Richard John Howson.
- Click **here** for the Decision Notice: Richard Adam.
- Click **here** for the Decision Notice: Zafar Khan.

FRC publishes New Public Interest Entity Auditor Registration Regulations

On 18 August 2022, the FRC published its Public Interest Entity Auditor Register Regulations, creating the FRC's new registration regime for statutory auditors of Public Interest Entities ("**PIEs**").

August 2022

As part of the government's broader ongoing reform efforts, with a view to restoring trust in audit and governance, and following a number of reviews and consultations since 2018, the Public Interest Entity Auditor Register Regulations due to come into force on 5 December 2022 will empower the FRC to establish and maintain a published PIE Auditor Register.

From 5 December 2022 onward, all audit firms and responsible individuals ("**RIs**") undertaking statutory work for PIEs must be registered on the PIE Auditor Register.

A transition period will be observed, under which firms that are currently auditing PIEs must submit their applications for registration to the FRC from 5 September 2022.

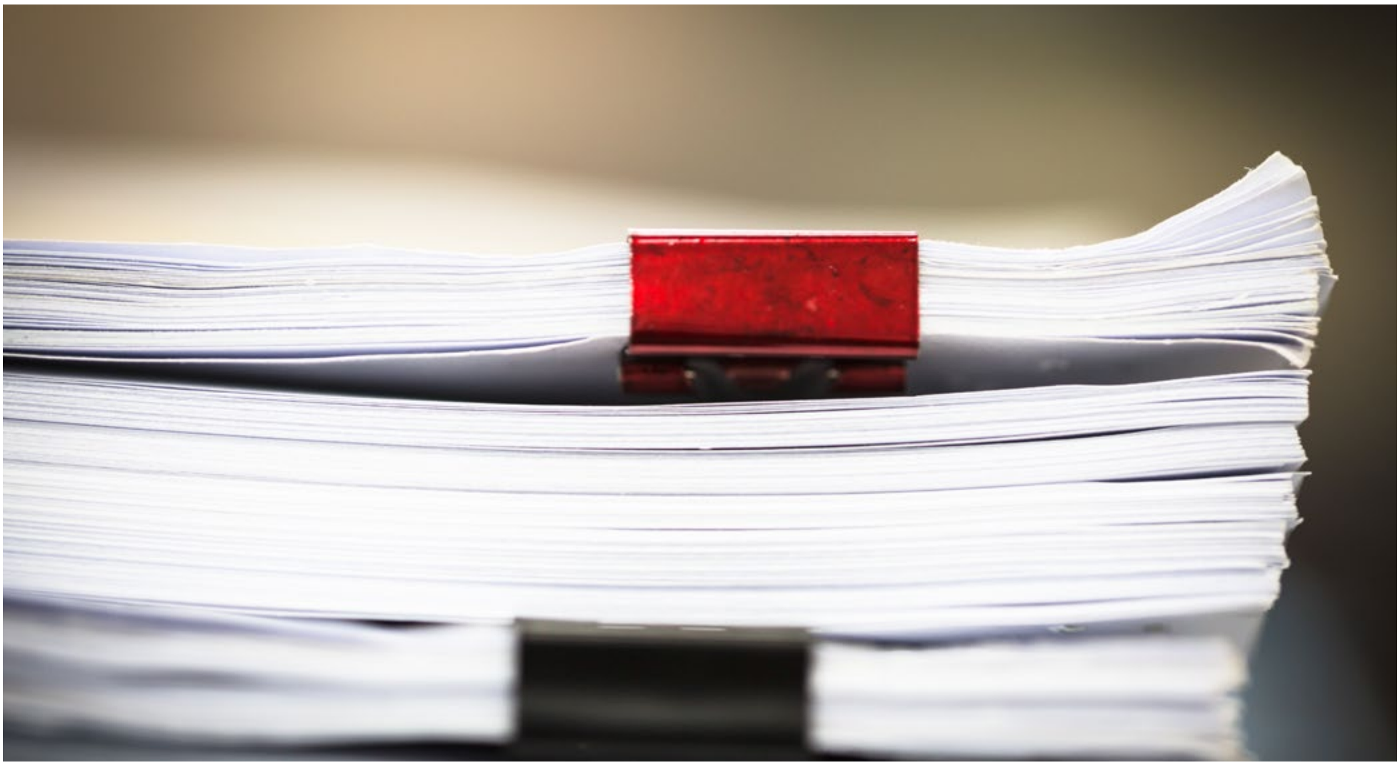
The FRC currently relies on the ICAEW and the Association of Chartered Certified Accountants, as recognised supervisory bodies, to approve and monitor PIE auditors. However, following the FRC's anticipated transition to ARGA, it will be directly responsible for approving PIE auditor firms, and for the oversight and maintenance of the PIE Auditor Register.

Next steps:

It is important for audit firms and their RIs to comply with the new incoming registration requirements within the transitional period and to ensure their timely compliance with any ongoing notification obligations (e.g. relevant changes, such as being appointed to undertake the statutory audit work of a PIE, or a change in the firm's or its registered individuals' contact details).

Further information:

- Click **here** for a copy of the PIE Auditor Registration Regulations.
- Click **here** for a copy of the PIE Auditor Registration Guidance for Transitional Applications.



FRC Lab publishes a report on digital security risk disclosures

On 3 August 2022, the FRC Lab published a report aiming to improve companies' disclosures on digital security strategies, risk and governance in their annual reports.

August 2022

The FRC Lab's Digital Security Risk Disclosure report (the "**Lab Report**") has been published to provide practical advice to companies when making disclosures in respect of digital security strategies, risk and governance. The Lab Report reiterates the "fundamental" importance of management of digital security risk, and highlights the importance of providing sufficient information to assist stakeholders in assessing a company's ongoing viability and resilience against cyber, data and other digital threats. It reminds companies of recent high profile cyber and data incidents and the landscape of increased geopolitical tensions.

The Lab Report found that, whilst many FTSE 350 companies report on digital risk (often disclosing cyber risks), such disclosures tended to reflect an approach described as "boilerplate and overly static", thereby falling short of the level of disclosure required by stakeholders to make informed assessments.

To improve disclosures, the Lab Report makes a number of practical recommendations on how to make useful and material 'core' and 'enhanced' disclosures, falling into the following broad categories:

Investors seek disclosures that:

Strategy

- Provide the context for digital security and strategy and its importance to a company's broader strategy and business model and ability to generate value;
- Indicate how external trends associated with digital security and strategy are integrated into the company's approach; and
- Link digital security and strategy disclosure to the company's broader strategy.

Governance

- Link the governance of digital transformation and security risks to strategy and risk appetite;
- Show how the board and its committees have oversight of these risks. This may also include who within the company has ownership of specific risks, and the access they have to senior leaders;
- Explain what a company has done to foster a digital security (or cybersecurity) culture; and
- Outline the relevant skills of the board and assurance obtained.

Risk

- Link the digital security and strategy risks to strategic objectives and risk appetite;
- Consider the actions and activities taken to mitigate risk and how risks have evolved;
- Provide information about the risk and mitigations at the right level of granularity; and
- Connect digital security and strategy with disclosures on viability and resilience.

Events

- Provide information about the actions taken and events themselves; and
- Help them to understand the effectiveness of a company's response and how lessons learned from the event will be, or have been, incorporated into changes to relevant structures and processes.

The Lab Report also sets out some practical examples of useful disclosures made under each of the four categories by reference to an 'Example Bank'. However, the report also notes that its practical examples and recommendations should not be treated as a disclosure checklist, as not all risk disclosures apply to each company. The Lab Report reminds companies that a tailored and considered approach, providing disclosures which are material and relevant for the company and its stakeholders, should be applied.

Next steps:

- Internal report and risk teams should refer to the practical examples and useful resources provided in the Lab Report and consider how internal reporting lines and processes may need to be updated or improved in order to provide valuable disclosures to stakeholders on management of cyber, data and digital risks and threats.
- Review existing communications and escalations channels and consider to what degree these channels are functioning effectively – consider how effectively the company's digital security strategy is communicated throughout the company and whether such strategy is adequately implemented and monitored.

Further information:

- Click **here** for a copy of the FRC Lab's Report.

UK Government launches the register of overseas entities

On 1 August 2022, the UK government launched the new Register of Overseas Entities.

August 2022

The new register of overseas entities (the "**Register**") has been launched by the UK government as one of a number of measures under its Economic Crime (Transparency and Enforcement) Act 2022 (the "**Act**") which seeks to prevent non-UK incorporated companies using UK land to hide illicit wealth and which grants powers to Companies House, who maintains the register, to challenge suspicious information.

As outlined in the **third** of our series of briefings on corporate governance, overseas entities must apply to be added to the Register if they are a registered proprietor of a qualifying estate in land in England and Wales, which was acquired on or after 1 January 1999, and provide details about those persons who exercise significant control over the entity.

BEIS has published guidance on complying with the requirements of the new Register. The guidance confirms that, as part of the registration process, overseas entities are required to disclose information about their beneficial owner(s) (if any) and/or managing officer(s) to Companies House. This information will be held on the Register and the overseas entity must update this information annually.

'Beneficial owners', for the purposes of the Act, are individuals, governments and public authorities, and other legal entities which are 'subject to their own disclosure arrangements', in each case which are not exempt and which meet at least one of the following conditions, i.e. that they:

- Hold, directly or indirectly, more than 25% of either the shares or the voting rights in an overseas entity;
- Hold the right, directly or indirectly, to appoint or remove a majority of the board of directors of an overseas entity;
- Have the right to exercise significant influence or control over an overseas entity;
- Be trustees of a trust, members of a partnership, unincorporated association or other entity that fulfil one or more of the conditions above; or
- Be a person who has the right to exercise, or actually exercises, significant influence or control over the activities of that trust or entity.

A beneficial owner for the purposes of the Act is exempt from being registered on the Register if:

- They do not hold any interest in the overseas entity other than through one or more legal entities;
- They are a beneficial owner of every legal entity through which the person holds such an interest;
- They indirectly hold any shares or rights in the overseas entity through a beneficial owner of the overseas entity that is subject to its own disclosure requirements; and
- At least one of the legal entities through which these shares or rights are held is a beneficial owner of the overseas entity and is subject to its own disclosure requirements.

Next steps:

- Overseas entities wishing to buy, sell or transfer property or land must register with Companies House.
- Overseas entities that already own land in the UK must register their beneficial owners or managing officers by 31 January 2023.
- Overseas entities must arrange verification checks by a UK-regulated agent to be completed on their beneficial owners and managing officers before registering a property.
- Overseas entities that have disposed of property after 28 February 2022 (after the announcement of legislation to create the ROE) must provide a statement to Companies House registering the details of the disposal(s).

Further information:

- Click **here** for a copy of the UK government press release for the ROE.
- Click **here** for a copy of the Companies House guidance note for the ROE.
- Click **here** for a copy of the Economic Crime (Transparency and Enforcement) Act 2022.
- Click **here** for a copy of the BEIS guidance.

The FRC publishes thematic reviews on reporting earnings per share and deferred tax assets

On 8 and 21 September 2022, the FRC published two separate thematic reviews. The reports relating to each review consider and provide guidance for improving the compliance and reliability of listed companies' disclosures of earnings per share and deferred tax assets.

September 2022

In both reports, the FRC emphasises the importance of listed companies providing high-quality disclosures and explanations in their financial statements and annual reports, both to improve transparency and to enable the readers to understand calculations relating to earnings per share and deferred tax, as well as management's considerations behind its decisions. The reports each make use of case studies and examples of listed companies' past reports to provide illustrations of good practice of informative, transparent disclosure.

FRC's Thematic review: Earnings per share ("EPS")

On 8 September 2022, the FRC published its thematic review on EPS, which all listed companies (including companies reporting under the UK GAAP standard FRS 102) are required to report on in their annual and interim financial statements in accordance with International Accounting Standard 33 ("**IAS 33**"), including comparatives for the period presented.

The FRC's review of companies' financial statements found that the main principles of IAS 33 are not always well understood and notes that, in some instances, when the FRC's Corporate Reporting Review ("**CRR**") team had queried certain disclosures, this had resulted in restatement of the company's EPS in the following year.

The FRC's report highlights common errors made by listed companies, which generally fall into the following broad issues:

- **Weighted average number of ordinary shares outstanding:** It is not always clear from a company's disclosures how the weighted average number of shares relates to the number of shares in issue and potential ordinary shares.
- **Effect of certain arrangements on EPS calculations:** The FRC found that it was rarely possible to tell from disclosures when a company had made judgements about how a share reorganisation or other arrangement had affected EPS calculations.
- **Lack of understanding of IAS 33:** The FRC noted that the requirements of IAS 133 often appeared to have been overlooked or not well understood.

The report provides various illustrations of how companies can provide more comprehensive disclosures and improve the reliability of their EPS, but the overarching message is that reporting by companies on EPS can be improved by:

- **Complying with IAS 33's specific disclosure requirements:** Disclosing any judgements with a material effect on EPS in accordance with paragraph 122 of IAS 1 and their disclosures for adjusted EPS must meet the requirements of the ESMA Guidelines on APMs; and
- **Explaining the methodology for their EPS calculations:** Explaining the basis used for tax on adjusting items and the weighted average number of shares, especially if it is significantly different from information disclosed about issued ordinary shares and potential ordinary shares.

FRC's Thematic review: Deferred tax assets

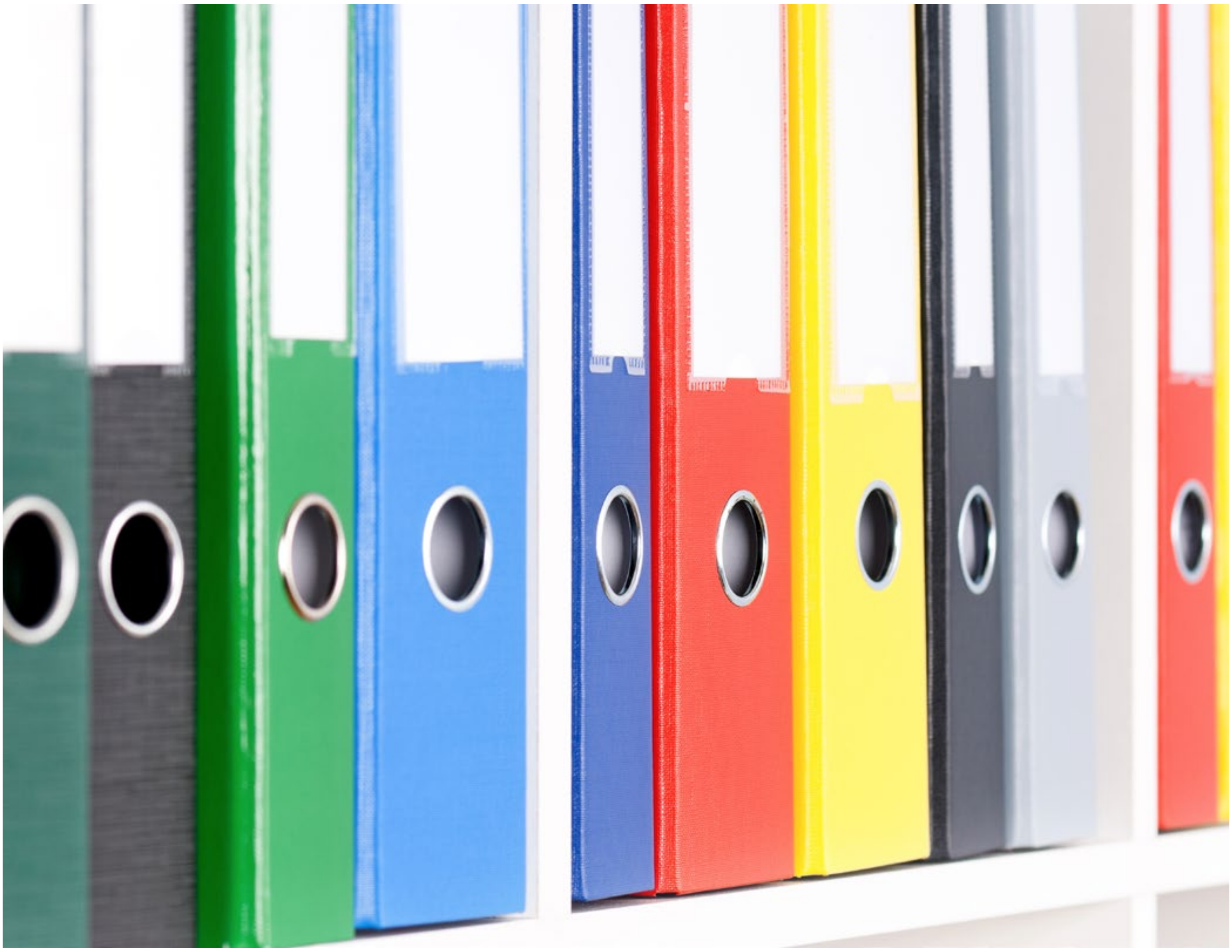
On 21 September 2022, the FRC published its findings on the disclosure of deferred tax assets by 20 FTSE 350 listed companies in their annual reports and accounts, as required by the International Accounting Standard for income taxes ("**IAS 12**"). The FRC found that there was generally good disclosure practice amongst the sample companies but that, as more companies have reported losses after the COVID-19 pandemic and have recognised an increased number of material deferred tax assets, it recommends that listed companies should provide more specific disclosure about the nature and extent of supporting evidence used to assess the recoverability of net deferred tax assets.

The report identifies four key ways for listed companies to improve their disclosures:

- **Provide specific evidence**: avoid using boilerplate disclosures of evidence used to assess the recoverability of deferred tax assets and specifically refer to either expected improvements in profitability during the forecast period or to a loss being the result of a one-off event. Companies should separately identify and specifically describe the individual material components of the tax expense and its rationale for the assessment period.
- **Judgements and estimates**: disclose the specific nature of key judgements and the major sources of estimation uncertainty relating to deferred tax assets, changes in assumptions or the range of possible outcomes for the next financial year; and consider the effect of climate change on the recoverability of deferred tax assets.
- **Transparency**: disclose the expected period of recovery of deferred tax assets and geographical analysis of the deferred tax balance and profits/losses in each jurisdiction, ensuring that there is consistency and cross-explanation between narrative disclosures in the reports and financial disclosures in the accounts.
- **Consistency**: ensure underlying assumptions used in estimates of future taxable profit are consistent with their impairment, viability, going concern and future cash flow forecasts. The base forecasts of future taxable profit on assumptions should be consistent with other forecasts used in the preparation of the annual report and accounts, ensuring that there is consistency and cross-explanation between narrative disclosures in the reports and financial disclosures in the accounts.

Further information:

- Click **here** for a copy of the FRC's Thematic review: Earnings per share (IAS 33).
- Click **here** for a copy of the FRC's Thematic review: Deferred tax assets.



The FRC publishes Lab report on improving structured digital reporting

On 23 September 2022, the FRC published its Lab report: "Structured digital reporting" identifying the lessons learnt from the first year of UK listed companies' mandatory structured electronic reporting.

September 2022

Under DTR 4.1.14, it is mandatory for companies with transferable securities admitted to trading on UK regulated markets to produce their annual financial reports for financial periods starting on or after 1 January 2021 in the structured digital report format specified in the TD ESEF regulation (the UK version of the European Single Electronic Format ("**ESEF**"). Filing of annual reports with the National Storage Mechanism ("**NSM**") in ESEF has been voluntary since 1 January 2021 (in respect of reports on financial periods starting on or after 1 January 2020), and mandatory from 1 January 2022 (in respect of financial reports on financial periods starting on or after 1 January 2021).

This report follows and builds on the FRC's first review in 2021 of early voluntary digital reports from across the UK and Europe, and found that whilst many companies had risen to the challenge of transitioning to the new reporting format and taken on board tips provided in the FRC's 2021 findings, '…data quality and usability are below the level expected for companies in a leading capital market'.

The report therefore sets out a number of practical recommendations organised into three key areas for improvement (process, usability and design, and tagging) with a view to enabling companies to better meet the needs of investors. It also highlights some further upcoming changes of which companies should be mindful, including in respect of tagging and timetables.

The report includes, amongst many other practical tips and suggestions, the following findings and related recommendations:

Process

- Many companies continued to focus on producing their report in PDF, converting to a structured report as an afterthought – companies should take more ownership and responsibility for tagging, and ensure there is enough time to produce a good quality structured report. Consider using integrated disclosure management tools to directly produce annual reports in different formats and tag them in parallel to finalising the content and design process. This may be more efficient than the "bolt-on" approach of tagging the report once it is converted into XHTML, which most companies continue to apply.
- The structured report is the official version of the company's report for the purposes of the DTR regime, and should therefore be subject to appropriate review and governance processes. Companies might consider improving the engagement and education of its board and developing a review process which helps to appropriately direct the board's attention to the most important aspects for review. Further, consider documenting processes and controls, so that knowledge is retained notwithstanding staff attrition.
- Companies can reduce the risk of a filing of the company's report being rejected by making use of the FCA's test facility, which will help to catch any errors relating to incorrect file naming and/or structure. (**Note, however, that test reports must not contain any inside information**.) The Lab report contains a section of 'tips for submitters', covering how to appropriately submit the report to the FCA depending on file type (e.g. ZIP vs HTML).
- For companies who are required to submit structured reports in more than one jurisdiction, keep filings as consistent as possible, and clearly label different versions on the company's website.

Usability and design

- Where PDF-to-XHTML conversion process is used, companies should make their design agencies aware of particular font, colour and other settings used in the PDF, to avoid issues in the conversion to XHTML. The Lab report also recommends that companies include the front half of their report in any dry run, as this is where more complex design issues in XHTML are likely to arise.
- Companies should ensure that it is the FCA-validated and filed version of the report which is made available on the company's website, and be sure to make the file available with an Inline XBRL viewer, as per the FRC's 2021 recommendation (the Lab report found that only 21 out of 50 companies did this in respect of the latest reporting round).

- Companies should minimise potential issues around slow opening, downloading or corruption of reports by testing reports in advance in different browsers and viewers, and ask the company's tagging provider to optimise report loading. The FRC notes that simple technical changes can make a big difference. Companies should also 'embrace' XHTML as a web-based format when producing their structured reports: e.g. reports can be designed to be responsive to different screen sizes and can incorporate interactive elements such as dynamic graphs, videos and improved navigation features.

Tagging

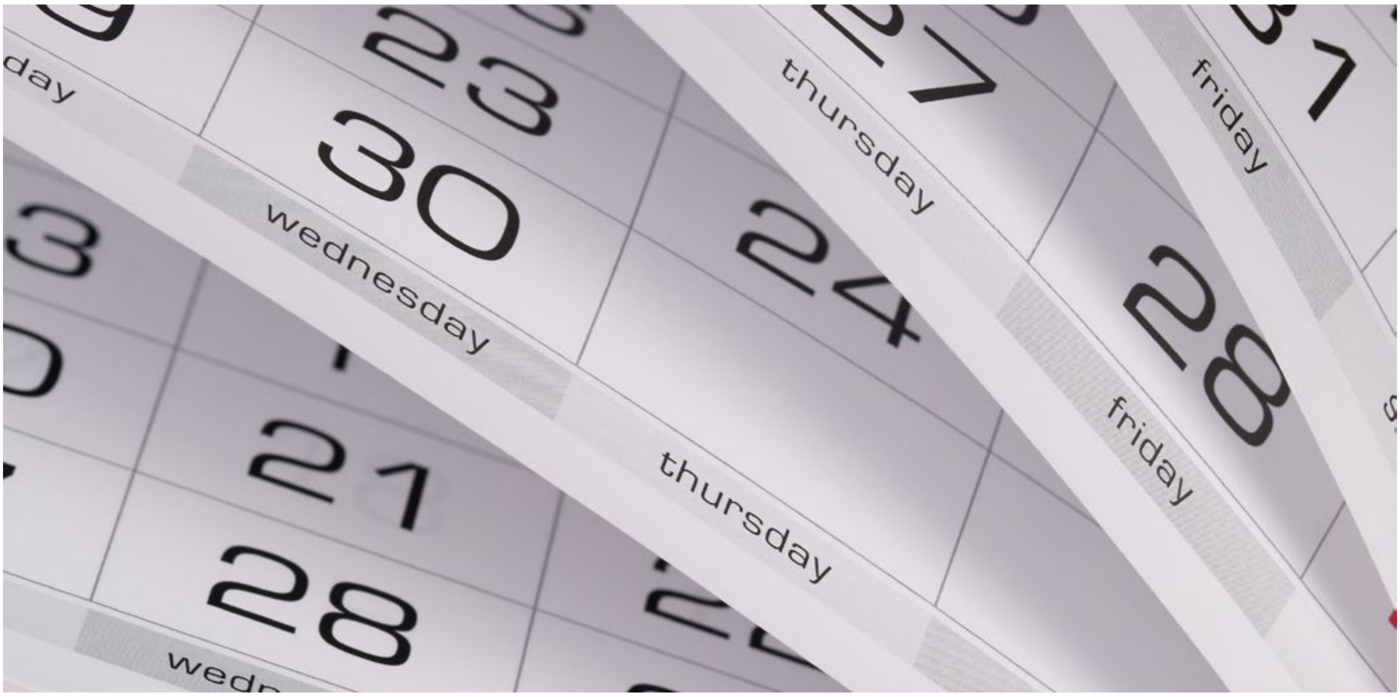
- The Lab report notes that significant inaccuracies remain in the application of core tags, unnecessary creation of extension (custom) tags, and appropriate anchoring between tags. Minimise issues around incorrect tagging by ensuring that technical accounting staff who are familiar with the tagging taxonomy review the accuracy, consistency and interrelation of the report's core and extension (custom) tags.

Next steps:

- Ensure adequate technical (internal and external) and board review processes are put in place in sufficient time to produce an accurate structured report in the next publication round.
- For financial years starting on or after 1 January 2022, companies will also be required to tag the notes to the accounts, including accounting policies. Companies should test text block tagging of the notes well ahead of year-end, as such text block tagging will involve spending time mapping the mandatory tags to their notes and applying judgement.
- Check whether any changes to the core tagging taxonomy will have any impact on tagging. E.g. those companies changing from using the ESEF/IFRS 2020 taxonomy to the ESEF/IFRS 2021 taxonomy may want to have a look at relevant recent changes.
- Be prepared to accelerate the issuance of the digital report as the deadline will revert from the extended Covid-related period of six months to four months for year-ends on or after 28 June 2022.

Further information:

- Click **here** for a copy of the FRC Lab report: Structured Digital Reporting report.
- Click **here** for a copy of the FRC Lab report: Structured Digital Reporting Summary of findings.



FRC publishes Lab report to assist companies with reporting on net zero commitments in their financial reports

On 11 October 2022, the FRC published its Lab report: "Net zero disclosures" providing companies with practical recommendations on how to meet investor expectations on net-zero and greenhouse gas ("**GHG**") emission reduction disclosures in financial reports.

October 2022

The Lab report reminds companies that investors are increasingly seeking detailed disclosures from companies about how they intend and expect to achieve targeted reductions in GHG emissions and net zero targets, and notes that better connectivity between TCFD and financial disclosures was one of the key areas for improvement identified in the FRC's and FCA's respective thematic reviews of TCFD reporting published in July this year (see **item 3** of this briefing).

The Lab report notes that improvement in reporting is still required, as "reporting is too often aspirational and high level" and, to that end, identifies three "inherently interconnected" elements that investors are seeking to better understand from a company's net zero disclosures:

1. **Commitments:** Describe the company's level of ambition, scope, nature and timing of its commitment to company disclosures. Companies should clearly define the types of GHG emissions and reductions it is committed to; the boundaries and timelines of each commitment; and the types of GHGs, regions or operations included or excluded in each commitment.

2. **Impacts:** Explain the current and expected impacts of a company's net zero and GHG reduction commitments on its company's strategy and business model such that investors can assess whether the company's plans are robust and credible for the future. Disclosures should include analysis of the company's present transition plans, assumptions, uncertainties, and risks and opportunities relating to its commitments, such as its reliance and dependency on future public energy and infrastructure policies, developing future technologies and critical supply chains. Include disclosure against the potential future costs of the company's commitments, including the proportions of overall planned capex used on low carbon assets and technology and the proportions of future R&D expenditure used on low carbon technologies and solutions.

3. **Performance:** Explain how performance in the short, medium and long term is being measured and provide information on the pace of progress against net zero targets. Progress is likely to be seen in rapid and significant, not smooth and linear, reductions in GHG emissions at key changes, such as when high-emission assets are decommissioned or new green technology is used.

   Investors prefer a company to disclose data that connects to its business model and allows it to monitor the progress of different business lines and regions of the business and what controls and governance procedures are in place. Companies are encouraged to apply this data against consistent, established frameworks that align with the latest climate science to set net zero targets, such as the GHG Protocol to measure their GHG emissions and the Science Based Targets initiative ("**SBTi**") frameworks.

The report finds that effective and robust processes are central to enabling companies to better understanding their progress, iterating and achieving their net zero commitments over the long term, and recommends that the above key elements should be considered and reported on as part of a four-stage iterative process.

1. **Define the commitment:**
   - what can and will be reduced (both internal and external to operations) and what offsetting approaches can be used?
   - what interim targets should be set?
   - how should these goals be communicated internally and how will corporate culture support achievement of these goals?
2. **Assess the impact (of the company's commitment):**
   - how might business strategy need to change?
   - what gaps exist within current operations and processes, and what resources and policies (e.g. re business travel and supplier relationships) are needed?
   - how can the commitment be embedded into decision-making?
   - how much will it cost and how will it be funded?
3. **Measure progress:**
   - what systems, controls and processes (including internal review processes) are in place or should be put in place to measure and monitor progress?
   - is there sufficient access to relevant data, including from third parties?
   - how do measures link to individual objectives?

4. **Refine the approach:**

- what lessons have been learned already and what can be improved upon?
- do any commitments need to be redefined, e.g. should progress on certain items be accelerated?
- is external review also needed?
- how will lessons be shared with the wider workforce?

Whilst the report provides helpful, specific suggestions and tips, and provides a framework for making investor-friendly disclosure on net-zero targets, it also makes the following caveats:

- Net-zero reporting is part of a developing area of broader climate-related corporate reporting, and the quality of reporting should only continue to improve as companies develop definitions, mature their processes, controls and data collection, and refine the scope of their commitments. The FRC expects that companies will improve their reporting from a 'foundational' level to a more 'advanced' level.
- The information highlighted in the report may not be relevant to all companies, and each company should consider on a case-by-case basis what is material to them and their business when preparing and drafting their disclosures.
- The suggestions in the report should not be viewed as a means of achieving 'minimum compliance'. Companies should consider whether 'advanced elements' of disclosure may be applicable.

Next steps:

- The FRC will be looking for companies to improve on their reporting across the three 'inherently connected' areas of focus, such that improvement in one area should necessarily help to improve the other areas.
- Refer to the Lab report (including applicable regulatory requirements and guidance further set out in Appendix 2 of the Lab report) and the 'example bank' as useful sources of practical guidance when preparing your company's net-zero disclosures.
- Whilst this Lab report provides practical guidance, pay close attention to continued developments in investor and regulatory expectations and reporting requirements, e.g.:
  - development of ISSB standards and proposals for the publication of transition plans in the UK; and
  - further clarity on any local jurisdictional net zero commitments.

Further information:

- Click **here** for a copy of the FRC Lab Report: Net zero disclosures.
- Click **here** for a copy of the FRC Lab Report: Net zero disclosures - Example bank.
- Click **here** for a copy of the FRC Lab Report: Net zero disclosures - Summary of findings.

Taskforce on Climate-related Financial Disclosures ("TCFD") publishes its 2022 status report

On 13 October 2022, the TCFD published its fifth annual status report setting out the progress of companies' reporting of climate-related financial risk information since the TCFD published its recommendation framework (the "**Recommendations**") in 2017.

October 2022

The status report provides an overview of current reporting practices based on a review of 1,434 large companies across five regions and across eight industries, including progress against milestones set out in the TCFD's initial 2017 recommendations. The report finds that there has been significant momentum in the uptake of reporting against the Recommendations, with a steady year-on-year increase in the number of companies disclosing, and the amount of information disclosed, in line with the Recommendations. However, the report notes that "more urgent progress" is needed in improving transparency on actual and potential impact of climate change on companies.

The report highlights an ongoing lack of connectivity in climate-related and financial disclosures (for further discussion on which, see **item 3** of this briefing), citing the IPCC's concerns highlighted in its report of April this year that, whilst finance is a critical enabling factor in the transition to low carbon "aligning financial flows with low GHG emissions pathways remains slow" and that climate-related financial risks "remain greatly underestimated by financial institutions and markets – limiting the capital reallocation needed for the low-carbon transition". The IPCC report recommends that enhancing transparency and the quality of climate-related financial risks and opportunities may help with the reallocation of capital market resources to the low carbon transition. In that respect, the status report highlights that the IPCC report referred to the Recommendations as a helpful set of guidance.

The status report's key findings include the following:

- In 2021, 80% of sample companies disclosed in line with at least one of the 11 recommended disclosures. However, only 4% disclosed in line with all 11 recommended disclosures.
- Based on survey responses, 90% of investors and other users include climate-related financial disclosures in their financial decision-making, 66% of whom further indicated that such disclosures factored into pricing of financial assets.
- Based on survey responses, more than 60% of asset managers and more than 75% of asset owners indicated that they report climate-related information to their clients and beneficiaries respectively.

Next steps:

Ensure your company makes "**decision-useful**" climate-related disclosures: ensure relevant internal (and external) teams with reporting responsibility are familiar with the aims of climate-related financial reporting as explained in this TCFD status report and in other related guidance (see for example, the FRC's and FCA's thematic reviews at **item 3** of this briefing, and the FRC Lab report on net-zero reporting at **item 10**) and ensure that internal data collection and drafting processes are updated as required to enable greater compliance with climate-related reporting requirements and expectations.

Further information:

- Click **here** for a copy of the TCFD 2022 Status Report.
- Click **here** for a copy of the TCFD 2017 Recommendations: Final Report.
- Click **here** for a copy of the IPCC 2022 report.

FRC publishes its annual review of Corporate Governance Reporting 2021/2022

On 27 October 2022, the FRC published its key findings from its annual review analysis of reporting practices under the UK Corporate Governance Code.

October 2022

This year the FRC's annual review focused on FTSE 350 companies in the travel, hospitality, retail, property and financial services sectors. The FRC noted that, despite the backdrop of increased uncertainty (precipitated by the effects of the pandemic and exacerbated by Russia's invasion of Ukraine) the quality of corporate reporting remained good within the FTSE 350. However, the review found that scope for improvement remains within financial reporting (particularly in respect of financial instruments and deferred tax) and that cash flow statements "remain an area of considerable concern".

The review therefore sets out the various key areas in which improvements must be made, and includes specific inflation and interest rate related considerations for companies to take into account when making their disclosures. The FRC's report provides links to direct companies to various guidance materials and thematic reviews which contain useful practical advice on the various key areas flagged for improvement.

Top Ten Corporate Reporting Issues

The "Top Ten" issues noted by the FRC from this year's review are as follows:

1. Cash flow statements
2. Financial instruments
3. Income taxes
4. Strategic report and other Companies Act 2006 matters
5. Revenue
6. Provisions and contingencies
7. APMs (alternative performance measures)
8. Judgements and estimates
9. Impairment of assets (joint with No.10)
10. Presentation of financial statements and other disclosures (joint with No.9)

Section 3 of the report takes each "Top Ten" topic in turn and provides specific examples of issues identified by the FRC's Corporate Reporting Review ("**CRR**") team and how they should be resolved, providing links to additional guidance from previous years and from this year which companies and preparers of their annual report are encouraged to consider and reflect in order to ensure that the expected quality of reporting is met.

Strategic Report Reporting Issues

Particular issues arising from the CRR's review of strategic reports include the following:

- The CA 2006 requirement for strategic reports to be "fair, balanced and comprehensive":
  - "In some cases, the financial review focused on the financial performance of the company, with limited or no information on significant movements in the statement of financial position or cash flow statement."
  - "…information was omitted or lacked specific detail about matters that appeared significant to the company, such as prior year restatements, government funding and climate related matters."
- SECR (Streamlined Energy and Carbon Reporting):
  - Several large private companies omitted energy and carbon reporting disclosures.
  - One listed company did not disclose its energy consumption, separate emission figures and the methodology used to calculate the annual emissions.
- Section 172 Statement:
  - In several instances, the annual report lacked a statement about the company's engagement with suppliers, customers and others in a business relationship, and the effects on the principal decisions taken by the company during the year.
  - One company did not provide a Section 172 statement at all.
- **Distributable profits:** a number of queries were raised concerning disclosures around the lawfulness of dividends for varying reasons, including a lack of support shown in the company's latest audited accounts, failure to file the supporting accounts at the proper time, and unclear or inappropriate accounting treatment of capitalisation of amounts.

The FRC review encourages companies to consider the **FRC's Guidance on the Strategic Report** which was published in June 2022, and to consider the guidance provided in the FRC's **SECR thematic report**, to help with improving disclosures in the strategic report in the next cycle.

Reporting in uncertain times

A recurring concern throughout the FRC's review concerns the uncertain backdrop against which companies have reporting in this latest cycle. The FRC notes that *"the Russian invasion of Ukraine…sent geopolitical shockwaves around the world and exacerbated the economic uncertain created by the Covid-19 pandemic. Rising inflation, slowing economic growth, increasing interest rates, stresses in supply chains, constraints in the labour market and changing consumer behaviour, are some of the challenges business are currently facing."*

To that end, the FRC's overarching advice to companies to improve their reporting in uncertain times is to ensure that they:

- Clearly explain risks and changes in the business environment that they are facing; and
- How the risks and uncertainties have been reflected in the strategy, business model and going concern viability assessments (and any changes to definitions and/or calculations of APMs (e.g. inflation-adjusted measures) should be adequately explained).

Disclosure expectations for 2022/2023

The FRC flags that it will be looking for the following in next year's review of company annual report disclosures:

- Unambiguous description in the strategic report of risks facing the business, their impact on strategy, business model, going concern and viability, and cross-referenced to relevant detail in the reports and accounts;
- Specific, balanced and well-integrated information about the impact of climate change on the company in narrative reporting, and appropriate reflection of material climate-related commitments, risks and uncertainties in the financial statements; clarity about the relationship between assumptions and sensitivities considered in any TCFD scenarios (including any Paris-aligned scenarios) and those applied in the financial statements;
- Impairment disclosures that assign values to, and explain how, the key assumptions used have been determined, with reference to future expectations regarding external conditions and the company's own strategy;
- Clear disclosure of significant management judgements and key assumptions underlying major sources of estimation uncertainty, including information about the sensitivity of reported amounts to changes in assumptions;
- Transparent disclosure of the nature and extent of material risks arising from financial instruments, including changes in investing, financing and hedging arrangements; the use of factoring and reverse factoring in working capital financing and the approach to and significant assumptions made in the measurement of expected credit losses; concentrations of risks and information about covenants (where material);
- Company-specific information that meets the disclosure objectives of the relevant accounting standards and not just the specific disclosure requirements. Additional information (beyond the standards' requirements) should be included where needed to understand the impact of particular transactions, events or circumstances;
- Clear explanation of the nature of significant inflationary features in revenue, supply, leasing and other financing contracts, and their effect on the financial statements; and
- Clear, concise and understandable disclosure that omits immaterial information.

Next steps:

Companies should consider whether any of the "Top Ten" recurring areas for improvement, and any of the specific examples highlighted in Section 3, might be an area which they can improve upon for the next cycle, and take into account the FRC's practical suggestions and various guidance materials in order to address any weaknesses and/or gaps in its own reporting.

Further information:

- Click **here** for a copy of the "Annual Review of Corporate Reporting 2021/22".
- Click **here** for a copy of the "Annual Review of Corporate Reporting 2021/22: Corporate Reporting Highlights".
- Click **here** for a copy of the "Key matters for 2022/2023 reports and accounts".

IA publishes its annual guidance on executive remuneration for 2023

On 9 November 2022, the Investment Association published its annual Principles of Remuneration, outlining executive pay expectations from its members.

November 2022

The Principles of Remuneration sets out guidance for Remuneration Committees on applying the IA's principles and this year's publication states from the outset that stakeholder interest in remuneration shows no signs of abating and will come into even sharper focus as a result of the differential effects that the cost-of-living crisis will have on those across income distribution. The IA advises that, "as companies and their Remuneration Committees seek to navigate this period, shareholders continue to expect that they balance the need to reward and incentivise management whilst reflecting the experiences and expectations of their wider stakeholders, and in particular employees".

General Guidance (Section A)

Guidance in relation to executive directors' pay has largely remained the same.

However, for non-executive directors, updated guidance is that their fees should reflect "the time commitment of their role on the Board and its sub-committees, and the scope and complexity of their role(s)", and that any increases should also be properly justified.

See "QCA findings on the role of non-executive directors" in our **third** briefing for further insights from the Quoted Companies Alliance's survey on non-directors.

Fixed Remuneration (Section B)

Given the costs of living backdrop, the IA guidance expects that executive salaries should not be increased at a rate greater than inflation or than the level for other employees without careful consideration or justification with regard to the wider employment context for that company. If base pay for executives does increase more so than for the wider workforce, companies should fully disclose its reasons for doing so. The IA also recommended that salaries are not set solely according to "market-level" or in line with peers and competitors, this being cited as a key reason for spiralling pay figures.

Members also expect that pension contribution rates for directors should be aligned with the rate given to the majority of the company's workforce. Companies are expected to disclose the rate given to the majority of their workforce and how this rate has been calculated – for example, whether it is the average of all employees or the rate offered to new employees. The FRC may pick up on and query any misalignment in its annual review and regulatory role.

Variable Remuneration (Section C)

Members expect companies to be conservative with any increases in variable pay. In terms of annual bonuses, the IA has noted an increasing trend for using strategic targets and/or personal objectives, but its expectation is that most of the bonus should be tied to financial metrics, and any personal objectives should be linked to long-term value creation. Any changes to long-term incentives are expected to be fully justified and subject to prior approval from shareholders.

Expected falls in share price also raise the issue of windfall gains in relation to LTIP grants. Remuneration Committees are expected to review the grant level and scale back awards where there have been reductions in the share price, in order to avoid executives benefitting from the lower share price. Committees are expected to explain to shareholders their consideration of potential windfall gains and the rationale behind their decisions, including if no adjustments are made.

ESG metrics

The guidance notes the increasing importance of managing ESG risks to the long-term strategy and value of companies. It is recommended that committees should consider whether management of these risks should be included as performance conditions for variable remuneration. Any metrics should be quantifiable, have a clearly explained method of performance, and be linked to company strategy.

Next steps:

The IA expects the interest in remuneration from members, shareholders and wider stakeholders to only continue to grow in the wake of various drivers of economic uncertainty. These include the impacts of the COVID pandemic, the invasion of Ukraine, high levels of inflation and the cost-of-living crisis. In this context, a focus on income distribution and widening inequality is expected to heighten, with executive remuneration becoming a key indicator for the state of corporate governance generally. The IA therefore recommends even greater restraint and sensitivity in 2023, and anticipates that most companies will seek shareholder approval for their remuneration policies.

Further information:

- Click **here** for a copy of the IA's Principles of Remuneration 2023.
- Click **here** for a copy of the IA's letter to remuneration committee chairs of FTSE 350 companies.

FRC publishes 2022 review of stewardship reporting

On 24 November 2022, the FRC published its review of the quality of the reporting by signatories to the UK Stewardship Code 2020 (the "**Code**") in 2022, in which it sets out the FRC's reporting expectations for 2023.

November 2022

The FRC first published the Code in 2010 to develop and encourage best practice stewardship of UK listed companies by institutional investors. Organisations who wish to become signatories to the Code must produce a Stewardship Report demonstrating how they have applied the Code's Principles in the previous 12 months (see the **third** of our briefings on Corporate Governance Key developments). Existing signatories must continue to apply the Code and update their reporting annually to remain a signatory as renewal of their signatory status is not automatic. The Code's signatories include asset managers, asset owners and the service providers that support them. The FRC later revised the Code in 2019 to introduce more rigorous reporting requirements and encourage asset owners and asset managers to integrate stewardship responsibilities into investment processes (see the **first** of our briefings on Corporate Governance Key developments).

The FRC continues to use the Code as a framework for signatories to provide evidence of the activities and outcomes of their stewardship to meet the needs of their clients and beneficiaries. In its review, the FRC is satisfied with the signatories' effective stewardship reporting and the growth of the Code's influence as its number of signatories nearly doubled from 125 in September 2021 to 235 in September 2022, with a total of £40.7 trillion in assets under management.

Reflections on 2022 applications

In its review, the FRC acknowledges that the quality of signatories' reporting across several areas has improved, including in their activity and outcome reporting on engagement, collaboration and escalation; their contributions to addressing market-wide and systemic risks and improving the functioning of financial markets; and monitoring and holding third parties, such as asset managers and service providers to account. The FRC's review makes positive observations regarding the signatories' increased transparency of their organisational purpose, citing many examples of good reporting on stewardship in asset classes outside of listed equity, such as fixed income and real estate.

However, the FRC seeks to align signatories' reporting of their organisations' activities and outcomes more closely with the Code's definitions of engagement (Principle 9), collaboration (Principle 10), escalation (Principle 11) and exercising of rights and responsibilities (Principle 12) to ensure reporting is fair, balanced and understandable, and to improve comparability across reports and organisations. To that end, the FRC review provides case study examples of good practice engagement to underpin its recommendations for 2023 signatory applications.

Rights and responsibilities

The FRC encourages all signatories to provide both visual representations of quantitative information and high-quality, informative qualitative case studies of engagement activity across asset classes from all signatories, with more examples expected from larger asset managers. The FRC expects the quantitative information to identify key themes and identified patterns, and the case studies of engagement activity across asset classes to identify specific objectivities, activities and outcomes.

Signatories are encouraged to disclose the rationale behind their choice of external assurance for reviewing stewardship policies and consider what assurance is appropriate in future to reassure their clients and governing bodies of any greenwashing concerns.

Signatories are encouraged to hold their agents to account where their stewardship policies are not followed. The FRC encourages indirect investors to monitor their external managers or service providers who make investments and use examples to explain how external managers have met their expectations to the extent they have or to show how they have held them to account to the extent they have not.

Next steps:

The FRC has introduced new application deadlines for 2023.

- The deadline for new and renewal applications from asset owners has been extended from 30 April 2023 to 31 May 2023 to accommodate the challenge of asset owners sourcing information from their asset managers and service providers to show the activities and outcomes undertaken on their behalf.
- The FRC will only accept renewal applications from existing signatories in October 2023 and will not accept any new applications or reapplications during this period, allowing the FRC Stewardship team to conduct its planned annual review of the regulatory framework for stewardship by engaging with stakeholders and consulting on the Code.

Further information:

- Click **here** for a copy of the Review of Stewardship Reporting 2022.
- Click **here** for a copy of the Review of Effective Stewardship Reporting 2021.
- Click **here** for a list of signatories of the UK Stewardship Code.

ISS announces 2023 updates to proxy voting guidelines

On 1 December 2022, ISS published its international Benchmark Policy Updates for 2023, as part of its annual global review of its benchmark proxy voting guidelines. Its updates will be applicable for shareholder meetings held on or after 1 February 2023.

December 2022

The ISS conducts an annual global review of its benchmark proxy voting guidelines, by collecting feedback from investors and companies and conducting an internal review of emerging issues, regulatory updates and notable trends across the year. The guidelines will consider and bring together regulatory requirements, best practices and market participants' input.

For the 2023 updates, a key focus for the UK was in relation to directors' salary increases and in particular, keeping them low and at least proportional. On the global agenda was climate board accountability – i.e. voting against relevant directors where the company is not adequately disclosing climate-related risk information.

Board Diversity

The new policy includes guidance that for standard and premium listed companies with financial years beginning on or after 1 April 2022, the ISS may recommend against the chair of the nomination committee or other directors if the company has not met the FCA Listing Rules reporting requirements. These requirements are:

- At least 40% of the board are women;
- At least one of the senior board positions (Chair, CEO, Senior Independent Director or CFO) is a woman; and
- At least one member of the board is an individual from an ethnic minority background.

The same may apply to ISEQ 20 and AIM companies with a market capitalisation of over £500 million, but with a lower benchmark of at least one female director, and one director from a minority ethnic background by 2024.

If a company was compliant at the previous AGM and made a publicly available and firm commitment to comply with the requirements within a year, then this will be considered as a mitigating factor.

Audit Committee

A new policy has been introduced requiring greater focus on the number of audit committee meetings being held during the reporting period. If four or fewer have been held by a FTSE 350 company, or if three or fewer have been held by FTSE All-Share companies (excluding investment companies), the ISS will draw attention to these companies.

This guidance has been created based on existing FRC guidance, following the government's publication of auditing recommendations and an expectation of increased scrutiny over the work of audit committees.

Remuneration

The previous ISS policy stated that annual salary increases should be low and in line with increases for the wider workforce, whereas the new ISS policy goes further and recommends that salary increases are kept low and "ideally lower proportionally than general increases across the broader workforce".
The ISS notes that this language is intended to clarify best practice and to avoid widening the gap between executives and other employees.

Next steps:

The updated benchmark policies will take effect for meetings occurring on or after 1 February 2023.
The ISS is planning to publish updated FAQ documents on its website by the end of January 2023. Further updates for off-cycle markets (outside of the UK) may occur later in 2023.

Further information:

- Click **here** for a copy of the Executive Summary of Key Updates and Policy Development Process.
- Click **here** for a copy of the Europe, Middle East, and Africa Policy Updates for 2023, with UK updates from page 4.

FRC publishes report on what makes a good annual report and accounts

On 13 December 2022, the FRC published its report setting out its view of the key characteristics associated with a high quality annual report and accounts ("ARA").

December 2022

The FRC seeks to improve the quality of companies' reporting in their ARAs following the publication of its annual review of the current state of UK corporate reporting in October 2022 (see **item 12** of this briefing). The FRC's report provides key principles and specific recommendations on the drafting and inclusion of content in the ARAs to key figures in the company specifically involved in the preparation of the ARAs, including audit committee chairs and company secretaries.

High Quality ARAs

The FRC's Executive Director of Supervision highlights the importance of ARAs as the "cornerstone of corporate reporting" and describes high quality ARAs as both "vital, and in the public interest" to promote effective stewardship to investors and stakeholders and provide them with detailed, reliable and accessible information on companies' performance which is useful for their decision making.

By contrast, the FRC describes lower quality ARAs as "long and full of boilerplate text" with excessive detail. The FRC recommends that the ARA's information is company specific and tailored to its transactions with jargon-free explanations to avoid boilerplate disclosures and those who prepare the ARAs apply materiality to identify and only include the key relevant information to avoid ARAs becoming over long and too detailed. The information included should either be quantitatively material through its significant impact in influencing a stakeholder or investor's perception of the company's performance or prospects or qualitatively material through its unexpected or uncommon effect on the company.

The FRC believes a high quality ARA adheres to the following key principles and its report provides good practice examples to show how these principles are reflected in practice:

- **Accuracy and bias**: to comply with the UK Corporate Governance Code's requirement to be both "true and fair", the ARA should be balanced and free from material misstatement and error by referencing both the positive and negative aspects of the company's performance;
- **Consistency**: the package of reports including the narrative reports and financial statements should be aligned and support each other, with effective links between different parts of the ARA such as a company's principal risks and uncertainties and its key performance indicators;
- **Completeness**: an ARA should be a standalone document with sufficient breadth to include all positive and negative information needed to understand the company's transactions, financial performance and position, liquidity status and future prospects. Preparers of the ARA can largely be guided by the content requirements of legislation and accounting standards although complex or unusual cases may require additional disclosures;
- **Timeliness**: the FRC encourages companies to ensure that adequate time is given to the preparation and audit of high quality ARAs and the information is useful to its users by publishing the ARA shortly after the balance sheet date;
- **Accessibility**: a good ARA is accessible and easy to navigate, with a detailed hyperlinked contents pages and specific hyperlinked cross references. An ARA published on a company's website should be easy to find and available for download in its entirety; and
- **Transparency**: an ARA should faithfully represent the economic substance of a company's transactions by disclosing any significant judgments and additional disclosures that are necessary to fully understand the transactions entered into.

Next steps:

As companies are required to collect and disclose an increasingly wide range of data in new areas of activity, particularly with regards to ESG reporting, it is of increasing importance that companies develop effective information and accounting systems to collect complete data as well as robust data capture internal controls to protect the data's integrity.

Further information:

- Click **here** for a copy of the report on What Makes a Good Annual Report and Accounts.
- Click **here** for a copy of the FRC's Guidance on the Strategic Report.

FRC publishes its draft Three Year Plan for 2023 to 2026

On 16 December 2022, the FRC published its draft Three Year Plan 2023 to 2026. It outlines the FRC's priorities and planned expenditure for 2023 to 2026.

December 2022

This is the FRC's second three-year plan, and it once again focuses on plans to support its transition to the Audit, Reporting and Governance Authority ("**ARGA**"). The government was expected to introduce legislation in 2023 to grant the FRC new regulatory powers and funding as an independent statutory regulator, thereby creating the ARGA. The FRC's draft plan acknowledges the government's delay in bringing this legislation, and has planned around the new expectation that the ARGA will be created in 2024.

The FRC intends to continue the work set out in its Position Paper published in July 2022, which outlines how it will support the transition in the period leading up to the passing of legislation. It expects its costs to increase by £8.1 million for 2023-2024, and its headcount to increase by 9.7% to 533 by March 2024, and to 600 by 2026-2027. The FRC notes that staff costs account for the largest proportion of its expenditure.

2023 - 2024 Priorities and Deliverables

The FRC has set out its intended actions and priorities under each of its divisions, to include:

Regulatory Standards: this division sets the FRC's audit, assurance, ethical, FRS accounting, and technical actuarial standards for the UK.

- Development and maintenance of standards and codes;
- Contribution to and influence of auditing, assurance and ethical standards, and non-financial reporting developments;
- Policy support for ARGA's local audit systems leader role;
- Improving and innovating support for high-quality reporting and audit;
- Promoting the use of technology (e.g. digital reporting); and
- Increased stakeholder engagement.

Supervision: this division delivers the FRC's monitoring and oversight obligations in respect of audit, accounting, corporate reporting, and actuarial work.

- Deliver a programme of AQR inspections, CRR reviews and oversight functions and reporting;
- Improving and innovating support for higher audit quality and resilience;
- Approval and registration of audit firms;
- Assess the effectiveness of the firms' implementation of new auditing and quality management standards;
- Develop a supervisory approach for audit committees and supervisory oversight strategy for the professional bodies;
- Develop the local audit system leader role and team in shadow form ahead of ARGA implementation;
- Reporting on implementation of operational separation;
- Develop market monitoring function; and
- Deliver projects on developing AQR and Improving the Quality of Auditor Education and Training.

Enforcement: this division ensures that those responsible for poor quality audit and reporting and the underlying poor behaviours are held to account, and supports root cause analysis.

- Fair, robust, and timely case closures;
- Upskilling and training to respond to enforcement changes and new powers from 2024 onwards;
- Collaboration with the Department for Business, Energy, and Industrial Strategy (BEIS) on planned legislative change; and
- Publication of the Annual Enforcement Review.

Corporate Services: this division is non-regulatory and focuses on supporting effective functioning, with a particular focus on creating a solid funding base during the three-year plan.

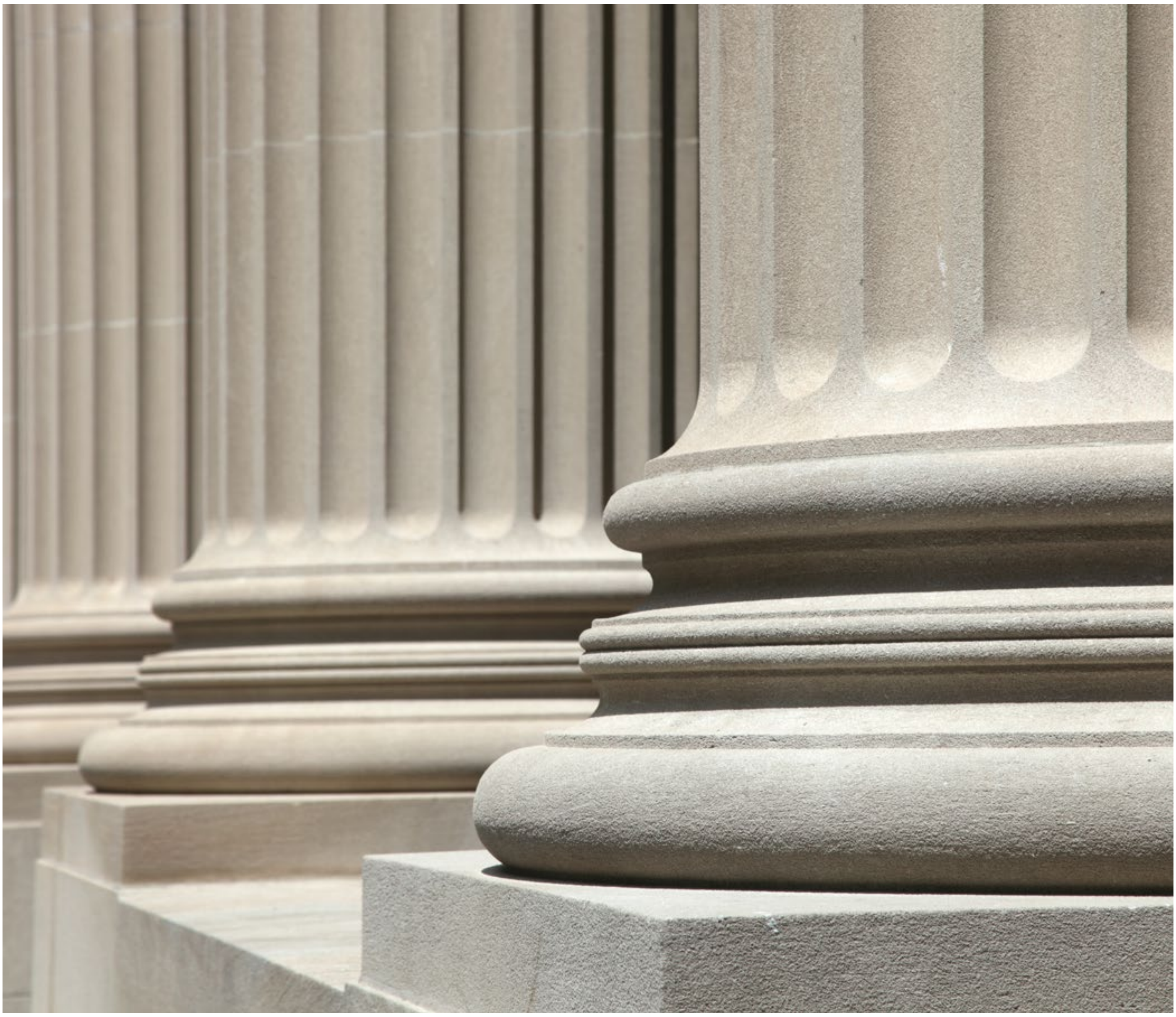
- Develop a statutory funding model for ARGA;
- Develop and implement an integrated information management strategy;
- Data analytics and reporting, economic advice and impact assessment, including to support the transition to ARGA;
- Appropriate workforce planning;
- Strengthen support infrastructure;
- Enhance the level of assurance activity against internal policies and controls;
- Legal support for all FRC activities; and
- Embed contingency planning processes and testing regime.

Next steps:

The 2023-2023 Strategy and Plan & Budget consultation is still in progress and will run until 27 January 2023. Comments can be sent to **FRC.Plan.Budget@frc.org.uk** until close of business on 27 January.

Further information:

- Click **here** for a copy of the FRC's Draft Three Year Plan.
- Click **here** for a copy of the FRC's July 2022 Position Paper.



FRC announces areas of supervisory focus for 2023/2024

On 16 December 2022, the FRC announced its areas of supervisory focus and priority sectors for corporate reporting reviews and audit quality inspections.

December 2022

After the FRC's annual review of Corporate Governance Reporting found scope for improvement in key areas of financial reporting (see **item 12** in this briefing), its Corporate Reporting Review team will supplement its routine reviews in 2023/2024 with four thematic reviews of corporate reporting and audits in the following sectors which are under particular pressure:

1. **Insurance contracts:** following the introduction of the new IFRS 17 standard on insurance contracts, the FRC will review insurers' 2023 interim accounts with greater scrutiny.
2. **Large private companies:** the FRC will review a selection of private companies' annual reports to identify areas of poor compliance with reporting requirements in light of the enhanced regulatory focus on the largest private companies. Following the introduction of the Public Interest Entity Auditor Register Regulations on 5 December 2022 (see **item 5** in this briefing) there is also a proposed change to expand the definition of a Public Interest Entity to include companies and LLPs with over 750 employees and an annual turnover of over £750m.
3. **Task Force on Climate-related financial Disclosures** ("**TCFD**"): after the FRC's thematic review of TCFD disclosures in 2022 highlighted room for improvement for companies' disclosures and metrics (see **item 3** in this briefing), the FRC will carry out a targeted follow-up in 2023 and assess if companies have addressed their net zero commitments in their financial statements.
4. **Fair value measurement (IFRS 13)**: the FRC will highlight examples of better disclosure and common pitfalls of companies in the non-financial sector.

The FRC's Audit Quality Review team will carry out its audit quality inspections in line with ISQM 1, the new quality standard for firms. For its 2023/2024 inspection cycle, the FRC has chosen to cover sampling, hot review, root cause analysis and network resources and service providers and pay particular attention to going concern, fraud risks, the application of ISA (UK) 315, the revised auditing standard for risk identification and assessment and climate-related risks, including the link between audited financial statements and the Annual Report's climate-related disclosures.

Priority sectors

When selecting corporate reports and audits to review, the FRC will generally tailor its selection of company reports for review and audits for inspection where commercial and financial pressures have been felt most acutely in the difficult economic conditions. After the FRC's 2022 annual review focused on FTSE 350 companies in the travel, hospitality, retail, property and financial services sectors (see **item 12** in this briefing), the FRC will adjust its scope for 2023/2024 and give priority to the following sectors considered to be a higher risk from economic pressures:

- Travel, hospitality and leisure;
- Retail and personal goods;
- Construction and materials; and
- Industrial transportation.

Further information:

- Click **here** for a copy of the Announcement of the FRC's areas of supervisory focus for 2023/2024.

Governance in the news

FCA fines former chairman of a listed company for disclosing inside information (August 2022):

On 5 August 2022, the FCA published a Final Notice to Sir Christopher Gent, the former non-executive chairman of ConvaTec Group plc ("**ConvaTec**"), and fined him £80,000 for unlawful disclosure of inside information.

The FCA found that Sir Christopher breached Article 14(c) EU Market Abuse Regulation ("**MAR**") and acted negligently by privately disclosing inside information on 10 October 2018 on private phone calls to senior individuals at two of ConvaTec's major shareholders. The inside information concerned ConvaTec's expected RNS announcement about revising its financial guidance and the CEO's retirement.

Listed companies' senior employees should exercise caution and seek advice from advisors before disclosing any inside information, with an awareness of the key MAR provisions.

Supreme Court confirms directors' duty to act in interest of creditors (October 2022):

On 5 October 2022, the Supreme Court unanimously dismissed BTI's appeal and held that directors owe a common law duty to the company to act in the interests of a company's creditors in certain insolvency situations.

The creditor duty applies when the directors know or ought to know that the company is insolvent, that insolvency is "just around the corner and going to happen", or that insolvent liquidation or administration is probable.

If the duty is engaged, the interests of creditors should be considered alongside the interests of shareholders, and the two should be balanced where they conflict. The worse a company's financial status, the greater the priority to creditors. The point at which insolvent liquidation or administration becomes inevitable, the company's interests are considered equivalent to creditors' interests.

The White & Case UK Public Company Advisory ("**PCA**") team advises UK public companies on their day-to-day legal affairs. In particular, the team engages with listed companies outside of their transaction cycle and provides advice across a range of matters, with particular expertise in corporate governance and corporate advisory. The team is experienced in company secretarial matters and regularly provides support to non-legal functions (as well as legal and company secretarial teams) within PLCs. Our clients range in size and maturity from newly listed companies to mature companies and from small cap companies to global FTSE 350 companies.

The PCA team is part of the network of White & Case offices offering public company advisory services, with specialist practice teams in the US, Germany, Italy and France.

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