CLIFFORD CHANCE

YOUR 2020 AGM UPDATE AND BEYOND

This coming AGM season will inevitably be dominated by the need for premium listed companies to report against their compliance (or explain any non-compliance) with the updated 2018 UK Corporate Governance Code, coupled with the new statutory requirement to publish a section 172 statement.

One further area where we are also seeing an increasing number of queries is the additional new statutory requirement for "large" unlisted UK-incorporated companies to publish a statement of their corporate governance arrangements in their directors' reports. Many premium listed companies with subsidiary companies that are affected by this requirement are currently deliberating whether to report against the application of the Wates Principles or adopt a different approach.

Thankfully, against this backdrop of regulatory change, most companies' AGM notices are not expected to require any substantive change.

In this Update, we examine the above developments and other changes affecting the coming AGM season and the preparation of the annual financial report. We also look ahead to other governance and narrative reporting-related changes on the horizon.

Key issues

- UK companies with a 31 December financial year end will be required to report against new statutory narrative reporting requirements - in particular, the requirement for a section 172 statement
- Premium listed companies will be reporting against their compliance (or explaining any non-compliance) with the updated 2018 version of the UK Corporate Governance Code
- No substantive changes are required to the form and content of the 2020 AGM notice

New Narrative Reporting Requirements

Section 172 Statement

Readers will be aware of the new statutory requirement[1] for all UK-incorporated companies that currently prepare a strategic report, unless they qualify as medium-sized[2], to include a statement in their strategic report

1 Section 414CZA Companies Act 2006.

2 See box on page 2.

describing how the directors have had regard to the matters set out in section 172(1) Companies Act 2006 (the directors' duty to promote the success of the company) (**section 172 statement**). For premium listed companies, there is a further gloss to this requirement in the form of Provision 5 of the updated 2018 version of the UK Corporate Governance Code (**2018 Code**), which requires the board to understand the views of its key stakeholders and describe in the annual report how their interests, and the matters set out in section 172(1), have been considered in board discussions and decision-making. The section 172 statement is an opportunity for companies to inform both shareholders and other stakeholders about their engagement with key stakeholders. Companies should consider addressing the following matters in their section 172 statement, focusing on matters that are of strategic importance to the company:

- identify key stakeholder groups and those other issues or factors that the board has had regard to;
- describe the main methods of engagement with key stakeholder groups;
- explain how the board ensures that it is sufficiently informed in order to understand key stakeholders' views; and
- describe how the directors have had regard to stakeholder interests in decision-making and strategy.

Please refer to our briefing *From Shareholders to Stakeholders: Section 172 Statement: Telling your Story* (updated in January 2020) for further insights into the types of additional disclosures that may be used to support and evidence these key disclosures. Readers may also wish to refer to the voluntary section 172 statements published during the 2019 reporting season by Land Securities Group plc (see pages 72 to 73 of its 2019 annual report), United Utilities Group plc (see page 152 of its 2019 annual report), and Standard Life Aberdeen plc (see page 22 of its 2018 annual report).

There are also new additional content requirements for the directors' report:

- All UK companies that satisfy two or more of the following (i) turnover of more than £36m; (ii) balance sheet total of more than £18m; and (iii) more than 250 employees, must include information on how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others; and
- All UK companies with more than 250 UK employees need to disclose information on how the directors have engaged with employees[3].

Given the overlapping requirements of these reporting requirements with the section 172 statement, companies may wish to include all relevant disclosures in the strategic report so long as they include a statement in the directors' report that they have done so.

Groups will need to examine which subsidiary companies satisfy the threshold for preparation of a section 172 statement and ensure that each such company publishes its own statement.

What is a medium sized company?

Sections 465-467 Companies Act 2006 set out the criteria for a medium-sized company. Broadly speaking, in order to qualify a company must satisfy two or more of the following: (i) turnover of not more than £36m; (ii) balance sheet total of not more than £18m; and (iii) not more than 250 employees.

Note that certain companies are excluded from being treated as medium-sized even where they otherwise meet the criteria - this includes public companies, insurance companies and companies that are part of an ineligible group (for example, where there is a traded company in the group).

[3] Note that where the company is a parent company, the average number of persons employed by the company refers to the number within the group.

New requirement for a corporate governance statement

New corporate governance reporting requirements apply to UK-incorporated companies with either (i) more than 2,000 employees; or (ii) turnover of more than £200m and a balance sheet total of more than £2bn[4]. Groups should identify all relevant subsidiaries that will have to prepare a corporate governance statement. Note that listed companies are excluded from this requirement where they are required to make a corporate governance statement under the DTRs.

The corporate governance statement must include details of the corporate governance code, if any, the company applied for the financial year (along with details of any departures from such code and the reasons for such departures). If the company has not applied any corporate governance code, the statement must explain the reason for that decision and what corporate governance arrangements were applied instead. The statement must be included in the directors' report and must also be made available online (publication on a listed parent company's website will suffice).

We are seeing a mixed approach to this new reporting requirement. Whilst it is the government's hope that many large subsidiaries will look to adopt the Wates Corporate Governance Principles for Large Private Companies launched in December 2018, a number of companies that we have spoken to are intending to report that they do not apply any formal corporate governance code, and will either describe those governance arrangements that apply across the wider group or which are applied by that particular entity.

The Wates Principles comprise of six high level principles covering (1) purpose and leadership; (2) board composition; (3) director responsibilities; (4) opportunity and risk; (5) remuneration; and (6) stakeholder relationships and engagement. There is accompanying guidance for each of the principles. Companies adopting the Wates Principles should follow them on an "apply and explain" basis, describing their application of each principle in the context of the company's specific circumstances. The guidance is intended to assist companies in explaining their approach to the principle in question but companies are not required to report against the guidance in the way that premium listed companies "comply or explain" against the provisions of the 2018 Code.

The Wates Principles expressly recognise that for group subsidiaries, governance practices may well be included in policies issued by the parent company, for example in relation to remuneration practices and policies (Principle 5 – remuneration). This would not of itself stop a subsidiary company from choosing to adopt the Wates Principles as the company could, in its explanation that demonstrates the application of the relevant principle, refer to the parent company's corporate governance statement/report, if that report explains the governance procedures of the subsidiary.

In a similar vein, BEIS FAQs, published alongside the regulations which introduced this new reporting requirement, state that a subsidiary of a premium listed company which applies the 2018 Code could, in principle and if the circumstances warrant it, state that it does not apply a code because the parent applies the 2018 Code which is applied throughout the group. The

Do I need to make any substantive changes to the AGM notice itself?

Generally speaking, no. However, if the company is either required, or elects, to put an updated **remuneration policy** to shareholders for approval this year, then it will be necessary to include a resolution to this effect.

If you are considering a **hybrid AGM** (see page 2 of this Update), then changes to the AGM notice will also be required to inform shareholders how they can participate electronically in the meeting.

Finally, if the company received **significant dissent** (a vote of more than 20% against) in respect of any resolution proposed at the 2019 AGM, a summary must be included in either the annual report or notice of AGM detailing the impact that shareholder feedback has had on the decisions the board has taken and any actions or resolutions now proposed (see page 2 for further details).

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[4] Part 8 (Statement of corporate governance arrangements) of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

subsidiary would still need to explain however, how the 2018 Code applied to governance arrangements in relation to the subsidiary itself.

The simply reality is that there is no one size fits all approach to this reporting requirement and companies must decide which approach to adopt on the basis of what corporate governance arrangements are actually in place. Where a company states that no code applies and describes the arrangements that are in place, it may still wish to structure the disclosure along the lines of six principles set out in the Wates Principles in order to provide a framework for the disclosure itself.

Workforce Engagement disclosures

As mentioned above, UK companies with more than 250 employees are now required to include an employee engagement disclosure in their directors' report.

For premium listed companies, Provision 5 of the 2018 Code recommends that, as part of a board's obligation to understand the view of the company's stakeholders', that for engagement with the workforce, one or more of a combination of the following methods should be used: (i) a director appointed from the workforce; (ii) a formal workforce advisory panel; or (iii) a designated non-executive director. If the board has not chosen one or more of these methods, the 2018 Code requires an explanation of the alternative arrangements put in place and why the board considers that they are effective.

From conversations with many of our clients, it is clear a variety of different approaches are being adopted.

This is also evidenced by the results of a poll[5] conducted amongst GC100 members in November 2019. Of the 36 respondents:

- 36% have or will be adopting alternative arrangements;
- 28% have or will be appointing a designated NED;
- 8% have or will be setting up a workforce advisory panel;
- 11% have or will be appointing a designated NED in conjunction with a workforce advisory panel; and
- 12% have or will be adopting a combination of methods.

Whilst it was not mandatory to report against the 2018 Code in 2019, a number of companies took the opportunity to enhance their reporting around employee (and indeed, wider stakeholder) engagement in their annual reports.

A report published by Practical Law in November 2019, entitled *Annual reporting and AGMs 2019* reported that 171 companies included a statement in their annual report on the workforce engagement mechanism(s) that they have adopted or will adopt to comply with Provision 5 of the 2018 Code. The report concludes that the most popular method, adopted by approximately 60% of those 171 companies, is a designated NED. Fewer companies have adopted or will adopt a workforce advisory panel and only five companies have elected a director appointed from the workforce. The report also found that a substantial number of companies have mentioned already having

Significant dissent: implications for shareholder votes held after 1 January 2019

The 2018 Code introduced new reporting requirements in circumstances where there is "significant dissent" – a vote of 20% or more cast against a recommended resolution on which shareholders were asked to vote after 1 January 2019.

Where there is significant dissent, the 2018 Code recommends that:

- when announcing the voting, the board disclose what action it intends to take to consult shareholders in order to understand the reasons for the significant dissent;
- an update on the views received from shareholders or actions taken be published no later than 6 months after the shareholder meeting; and
- a final summary be included in the annual report or notice of AGM (as applicable) detailing the impact that the feedback has had on the decisions the board has taken and any actions or resolutions now proposed.

Companies that received significant dissent in respect of any resolution proposed at their 2019 AGM will need to have regard to this requirement when preparing their 2019 annual report or 2020 AGM notice and include the relevant disclosures.

5 Refer to the GC100 webpage hosted on Practical Law's website for further details of the results of the poll.

alternative arrangements (which may be in combination with one or more of the other methods) in place, including existing employee forums, European works councils, board associates appointed from the workforce or employee events to meet the board.

Climate Change Activism – implications for AGMs

In recent years we have seen climate change shareholder activists (such as Climate Action 100+ and Follow This) become more willing to engage with companies directly at their AGMs - by asking boards challenging and probing questions or proposing that climate change-related resolutions be included in the AGM agenda. Certain sectors are more prone to climate change-related activism (e.g., oil and gas, mining and metals, chemicals, aviation, utilities, automobiles) and climate-change activists are systematically targeting larger companies in these sectors; however we have also seen action taken against companies in the financial sector that provide financial services to these companies.

Last AGM season saw a number of companies receive a shareholder requisitioned climate-change related resolution for inclusion on the AGM agenda. When faced with such action, a board will need to assess the reasonableness of the proposals and consider whether it is willing to support them: if it is not willing to support the proposals, the board should be prepared to explain why that is the case. At BP's 2019 AGM two special resolutions (resolutions 22 and 23) were requisitioned by shareholder groups coordinated by Climate Action 100+ and Follow This respectively, both in relation to climate change issues. While BP's board supported the climate change disclosures resolution (resolution 22) proposed by Climate Action 100+ and recommended that shareholders vote in favour of it, the board did not support the resolution on climate change targets (resolution 23) proposed by Follow This, and recommended that the shareholders vote against it. More recently, as reported in the press on 8 January 2020, Barclays PLC has received a shareholder-requisitioned resolution from a group of 11 pension and investment funds, spearheaded by the campaign group, Share Action. The resolution, which will be voted on at the company's AGM in May 2020, calls on Barclays to set clear targets to phase out services to energy companies that fail to align with Paris climate goals. This includes lending to specific fossil fuel projects or to companies themselves, which include electricity and gas providers, which fall foul of climate targets.

Given the risk of potential action either ahead of an AGM (for example, activist shareholders seeking to requisition a resolution) or at the AGM itself (by means of disruptive conduct), boards should keep a careful watch on the shareholder register ahead of the AGM and ensure that they are keeping stakeholders clearly informed of their plans in relation to climate change. Where activists come onto the shareholder register, boards should consider engaging early or pre-emptively with them and, separately, with other shareholders and stakeholders so as to reduce the likelihood that they would support such activism. In 2019, Shell was targeted by Follow This, who proposed a resolution calling on Shell to change its climate policy. The activist withdrew the proposed resolution following requests to do so from shareholders who had originally requisitioned the resolution because Shell had managed to turn things around by agreeing with shareholders that it would set out plans to introduce industry-leading targets to reduce greenhouse gas emissions and link them to executive pay.

Hybrid AGMs

2019 saw both Marks & Spencer Group plc and Equiniti Group plc hold a hybrid AGM with shareholders able to either attend the meeting in person or elect to participate electronically without the need to be physically present.

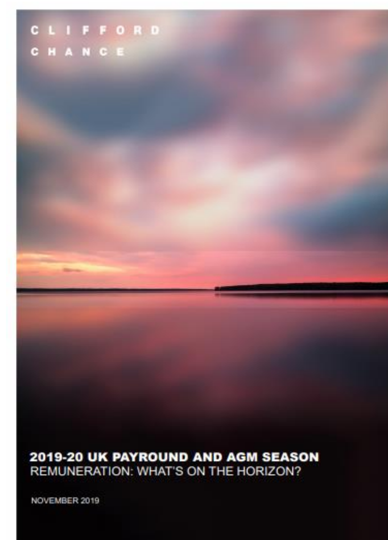
For companies with a large retail shareholder base or a significant non-UK shareholder base, offering a hybrid AGM has the potential to significantly increase shareholder participation at the AGM.

In recent year, a number of companies have made changes to their articles of association to permit hybrid AGMs but, despite these changes, few companies have embraced the hybrid format.

For companies wishing to do so, they will need to confirm that their articles permit hybrid meetings and instruct an organisation that can provide the electronic platform on which to host the virtual meeting. Attendees should be able to ask questions, vote and participate electronically in real time, as they would do at a physical meeting. Relevant information regarding how shareholders can participate electronically will need to be included in the AGM notice.

M&S partnered with lumiglobal.com to offer shareholders the option to participate electronically via an app or via a weblink. It remains to be seen whether other companies will follow suit in 2020 and offer electronic participation in the AGM to shareholders.

Where companies are anticipating disruptive behaviour at an AGM, careful consideration needs to be paid to the security arrangements put in place for the meeting. Ahead of the AGM, it will be important to brainstorm potential disruptive scenarios and ensure an appropriate response is planned, with all relevant people fully briefed. This will be particularly important for the chair who should be provided with a detailed script with the recommended response to each scenario. The chair should ensure he/she is clear about his/her powers both to adjourn the meeting and to eject people in the event of disorderly conduct.



Executive Remuneration remains in the spotlight

In November 2019, Clifford Chance published a briefing *2019-20 UK Payround and the AGM Season*, which looks back at the key themes and trends in relation to directors' remuneration seen in the 2018-19 AGM season and discusses the remuneration-related issues likely to dominate the 2019-20 AGM season.

The briefing addresses the new disclosure obligations for both the annual directors' remuneration report (including the statutory requirement to report on the difference in pay between a company's CEO and its UK employees, which will apply for the first time to financial years starting on or after 1 January 2019) and the directors' remuneration policy.

It is expected that a significant number of companies will be required to put forward a new directors' remuneration policy for shareholder approval this coming AGM season as they come up against the three-year requirement for approval of their policy. New policies will need to be brought in line with the recent recommendations of the 2018 Code, updated investor guidelines and the new statutory disclosure requirements.

Whilst also covered in the briefing referred to above, it is worth noting new Provision 38 of the 2018 Code which states that pension contribution rates for executives (or payments in lieu) should be aligned with those of the wider workforce. This requirement has been picked up by the various investor bodies, including both Glass Lewis and ISS (see below for further details) In addition, the Investment Association's (**IA**) Institutional Voting Information Service (**IVIS**) has stated that for companies with year-ends starting on or after 31 December 2019, it will from the start of the 2020 AGM season:

- ‘Amber top’ any company with an existing director who has a pension contribution 25% of salary or more, provided they have set out a credible plan to reduce that pension to the level of the majority of the workforce by the end of 2022.
- Red top’ any company with an existing director who has a pension contribution 25% of salary or more, and which has not set out a credible plan to reduce that contribution to the level of the majority of the workforce by the end of 2022.
- ‘Red top’ any company which appoints a new executive director or where a director changes role with a pension contribution out of line with the majority of the workforce, or which seeks approval for a new remuneration policy that does not explicitly state that any new director will have their pension contribution set in line with the majority of the workforce.

Generally, IA members do not consider that fixing the monetary value of pension contributions over time to be a credible action plan to bring the pension contribution in line with the majority of the workforce.

In addition, the IA also expects the following approach from companies during 2020:

- Companies should disclose in their remuneration report the pension contribution rate they consider to be given to the majority of the workforce and how this rate has been derived.
- The board, remuneration committee and management team should consider the pension contributions provided to all employees, not just the executive directors. IVIS will highlight those companies that have increased the pension contributions provided to all employees.
- For those companies that provide a defined pension benefit to their executive directors, they are expected to confirm if that future accrual is still open to other employees on the same terms as the executives. If this is not the case, the remuneration report will be "amber topped".

Updated proxy voting guidelines for 2020 AGM season

Glass Lewis: Glass Lewis published its 2020 proxy paper guidelines in November 2019. Key changes from the 2019 version include:

- **Board skills**. Board skills matrices should be included in the analysis of director election proposals at all FTSE 350 companies (previously just FTSE 100), excluding investment trusts. Glass Lewis may recommend voting against a nomination committee chair if the board has not addressed major issues of board composition.
- **Audit committee meetings**. Glass Lewis may recommend voting against an audit committee chair of any FTSE 350 companies, excluding investment trusts, where the audit committee has, without explanation, failed to hold a minimum of three meetings during the year under review.
- **Smaller premium listed companies**. At least half of the directors, excluding the chair, of all premium-listed companies (previously just FTSE 350) should be independent and all such companies should hold annual director elections. Glass Lewis will generally accept explanations in lieu of compliance if a company has failed, but intends, to meet the 2018 Code's enhanced board independence expectation. If an explanation of non-compliance is not provided, it may recommend voting against non-independent directors. By 2021, Glass Lewis will generally expect boards to have had enough time to meet the independence provision.
- **Salaries and pensions**. Salary increases and pension contributions should reflect those awarded to a company's wider workforce.
- **Incentive plan limits**. All incentive plans should feature clear and transparent award limits, expressed as a multiple of base salary per employee.
- **Post-exit shareholding requirements**. Post-employment shareholding requirements are now included among best practice features generally expected of remuneration policies.
- **Threshold vesting under LTI plans**. Long-term incentive plans should allow for no more than 25% vesting for threshold performance.

Women on Boards – Hampton-Alexander Review 2019 report

In November 2019, the Hampton-Alexander Review published its annual report on improving gender balance in the FTSE. The report found that:

- 2019 has been the strongest year of progress since targets were first set in 2011 for women on boards;
- the FTSE 100 are on track to reach the 33% target for women on boards ahead of the 2020 deadline - women now hold 32.4% of all FTSE 100 board positions and 29.6% of all FTSE 250 board positions;
- there remain 39 boards with just one female board member, 28 of which had just one female board member last year as well;
- there are two all-male boards remaining;
- a step-change is needed for senior leadership roles below board level - women's representation in the senior leadership of FTSE 100 and 250 companies is 28.6% and 27.9% respectively. If 50% of all appointments next year do not go to women, the 2020 target of 33% will not be met. Some 175 companies are still well adrift from the 33% target and there are still 44 all-male executive committees.

During the course of 2020 there is likely to be a continued focus and push on the issue of gender diversity on boards in order to try to ensure that the targets first set by the Davies Report in 2011 are met.

- **Remuneration committee discretion.** Downward discretion should be considered where the company has suffered an exceptional negative event, even if formulaic targets have been met.

Glass Lewis has also reminded companies that it may not recommend for re-election the nomination committee chair at any FTSE 350 company that has not met the Hampton-Alexander 33% gender diversity target nor disclosed any cogent explanation or plan to address the issue.

The Institutional Shareholder Service: The ISS has also published its UK proxy voting guidelines for 2020 which will apply to shareholder meetings on or after 1 February 2020. Changes include:

- **Board diversity**. ISS has included a new policy on board gender diversity whereby it will generally recommend voting against the chair of the nomination committee (or other directors on a case-by-case basis) where there are no female directors on the board of a widely-held company. Mitigating factors would include the presence of a female director on the board at the preceding AGM together with a publicly available firm commitment to appoint at least one female director within a year.
- **Chair tenure**. ISS has amended the policy on chair tenure to clarify that ISS will not consider chair tenure in isolation but as one of several key indicators relevant to the re-election of chairs.
- **Board and committee composition**. ISS has removed the exception for companies below the FTSE 350 from the expectation that at least 50% of their boards, excluding the chair, should comprise independent directors. ISS has also removed the exception for such companies that allowed chairs to sit on the audit committee.
- **Remuneration**. ISS has amended the pension contribution policy to provide that for new directors, pension arrangements should be aligned with the wider workforce, and companies should disclose whether or not this is the case. For incumbents, companies should seek to align contribution rates with the workforce. ISS has updated its policy on service contracts to clarify that outstanding long-term incentive awards should be pro-rated for performance and time served.
- **Remuneration report**. ISS has amended its bonus policy to specify that ISS now will (rather than may) recommend a vote against where bonus targets are not disclosed, and that disclosing one or more years in arrears may attractive a negative vote recommendation. ISS has also amended its exit payments policy to specify that formal notice should be served no later than the day on which the executive's leaving date is announced, and if a company chooses not to serve notice then, it should explain its reasoning in the report. The policy on use of discretion by remuneration committees has been expanded to include a requirement that the committee discloses how it has taken into account any relevant environmental, social and governance matters when determining remuneration outcomes. Such matters would include (without limitation) workplace fatalities and injuries, significant environmental incidents, large or serial fines or regulatory sanctions and/or significant adverse legal judgments or settlements.

Share buybacks: BEIS study concludes no evidence that repurchases are used to artificially hit EPS targets

Whilst PIRC continues to take a strict line on share buyback authorities (requiring the inclusion of a clear, cogent and compelling statement in the AGM notice from the board demonstrating how the authority would benefit long-term shareholders and that the directors are not conflicted in recommending the authority), it is interesting to note the publication in July 2019 of a BEIS research paper on share repurchases, which explored whether repurchases are used to meet performance targets of senior executives, and whether they displace companies making investment in their underlying business.

The research, prepared by PwC, concludes that the evidence does not suggest that repurchases are being used systematically to artificially hit EPS targets and inflate executive pay or at the expense of long term investment in the business.

Interestingly, an analysis comparing companies' EPS performance had they not repurchased shares to their EPS including the repurchase concluded that no company successfully used share purchases to beat its EPS target (although one company which undertook the largest repurchase exercise came close) and the evidence showed that companies rarely repurchase enough shares to materially impact their EPS measure.

On the horizon

Changing the future of corporate reporting

The FRC has commenced a major project to examine the future of corporate reporting, the first part of which was the launch in October 2019 of an online survey seeking stakeholders' views on what information users of corporate reports need. Responses will inform the FRC's project which will make recommendations for improvements to current regulation and practice and develop "blue sky" thinking. A key driver of the project is to challenge the FRC to think more broadly in responding to the recommendation by Sir John Kingman to promote greater "brevity, comprehensibility and usefulness in corporate reporting". A discussion paper is expected to follow in early 2020.

Conduct of external board evaluations

In May 2019, ICSA (now The Chartered Governance Institute (**TCGI**)) published a consultation into the effectiveness of independent board evaluation in the UK listed sector, intended to assess the quality of these evaluations and identify ways in which they might be improved.

TCGI has proposed a set of measures intended to incentivise both service providers and boards to ensure that independent evaluations are robust and objective, and enable companies to evidence that this is the case. In particular, TCGI sought views on the following proposals:

- a voluntary code of practice for the providers of board evaluation services, and formal arrangements for implementing and monitoring such a code, including whether there is a need for a formal oversight board;
- voluntary principles to be applied by listed companies when engaging external reviewers to undertake board evaluations – these would include (i) requirements to ensure that the company does not delegate the decision on the appointment of an external reviewer to a single board member or employee and that any decision is ratified by either the full board or the nomination committee and (ii) a prohibition on the company appointing an external reviewer with which it has other current commercial relationships, or that has carried out more than two previous consecutive full board evaluations for the company. The company will also be required to state in the annual report whether it has followed the principles, and whether the board reviewer is a signatory to the code of practice for reviewers. In addition, the company will need to obtain the reviewer's formal agreement that the description of the process followed and the findings of the evaluation to be included in the annual report are accurate; and
- guidance for listed companies on the disclosure of the conduct and outcomes of their board evaluation, in accordance with the 2018 Code.

Whilst Provision 23 of the 2018 Code introduced new disclosure requirements for reporting on the board evaluation in the annual report, it is too early to

Ethnicity pay reporting

In last year's AGM Update we reported on the consultation published in October 2018 by the government on mandatory ethnicity pay reporting, in which the government set out its proposals to require organisations employing more than 250 employees to report ethnicity pay information. The consultation closed on 11 January 2019 but no response has yet been published.

Separately, companies should be mindful of the recommendations of the Parker Review published in October 2017 there should be at least one director of colour on each FTSE 100 board by 2021 and on each FTSE 250 board by 2024.

ESG and Climate Change Reporting

Climate change — or rather what companies are doing about the likely impacts of climate change on their businesses — is at the forefront of investors' minds and has quickly risen towards the top of the board agenda.

We are seeing more and more companies adopt a dynamic approach to reporting on their sustainability initiatives and explaining what they are doing to ensure their businesses are operating in a responsible and sustainable way. For some companies, this includes the setting of targets and explaining how and by when they hope to achieve these (which all goes to demonstrate their commitment to transitioning to a net-zero economy). Increasingly, companies are reporting on ESG matters more frequently than once a year (not just at their AGMs or via the annual report, but also at their interim results presentation and/or by publication of a separate sustainability report), engaging with their investor base on different platforms (e.g. holding roundtable discussions with, or investor presentation days to, investors on sustainability and other key issues, such as governance issues); and/or using different methods of communication e.g. interview-style short video clips featuring the CEO or other senior executive directors.

While some companies are leading the charge on climate change-related reporting, as reported by the FRC's Financial Reporting Lab in its report on climate change reporting (published in October 2019), it remains the case that many companies are still falling short of investors' expectations. In its report, the Lab calls on companies to bridge this gap, outlining what investors want to understand from reports and providing practical guidance on how companies can improve their reporting. Among other things, the report includes recommended disclosures and a range of examples of the developing practice of climate-related reporting. In addition, the Lab recommends that companies use the Taskforce on Climate-related Financial Disclosures (**TCFD**) framework to report on climate-related issues, as this was well supported by participants and the UK government, which expects all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022 (as set out in its Green Finance Strategy).

In October 2019, the FCA published its response to its October 2018 discussion paper on climate change and green finance, stating that (among other things) it will publish a consultation paper in early 2020 proposing new disclosure rules for listed issuers aligned with the recommendations of the TCFD on a 'comply or explain' basis. It also clarified its view that existing disclosure obligations for listed issuers already capture the reporting of implications of climate change for a business where these are financially material to the company's prospects.

While the majority of FTSE 100 companies are not explicitly referencing the TCFD framework in their annual reports and accounts, the framework is gaining traction (particularly among companies in the financial sector). Some FTSE 100 companies appear to be applying the framework without explicitly referencing it. However, even where companies are applying the framework, many are not fully aligning with the TCFD recommendations. In his annual letter to CEOs published in January 2020, Larry Fink, CEO of Blackrock, warns in no uncertain terms of the risk that climate change presents to markets and that companies, investors and governments must prepare for a significant reallocation of capital into sustainable strategies. Positioning itself as a leader in sustainable investment, Blackrock is calling for improved disclosure to enable investors to have a clearer picture of how companies are managing sustainability-related questions. In particular, Blackrock is asking the companies in which it invests to (i) publish a disclosure in line with industry specific Sustainability Accounting Standards Board by the year end; and (ii) disclose climate-related risks in line with the TCFD's recommendations. With increasing investor pressure of this nature, coupled with likely adoption by the FCA of a 'comply or explain' approach to TCFD alignment, we can expect to see a greater number of companies starting to comply with the TCFD framework and hopefully, for those that are already doing so, a move towards reporting on a more fully-aligned basis.

For further information on the TCFD recommendations, and for a discussion of ESG / sustainability issues (focussing on environmental issues) relevant to listed companies, see our briefing, ESG issues for Corporate: Risks and Opportunities which was originally published in Growing the Green Economy: Addressing the Sustainability Challenges and Opportunities, our far-reaching look at developments in ESG and sustainable finance.

assess whether these changes will be sufficient on their own to improve the standard of board evaluation and reporting by listed companies. It may helpful for TCGI to allow time for a full cycle of compliance reporting against the 2018 Code before seeking to introduce any significant new measures. The consultation closed on 5 July 2019 and TCGI is yet to publish its findings and recommendations.

Adoption of European Single Electronic Format for Annual Financial Reports

For financial years starting on or after 1 January 2020, issuers with securities admitted to trading on a regulated market will be required to prepare their annual financial report in an electronic reporting format, Extensible Hypertext Markup Language (XHTML). This requires issuers to mark up or ‘tag’ specified disclosures in their annual financial statements using structured data formatting processes which will make the document ‘machine readable’ to enable investors and other market participants to use software tools to screen and analyse data across issuers.

For companies that prepare consolidated annual financial statements in accordance with IFRS, they must tag certain disclosures in those statements using inline Extensible Business Reporting Language (iXBRL) and following a taxonomy specified by EU regulatory technical standards.

There is a phased implementation of the mandatory tagging requirements. It will start with basic information on the company and figures in the primary financial statements (financial position, profit or loss, changes in equity and cashflow) for financial years beginning on or after 1 January 2020 and will cover all disclosures in IFRS consolidated annual financial statements (including the notes) for financial years beginning on or after 1 January 2022. Amendments to DTR 4.1 to implement the requirement to report in an electronic format took effect on 1 January 2020.

Brexit: UK to leave EU on 31 January 2020

Whilst we do not know what the terms of the future EU/UK relationship will be, the UK will leave the EU on 31 January 2020 on the terms of the EU/UK withdrawal agreement. Accordingly, at 11pm on 31 January 2020 the UK will enter a transition period until 31 December 2020 (unless extended), during which, although the UK will no longer be a member of the EU or participate in its institutions and decision making, the UK will continue to be subject to all EU laws (including new EU laws coming into effect during the transition period).

In September 2019, the FRC published a letter to Audit Committee Chairs and Finance Directors setting out a number of the most critical generic actions companies should consider in advance of the UK’s exit from the EU. With regard to corporate reporting, the FRC is encouraging companies to provide disclosure which distinguishes between the specific and direct challenges to their business model and operations from the broader economic uncertainties which may be a consequence of the UK’s exit from the EU, and which may apply when companies report. Where there are particular challenges posed, the FRC expects these to be clearly identified and for management to describe any actions they are taking, or have taken, to manage the potential impact. The letter notes that, in some circumstances, this may mean recognising or remeasuring certain items in the balance sheet.

Audit Reform – Brydon report published

In December 2019, Sir Donald Brydon published his independent review into the quality and effectiveness of audit.

The report was first commissioned in December 2018 in response to a perceived widening of the "audit expectation gap" – that is, the difference between what assurance people think an audit offers and what it actually provides assurance in relation to.

The report makes 64 recommendations in relation to a whole range of issues, including the creation of a new profession of company auditing; reporting in relation to the prevention and detection of fraud; company reporting on the approach to assurance and resilience; and a proposal that the CEO and CFO provide annual attestations to the board in relation to the effectiveness of the company's internal controls over financial reporting.

Refer to our January 2020 briefing *Widescale audit reforms proposed by Brydon* for more details.

The FRC also states that it expects that many companies will want to consider a wide range of reasonably possible outcomes when performing sensitivity analysis on their cash flow projections and which should be disclosed and explained. Whilst recognising that not all companies will require extensive disclosure, the FRC states that where sensitivity or scenario testing indicates significant issues, relevant information and an explanation should be set out in the annual report and accounts (for example in the impairment disclosures). The FRC states that it will be for companies to decide whether exiting the EU impacts their statements on viability and even their ability to continue as a going concern.

Changes to accounting standards affecting going concern statements and non-audit services

Going concern standard ISA UK 570: The FRC has issued revisions to its going concern standard ISA UK 570 Going Concern. The revised standard has been issued in response to recent enforcement cases and a number of corporate failures, such as Carillion, BHS and Thomas Cook, where the auditor's report had failed to highlight concerns about entities which collapsed shortly after.

The revised standard follows concerns about the quality and rigour of audit and increases the work auditors are required to do when assessing whether an entity is a going concern. In particular, the revised standard will require greater work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement. The effect of this revision to the standard may mean that boards are challenged to a greater extent by their auditor about the going concern statement and the work that stands behind it. The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, although early adoption is permitted.

***Updated FRC Ethical Standard*:** In July 2019, the FRC published a consultation on revisions to ethical and auditing standards. The final version of the amended standard was published in December 2019 with an effective date of 15 March 2020 (later than the originally proposed effective date of 15 December 2019), save for certain limited provisions which take effect at a later date. Audit committees may wish to discuss with their auditors the potential impact of this revised standard, which has implications for the provision of non-audit services carried out by a company's auditor. This development may necessitate an update to a company's policy on non-audit services.

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