Striking the right balance – a review of FY22/23 FTSE 350 annual reporting

August 2023
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Introduction

The last major change to narrative reporting took place when the 2018 UK Corporate Governance Code (the Code) and the Companies (Miscellaneous Reporting) Regulations 2018 (MRR) came into force on 1 January 2019. In 2020, the Financial Conduct Authority (FCA) introduced a Listing Rule (LR) requirement for premium listed companies (followed by standard listed companies a year later) to include a statement in the annual report and accounts (ARA) setting out whether disclosures consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) have been made. Since then, the LR on the diversity of company boards and their executive management was issued, effective for financial years starting on or after 1 April 2022 and the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 were introduced, effective for financial years beginning on or after 6 April 2022.

Companies are potentially looking at more significant changes in the two years to come. In May 2023, the Financial Reporting Council (FRC) published a consultation on its proposals to revise the Code, and the Department of Business and Trade (DBT) has proposed via secondary legislation (laid in Parliament in draft on 19 July 2023) four new reporting requirements – the Audit and Assurance Policy (AAP), the Resilience Statement (RS), a distribution statement and a statement on steps taken to prevent and detect material fraud.

In this publication, we provide an overview of the current state of narrative reporting by premium listed companies, share good practice and, in some areas, indicate how we expect reporting to evolve if the changes noted above are introduced. Our observations are supported by a review of 100+ FTSE350 ARAs, predominantly with 31 December 2022 year ends. We have also updated our acid test - a practical tool for preparers and boards looking to ensure the narrative within the ARA covers the key qualitative aspects of leading practice. Each chapter begins with relevant considerations from the acid test, and it is produced in full in Appendix B.

We encourage companies to use the 23/24 ARA preparation process to streamline and refresh their reporting to the extent possible. This will ensure that their ARAs remain as concise as possible creating space for the changes to come in the next two years. Secondly, in areas of more significant change such as risk, internal controls and resilience reporting, existing reporting should be reviewed keeping in mind impending requirements. This will provide some early indications of what and how much will need to change in the near future.

High-quality reporting, that strikes the right balance in accurately telling a company’s true story whilst meeting all the reporting requirements, requires significant effort to achieve. We hope that those involved in preparing ARAs will find this publication helpful and insightful as they embark on preparing their 2023/24 strategic narrative.

We thank Luke Benson, Mithun Vijay, Rikta Ghosh, Muskaan Kumari and Bhavik Patel for all their help in producing this report.

Authors

Mala Shah-Coulon
Associate Partner
Governance and Public Policy
mshahcoulon@uk.ey.com
+ 44 20 7951 0355

Maria Kępę
Director
Governance and Public Policy
mkepa@uk.ey.com
+ 44 7795 645183

1 Under the draft Statutory Instrument, these will apply to UK incorporated companies with turnover of £750m or above and 750 global employees.
43% discuss capital allocation beyond dividend policy

35% disclose the number of whistleblowing reports in a year

54% explain the reason for KPI choices

72% do not provide targets or outlooks for KPIs

40% do not state who oversees TCFD reporting

53% disclose principal decisions

23% List out emerging risks

20% Provide examples of emerging risks

Principal risk attributes

- Level of risk appetite: 30%
- Changes to mitigating actions: 31%
- Changes to risks: 80%
- Time period: 6%
- Velocity: 5%
- Likelihood: 33%
- Impact: 90%
1. Purpose

► What is the company's purpose? Does it explain why the company exists?
► Is the purpose bespoke or could it be for any company?
► How did purpose influence any principal decisions the board has made?
► Are there tangible examples of purpose in action?
► Does the company's purpose clearly inform its strategy?
► Is it clear to a reader how strategy delivery helps with realising purpose?

The requirement for boards to establish the company's purpose and ensure it is aligned to the values, strategy and culture was introduced by Principle B of the 2018 Code.

Well established

Four reporting cycles later, the concept of purpose is well established. Majority of companies state their purpose upfront, and many include summary visuals that bring purpose, strategic objectives, values and stakeholders together. NatWest (ARA 2022, pp12-13) does this as part of its ‘Purpose framework,’ Anglo American (Figure 1.1) as part of its ‘Purpose to value’ disclosure. Some companies like Howden Joinery (ARA 2022, pp8-9) and Rio Tinto (ARA 2022, pp10-11) also reference their approach to sustainability within these summaries.

At the same time, the extent of the accompanying narrative has reduced substantially over time. This reduction is starker this year compared to 2020 – the first year of reporting during the COVID-19 pandemic, when many companies had prominent disclosures on their response and actions in the context of realising their purpose.

Avoiding a reporting “gap”

This year’s reduction is a natural evolution given that on one hand purpose is now well embedded and, on the other, the pandemic is behind us. It can, however, create a reporting gap. This is often the case if the purpose statement reads like a marketing slogan or is not sufficiently bespoke, most notably impeding a meaningful articulation of alignment between purpose and strategy. Achieving this alignment is generally easier when, like Spire Healthcare (2022 ARA, p18), a company evolves its purpose and refreshes its strategy, thus providing a natural opportunity to explain the development to the reader.

How to bring purpose to life

To help bring purpose to life against a business-as-usual backdrop, we recommend that companies give tangible examples of purpose in action, for example by demonstrating how purpose influenced principal decisions, as done by Mondi (Figure 1.2).
Figure 1.1  Anglo American: Summarising how purpose guides stakeholder value creation (2022 ARA, p10)

Purpose to value

We are guided by our Purpose – re-imagining mining to improve people’s lives – to deliver sustainable value for all our stakeholders.

Our Purpose
Re-imagining mining to improve people’s lives

Transforming the very nature of mining for a safer, smarter, more sustainable future.

Our Values
Anglo American’s Values and behaviours are at the heart of everything we do. Guided by our Purpose and our Values, we enable high performance and purposeful action. Our Values and the way in which we, as individuals, are expected to behave are the foundation of our Code of Conduct.

- Safety
- Accountability
- Collaboration
- Innovation
- People

Our strategy

Guided by our Purpose, our strategy is to secure, develop and operate a portfolio of high quality and long life mineral assets, from which we will deliver leading shareholder returns. We achieve this through innovative practices and technologies – in the hands of our world class people.

Portfolio

- Innovation
- People

Capital allocation

Underscoring our strategy, we have a value focused approach to capital allocation, with clear prioritisation. Our Sustainable Mining Plan outlines ambitious targets that our projects must support to ensure a Healthy Environment, Thriving Communities and our position as a Trusted Corporate Citizen.

- Investors
- Suppliers
- Employees
- Customers
- Communities
- Host countries
- Natural environment

Balanced reward

Anglo American’s directors’ remuneration policy is designed to encourage delivery of the Group’s strategy and creation of stakeholder value in a responsible and sustainable manner aligned to our Purpose.

The main elements of the remuneration package are base salary, annual bonus and Long Term Incentive Plan (LTIP).

- For more on remuneration, see pages 180-205
Mondi: Articulating the outcomes of a principal decision in the context of purpose and setting out trade-offs (2022 ARA, p34-35)

Section 172 statement
How stakeholder considerations shape decision-making

Mondi’s strategic decision-making framework focuses on delivering sustainable value for key stakeholders, and relies on the quality of the relationships it has with them. The Board’s deliberations take into account the long-term interests of our stakeholders, along with the impact of our business and the balance of actions required to deliver sustainable growth.

Our approach
Mondi categorizes its stakeholders into six key groups described in the preceding pages, and reviews these annually. As part of the Board’s responsibilities and as a methodology for maximising the effectiveness of their decisions, the directors deliberate stakeholder considerations in the short, medium and long-term, taking account of four key principles:

1. Local and personal engagement
   The Board has determined the most effective and scalable way of engaging stakeholders is to extend responsible care throughout the organisation, while fostering regular feedback from colleagues who maintain strong day-to-day relationships with our stakeholders. The Executive Committee and Sustainable Development Committee are important mechanisms for reporting these insights to the Board on a regular basis.

2. Informed decision-making
   The Board seeks to understand the material issues relevant to stakeholders by engaging with them in addition to the regular feedback from colleagues and stakeholders. In May 2022, a SEAT was carried out in the Czech Republic in a mill employing around 1,000 people and is the largest of Mondi’s paper and packaging mills in the country. The SEAT process included around 21 meetings and numerous conversations with a range of stakeholders such as employees, customers and community representatives.

3. Long-term horizons
   In order to provide informed feedback, the Board maintains a long-term view that stretches beyond the projected tenure of the directors and considers impacts far into the future. This can even be seen with the long-term focus of our HAP/0030 framework.

4. Two-way dialogue
   Mondi’s strategic decision-making, trade-offs and the nuances of local relationships mean it is important not only to talk to stakeholders but, at Board level, to effectively communicate our actions to them. This is integral to how Mondi communicates and manages its reputation, supporting the Board’s focus on promoting the strongest standards of ethics and governance.

Local and personal engagement
One way in which the Board gains insights from local personal engagement is from Mondi’s SEAT process. SEATs are carried as an open dialogue with a variety of stakeholders facilitated by an independent third party. The conclusions of such assessment are shared with the local management team as well as Mondi’s senior leadership, including the Sustainable Development Committee.

In May 2022, a SEAT was carried out at our Štětí mill in the Czech Republic. The mill employs around 1,000 people and is the largest of Mondi’s paper and packaging mills in the country. The SEAT process included around 21 meetings and numerous conversations with a range of stakeholders such as employees, customers and community representatives.

What did the Board’s decision entail?
In October 2022 the Board approved a €100 million investment in a new kraft paper machine at our Štětí mill in the Czech Republic. The investment forms part of the Group’s €1 billion expansionary capital investment programme to accelerate growth in sustainable packaging and will further strengthen Mondi’s leading position in the market.

What was the context for the decision?
- The investment and associated production optimisation will provide Mondi with the opportunity to develop new paper-based products that help customers in their efforts to achieve their sustainability targets.
- Demand for packaging that is fit-for-purpose and sustainable remains high. Regulations, such as the EU Packaging and Packaging Waste Directive, are accelerating requirements around waste reduction and promoting the use of renewable and recyclable products.

How did the decision account for stakeholder interests?
The Board bases its decision on an in-depth review of the benefits expected:
- Customers: The additional capacity will meet growing customer demands for sustainable paper-based flexible packaging and provide an opportunity to optimise production and develop new products across Mondi’s kraft paper operations. Employees will also benefit from new on-site product development and innovation capabilities.
- Employees: The investment will provide colleagues and potential new hires with long-term career development and training opportunities, and reinforce confidence in the future of the mill. It will also strengthen the mill’s reputation as an attractive employer and motivate colleagues.
- Investors: Our disciplined approach to investigating and executing capital projects is a key strength at Mondi. Successful completion will further lower our cost base, deliver volume growth and contribute to the Group’s overall performance.
- Communities: The investment contributes to the sustainable future of the mill and will stimulate local economic activity and employment.
- Environment: Kraft paper has sound sustainability credentials, is made from certified fibre and is fully recyclable. The investment will also increase the mills’ energy efficiency and reduce the mills’ specific greenhouse gas emissions.

What were the trade-offs?
- The Board reviewed numerous capital investments across multiple locations, taking into consideration various financial and non-financial benefits to Mondi. Ultimately, the Board directs capital to those projects with the strongest long-term return on investment in alignment with our sustainability goals and stakeholder expectations.
- Medium-term demand and supply market dynamics and consideration of the sustained competitiveness of the machinery in the European kraft paper market.
- The additional workloads for employees and resources available to execute the project as a result of such a large investment.
- Increased raw material consumption, most notably wood and energy, to supply our expanded production as well as rationalising market pulp for kraft paper production.

What was the outcome of the decision?
The Board approved the investment in a new kraft paper machine. By deciding to invest, the Board demonstrated its ongoing support for the Group’s strategy and prioritisation of sustainable packaging as the means to sustaining long-term value creation for all stakeholders. Despite this, the decision demonstrated the Board’s stewardship—by, and in line with, the Group’s purpose—in achieving its purpose to contribute to a better world by making innovative, sustainable packaging and paper solutions that are sustainable by design.
2. Culture

- Why are the desired behaviours critical to the achievement of strategic objectives?
- How does the board measure and monitor the extent to which the culture is embedded?
- What actions are needed to close any identified gaps between actual and desired culture?
- Is a clear update provided on progress against any past initiatives to close the gaps?

In Engaging stakeholders, restoring trust, our review of narrative reporting issued in September 2019, we had included a framework for meaningful culture reporting (p16 of 2019 report). Whilst some aspects of the culture narrative have moved on substantially since then, other areas continue to lag and therefore the framework from this report continues to have relevance and we have re-produced it as Figure 2.1 below.

Conveying how the desired behaviours support delivering strategy

Companies struggle to convey why the espoused culture is right for what they aim to achieve. Values are not translated into behaviours, and even when they are, it is not clear why they are essential to the delivery of strategic objectives. Next (2023 ARA, p18) provides a very detailed explanation of the behaviours that its employees expect from one another. Ocado (Figure 2.2) indicates how culture supports each of its five strategic priorities.

Improved narrative on sources of culture insight

On the other hand, there has been significant progress in disclosing the sources of culture insights the board considers. This includes metrics which are being monitored, although the values of those metrics are not always provided. References to whistleblowing are becoming increasingly common, with 35% of companies going as far as disclosing the number of cases in a given year. BAE (2022 ARA, pp76-77) goes as far as disclosing ethics enquiries by region, by type, by means raised and provides information on outcomes, including number of dismissals for reasons of unethical behaviour. WPP (Figure 2.3) discloses not only the number of cases, but also a metric of their risk impact.

The number of companies that provide commentary on the findings of monitoring remains low. One exception is ITV (Figure 2.4), which not only sets out how the board monitors culture, but explains what insights were gained and the resulting outcomes.

Follow up on actions/initiatives is rare

Most commonly the conclusions from culture monitoring are that behaviours throughout the business are aligned with purpose, values and strategy, even when some of the highlighted culture indicators are showing a downward trend.

On the rare occasions that actions needed to embed and promote culture are discussed in one year, they are almost never followed up on in next year’s reporting.

This will need to change given the FRC’s consultation on the revised Code proposes to expand Provision 2 to cover reporting on how effectively the desired culture has been embedded.

One company, whose reporting is worth following in this regard is Rio Tinto. In 2021, Rio Tinto commissioned an independent review of its culture and is now working to implement the 26 recommendations of the Every Respect Report. The 2022 ARA details the actions within this report that were accelerated during the year. It will also be
interesting to follow how Lloyds Banking Group reports on progress next year, given its new values launched in 2022.

<table>
<thead>
<tr>
<th>Culture vs DEI</th>
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<tbody>
<tr>
<td>Many companies have started to dedicate substantial space within their culture narrative to diversity, equity and inclusion (DEI), emphasising the importance they place on this topic. Whilst this is a vital social dimension of overall workplace culture, it should not dominate over attributes and behaviours which are critical to strategic delivery. In some cases, DEI can logically fit better as part of the stakeholder narrative.</td>
</tr>
</tbody>
</table>

35% disclose the number of whistleblowing reports in a year
Figure 2.1  From establishing purpose to reporting culture – an overview

PURPOSE
Establish a purpose that informs desired values

CULTURE
Translate the desired values into behaviours
Identify what aspects of your desired culture are essential to the successful delivery of your strategic objectives

EMBED/PROMOTE
Identify and execute on actions needed to promote and embed the desired culture

MEASURE
Identify reliable business data points/metrics that are indicators of desired behaviours
Design and conduct culture survey

ASSESS & MONITOR
Assess the current state against the desired culture
understand root causes for divergence

Responsibility for defining the right culture for the company and embedding it within daily operations falls to management...

... but the Board must oversee and hold management to account on how it is defining, aligning (to purpose and strategy), embodying and reporting on culture.
Figure 2.2  Ocado: Linking strategy and culture (2022 ARA, pp26-27)

<table>
<thead>
<tr>
<th>Our strategic framework</th>
<th>Our strategy delivery is focused on five priorities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term goals</td>
<td></td>
</tr>
<tr>
<td>Responsible business approach</td>
<td>Grow our revenue</td>
</tr>
<tr>
<td></td>
<td>Continuing to strengthen our strategic business foundations as we scale, from human and natural capital management, to governance, will support us to deliver on our operational objectives into the long-term</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Challenges and risks</th>
<th>How culture supports strategy</th>
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<tbody>
<tr>
<td>Carbon intensity (scope 1 and 2)</td>
<td>We're enabled by values and behaviours. Enabling us to grow and transform our business globally at pace – to build our success for the future.</td>
</tr>
<tr>
<td>Ocado Retail food waste</td>
<td></td>
</tr>
<tr>
<td>Technology spend</td>
<td></td>
</tr>
<tr>
<td>Modules ordered</td>
<td></td>
</tr>
<tr>
<td>Direct operating cost (%) site sales</td>
<td></td>
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<tr>
<td>Units picked per hour (U/P/H)</td>
<td></td>
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<tr>
<td>Technology headcount</td>
<td></td>
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<tr>
<td>Patents granted</td>
<td></td>
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<tr>
<td>Total cases processed</td>
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</table>

How culture supports strategy

We're enabled by values and behaviours. Enabling us to grow and transform our business globally at pace – to build our success for the future.

1. We're in it together.
   Our inclusive community enables our people to feel a sense of belonging, part of one respectful and supportive team. We've empowered and valued kind and understanding, honest and trusting – it’s in it together.

2. We can be even better.
   We're a community of tirelessly innovative and ambitious people who drive positive change, we're pioneers, we break the mould, we push boundaries, born from our mistakes and lead the way with our solutions. We inspire and challenge each other – to be even better.

3. We're proud of what we do.
   We deliver a fast, efficient and responsible service for our C-Partners, that customers value each other. We always anticipate the future and own our decisions – we're proud of what we do.
RISK IMPACT FROM WHISTLEBLOWER REPORTS 2022

All whistleblower reports received by the Group Chief Counsel and General Counsel, Corporate Risk, which includes all Right to Speak reports, are handled in line with WPP’s Whistleblowing and Investigations Protocols and logged, investigated and tracked through to a conclusion including any remediation or follow-up actions that might be required. Recommended remediation can include disciplinary action, changes to systems, controls and processes or wider review and monitoring for a particular time period.

Reports are also analysed for risk impact and root causes. Learnings generated from this analysis are converted into recommendations including for training sessions and practical resources by WPP’s business integrity team and implemented together with the support and input of the Risk Committees. WPP’s business integrity team also merges these learnings with other data feeds (both internal such as revenue source and breakdown or margin patterns, and external such as Transparency International’s Corruption Perception Index) to identify and focus on potential risk concerns.

The nature of each report, action taken and outcome is reported to the Audit Committee and the approach and process are reviewed by the auditors. WPP is committed to providing a safe and confidential way for people with genuine concerns to raise them, and to do so without fear of reprisals. WPP does not tolerate any retaliatory behaviour against individuals reporting concerns and is equally committed to preserving the anonymity of an individual who makes a report and does not wish to have their identity revealed.

The consequences of misconduct or retaliation range from individual performance management, training for a business or an office and one-on-one training or coaching for an individual through to staff relocation and staff dismissal.
Figure 2.4 ITV: Culture insights gained and resulting outcomes (2022 ARA, pp115-117)

<table>
<thead>
<tr>
<th>Engagement and feedback channels</th>
<th>Cultural Insight gained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review assessments of the Company's culture through the 2022 culture survey, an overview of the generation culture bench-marked by external peers, and how ITV's values link to its purpose and behaviour.</td>
<td>Understanding strengths, low-hanging fruit and opportunities (examples 1-10) in ITV's culture, scalable (ITV values and desired purpose internally reflect its culture and talent sources).</td>
</tr>
<tr>
<td>The Board continues to monitor how its insights from the engagement surveys conducted in 2021, through updates from the Chief Executive, through assessments and updates, the Board remains assured that its culture aligns to its purpose and values, while recognising the cultural behaviour required to deliver strategy as ITV becomes increasingly global.</td>
<td>The Board through the Audit Committee, acts feedback from internal and external auditors on cultural alignment to purpose and values, across the organization, assesses what it takes to embed the desired culture.</td>
</tr>
<tr>
<td>Interactions with stakeholders from Board members through (a) the Chief Executive (including access to the Chief Executive's workload and Q&amp;A sessions), (b) examples provided (c) in communications at every meeting (d) engaging culturally (e) interview with colleagues through various engagement mechanisms (see page 121 for details regarding the Board's workforce engagement, including the Workforce Engagement, Director/Executive/Member).</td>
<td>A nation-wide understanding of day-to-day operations, the practical execution of strategy, and the cultural content in the annual performance review, further insights into how colleagues have been supported in the transitions of the working environment resulting in cultural changes.</td>
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<table>
<thead>
<tr>
<th>Policies and Practices</th>
<th>How the Board monitors the culture</th>
<th>Cultural Insight gained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular board updates and relevant committee updates on a cross-functional and cross-business level, including board, executive and site-level meetings, and standard procedures and processes.</td>
<td>An understanding of processes and cultures and how these align with the purpose values and strategy of the Group, including understanding of the day-to-day operational supply chain partners and the culture of each business.</td>
<td></td>
</tr>
<tr>
<td>The Board and its Committees ensure appropriate scrutiny and challenging of management and receive assurance over ITV's approaches to managing risk and business integrity Hallmarks.</td>
<td>A nation-wide understanding of day-to-day operations, the practical execution of strategy, and the cultural content in the annual performance review, further insights into how colleagues have been supported in the transitions of the working environment resulting in cultural changes.</td>
<td></td>
</tr>
<tr>
<td>The Board monitors the culture, review of ITV's values asset (a) ITV's Code of Ethics and Conduct).</td>
<td>From the Code of Ethics and Conduct, the highest standards of ethical business underpinning ITV's values and supported through the culture.</td>
<td></td>
</tr>
<tr>
<td>The Board reassured that ITV's Code of Ethics and Conduct monitors ITV's values and culture and; continues to review this role annually; relevant items aligned to ITV's purpose including its Social Responsibility vision, values and strategy and where there is appropriate compliance across the Group.</td>
<td>A nation-wide understanding of day-to-day operations, the practical execution of strategy, and the cultural content in the annual performance review, further insights into how colleagues have been supported in the transitions of the working environment resulting in cultural changes.</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Social purpose, diversity and inclusion</th>
<th>Cultural Insight gained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual review of ITV's Social Purpose strategy, performance plans and results. How ITV's Social Purpose campaigns influence culture internally as well as externally.</td>
<td>ITV's Social Purpose campaigns influence culture internally as well as externally.</td>
</tr>
<tr>
<td>The Board will continue to monitor key strategies and undertakings in pursuit of ITV's Social Purpose strategy.</td>
<td>The impact of the Diversity and Inclusion strategy is measured in terms of the effectiveness of its execution, the impact of its execution on culture, and the impact of its execution on business performance.</td>
</tr>
<tr>
<td>Diversity and Inclusion - Regular updates on progress (a) ITV's diversity and inclusion strategy (b) from ITV's inclusion networks.</td>
<td>Regular management by Operations Committee. Committee of progress against diversity targets, with diversity on the Board agenda at least annually.</td>
</tr>
<tr>
<td>The Chief Executive attends to ITV's Cultural Advisory Council, comprising a group of independent external advisors (a) of different industries and expertise and observer (b) and observer (a) diversity and inclusion advisors.</td>
<td>The impact of the Diversity and Inclusion strategy is measured in terms of the effectiveness of its execution, the impact of its execution on culture, and the impact of its execution on business performance.</td>
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<table>
<thead>
<tr>
<th>Remuneration</th>
<th>How the Board oversees</th>
<th>Cultural Insight gained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remuneration Committee oversees performance on the remuneration committee and ensure the remuneration is fair, transparent, and consistent with ITV's values and purpose.</td>
<td>Insight into the role of remuneration, and setting performance goals, has an ongoing positive impact on how the workforce engages in the business and the alignment between goals and performance outcomes.</td>
<td></td>
</tr>
<tr>
<td>Live Q&amp;A and remuneration discussion for Ambassadors hosted by the Remuneration Committee Chair, which was reported back to the Committee.</td>
<td>Live Q&amp;A and remuneration discussion for Ambassadors hosted by the Remuneration Committee Chair, which was reported back to the Committee.</td>
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</tr>
</tbody>
</table>
3. Business model (BM)

- How does the company generate revenues?
- How and where are the company’s key assets and resources engaged in the process of value creation?
- What are the company’s competitive advantages; does the BM differ from others in the sector?
- How are environmental and social risks and opportunities being addressed to ensure the BM is sustainable? How is the BM evolving in response?
- Is the BM adapting to long-term trends and factors?

Business vs. operating model

A BM is commonly understood to describe how a company creates and captures value through its products/services — its customer value proposition — and the broader stakeholder outcomes it targets.

The operating model deals with how core processes are structured and how value chains are supported; it encompasses the organisation of people, processes and infrastructure (physical and non-physical including systems/technology and information) in support of the BM. Whilst the disclosure requirement relates to the BM, there are no clearly defined lines between the two, and disclosures often covers a mix.

Visual roadmap

Commonly, companies include a two-page visual BM overview. When done well, this can be an impactful, roadmap orienting the reader to further detail across the ARA, at the same time setting the tone for what is of material importance.

Too often however these disclosures are either not company specific, omit aspects that are material to value creation or list topics without demonstrating how they fit into the BM. References to sustainability are one of the most common of these apparent bolt-ons, with very few companies integrating this aspect of the disclosure as Mondi (Figure App1.1) has done.

The quality of these disclosures is also undermined when they cannot be ‘reconciled’ with the financial statements, such as when ‘inputs’ omit material fixed assets; or when they fail to articulate how revenues are generated. Spirax-Sarco (Figure 3.1) and Rotork (2022 ARA, pp12-13) both provide meaningful overviews of their routes to market.

Evolving the BM

Another pitfall is ‘form over substance’ — companies request that their design agency creates a new BM visualisation simply because a year on year “refresh” is felt appropriate. This sometimes results in a visual that looks exciting at face value, but doesn’t aid comprehension, nor is it specific to the company. A simple, concise and specific explanation of “What we do”, like Croda’s (Figure 3.2) or Essentra’s (2022 ARA, p8) can be much more meaningful.

That is not to say that companies should stick to the same disclosure every year. On the contrary, it is important to demonstrate how the BM is evolving. When LSEG first included a BM disclosure in its 2011 ARA, the main focus was on its role of bringing together companies seeking capital with investors. In its 2022 ARA (p36) the focus has shifted to being a leading provider of financial market data and infrastructure. It is such changes, including in response to the climate transition, that an effective BM disclosure needs to signal early.
Figure 3.1  Spirax-Sarco – Concise explanation of core activities and routes to market by end user (2022 ARA, pp22-23)
Figure 3.2  Croda – Concise summary setting out what the business does (2022 ARA, pp14-15)
4. Measuring strategic progress

- What are the company’s strategic objectives? Are they clear and measurable? Is it clear why key performance indicators (KPIs) and other metrics used to measure progress against them were selected?
- How did the company deliver against prior year goals and what are its priorities for the near and mid-term?
- Do the remuneration policy outcomes appropriately reflect prominent metrics and KPIs?
- Is the use of prominent financial and non-financial metrics balanced and reflective of their strategic importance?
- Is there clarity on the level of assurance obtained over each of the KPIs and other prominent metrics?

Reporting on achievement of prior year goals

Demonstrating ability to deliver against goals and targets increases confidence among stakeholders. Most companies set out a general progress update on strategic delivery in the year and some go on to detail areas of future focus. It is rare to find companies who report back in a transparent way with reference to the commitments they made at the start of the year. Ideally this should set out what aspects were not achieved and why, with clarity on whether these would be focussed on in future periods or if not, whether this represented a change in strategic direction or sentiment. Fresnillo, 2022 ARA (pp26-29) has a disclosure that presents this.

Choosing KPIs and prominent metrics

Incorporating KPIs in the discussion of strategic delivery, especially when combined with targets is powerful. JTC (Figure 4.1) does this effectively. Some companies provide directional narrative on their aims for the year ahead, for example to grow the number of clients served, without noting a hard target. From our research, less than a third of companies presented targets or an outlook for at least some of their KPIs. Kingfisher (Figure 4.2) uses “proof points” to demonstrate how they have progressed against key priorities. This also shows that there could be metrics beyond KPIs that demonstrate strategic progress. However, it is still common to see companies that label certain metrics as KPIs even though their relevance to strategic objectives is questionable. A little over half explained why particular metrics were chosen as a KPI, at least in respect of some of them.

This commonly occurs with E&S metrics. Examples of this include companies using board gender diversity as a KPI without explaining why the number of women on the board is critical to success or including greenhouse gas emissions as a KPI despite the company not identifying climate change as a principal risk or operating in a carbon intensive industry.

Conversely, many companies have “pay for performance” metrics set out in their remuneration reports, but these do not feature in front half either as KPIs or prominent metrics. This raises questions on whether the KPIs that are actually disclosed in the front half are relevant and meaningful i.e., represent true leading indicators that the board uses to judge delivery of strategic progress and incentivise executives.

Assuring KPIs and prominent metrics

Below we have set out our hallmarks for good KPI disclosure. One of these recommends that for metrics not derived directly from financial statements, companies should explain how data is obtained and its reliability. Only a handful of companies annotate on the KPI disclosure whether the metrics have been assured.
As companies in scope prepare to produce an AAP under draft secondary legislation, it will be important to first have internal clarity on the rationale for obtaining assurance over certain KPIs and then secondly to disclose this. For example, it may be more appropriate to obtain assurance over KPIs which determine remuneration outcomes; or in which there have been errors in the past or which are linked to a covenant. Aviva (2022 ARA pp1.31-1.32) is one of the few companies which sets both these aspects (link to remuneration and which KPIs are assured) clearly.

### EY UK’s hallmarks of a good KPI disclosure

- Define KPI and explain the methodology for calculating it
- For metrics not derived directly from financial statements, explain how data is obtained and its reliability
- Link to strategic objectives/principal risks as relevant
- Explain how KPI tracks progress against strategy (why the metric has been chosen) and whether it is a lead or a lag indicator
- Set a target and explain how that target was determined, or provide an outlook for the following year
- Provide 3 or more years of results
- Briefly explain outcome for the current year and cross-refer to further detail
- Make explicit the alignment between KPIs and executive remuneration

- 54% explain the reason for KPI choices
- 72% do not provide targets or outlooks for KPIs
Figure 4.1 JTC – Key Performance Indicators with clearly articulated targets and performance tracked against them (2022 ARA, pp18-19)

**KEY PERFORMANCE INDICATORS**

The JTC Board uses the following KPIs to measure the performance of the Group:

<table>
<thead>
<tr>
<th>FINANCIAL</th>
<th>REVENUE</th>
<th>UNDERLYING EBITDA MARGIN</th>
<th>NEW BUSINESS WINS</th>
<th>CLIENT ATTITRITION</th>
<th>STAFF TURNOVER</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEFINITION</td>
<td>Revenue is defined as income arising in the course of an entity's ordinary activities.</td>
<td>EBITDA margin of the business excluding non-underlying items.</td>
<td>Annualised value of new work won from clients where we have a signed contract.</td>
<td>Work lost that was not end of life.</td>
<td>Number of staff who leave in the year that we did not want to leave divided by average number of staff in the year.</td>
</tr>
<tr>
<td>WHY IT'S IMPORTANT</td>
<td>Revenue is a reflection of the work we do for clients. We seek to deliver a high quality service, do more work for existing clients and attract new clients.</td>
<td>Underlying EBITDA margin is our key measure of how well our business is performing, including relative to the wider industry.</td>
<td>Our industry has good growth fundamentals. Winning new business is an important component in the delivery of our organic growth targets.</td>
<td>We have a high proportion of annuity business. Minimising the number of clients that leave JTC is a key indicator of customer satisfaction.</td>
<td>We deliver a high touch service to clients. Maintaining continuity of staff ensures that we are best able to meet client needs.</td>
</tr>
<tr>
<td>2022 PERFORMANCE</td>
<td>Revenue growth of 35.6% which comprised 12.0% net organic revenue growth and 23.6% inorganic revenue growth.</td>
<td>Increase of 0.2pp to 33.0%.</td>
<td>Another record year for new business wins with an increase by value of 17.7% to £124.6m.</td>
<td>Total client attrition was 6.4% (2021: 7.9%) with negotiated attrition (non-end of life) of 1.7% (2021: 2.6%).</td>
<td>Turnover of 8.0% at Group level (2021: 9.1%).</td>
</tr>
<tr>
<td>COMMENTARY</td>
<td>The PCS Division achieved 15.7% growth and net organic revenue growth of 8.7%. The ICS Division achieved 47.9% growth and net organic revenue growth of 34.6%.</td>
<td>The ICS Division achieved 31.5% (+1.3pp) continuing the positive trend seen in recent years. The PCS Division achieved 36.3% (+0.9pp) remaining at the top end of our guidance range and reflecting investment for future growth.</td>
<td>The ICS Division won new business with a total annualised value of £17.2m and the PCS Division won new business with an annualised value of £7.4m.</td>
<td>98.3% (2021: 97.0%) of revenues that were not end of life were retained in the period.</td>
<td>Our attrition rate fell in 2022.</td>
</tr>
<tr>
<td>TARGET</td>
<td>We aim to achieve net organic revenue growth of 8% – 10% every year. We aim to deliver an underlying EBITDA margin in the range of 3.0% – 3.5%. We aim to achieve at least a 10% increase in the annualised value of new business wins year on year. We aim to keep regretted client attrition at less than 3.0% p.a. We aim to keep annual staff turnover, as defined, at less than 10%.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td>12.0%</td>
<td>33.0%</td>
<td>17.7%</td>
<td>1.7%</td>
<td>8.0%</td>
</tr>
<tr>
<td>2021</td>
<td>9.6%</td>
<td>32.8%</td>
<td>16.8%</td>
<td>2.6%</td>
<td>9.3%</td>
</tr>
<tr>
<td>2020</td>
<td>7.9%</td>
<td>33.6%</td>
<td>20.1%</td>
<td>3.4%</td>
<td>5.7%</td>
</tr>
<tr>
<td>TARGET</td>
<td>8% – 10%</td>
<td>33% – 38%</td>
<td>&gt;10%</td>
<td>&lt;2.5%</td>
<td>&lt;10%</td>
</tr>
<tr>
<td>FINANCIAL</td>
<td>NEW BUSINESS WINS</td>
<td>CLIENT ATTRITION</td>
<td>STAFF TURNOVER</td>
<td>SHARED OWNERSHIP</td>
<td></td>
</tr>
<tr>
<td>----------</td>
<td>------------------</td>
<td>------------------</td>
<td>----------------</td>
<td>-----------------</td>
<td></td>
</tr>
<tr>
<td>DEFINITION</td>
<td>Annualised value of new work won from clients where we have a signed contract.</td>
<td>Work lost that was not end of life.</td>
<td>Number of staff who leave in the year that we did not want to leave divided by average number of staff in the year.</td>
<td>The proportion of permanent employees who are direct owners of the business through our Shared Ownership programmes.</td>
<td></td>
</tr>
<tr>
<td>WHY IT’S IMPORTANT</td>
<td>Our industry has good growth fundamentals. Winning new business is an important component in the delivery of our organic growth targets.</td>
<td>We have a high proportion of annuity business. Minimising the number of clients that leave JTC is a key indicator of customer satisfaction.</td>
<td>We deliver a high touch service to clients. Maintaining continuity of staff ensures that we are best able to meet client needs.</td>
<td>Shared Ownership is our key differentiator. It is important that staff have a direct stake in our business to promote a stakeholder mentality and ensure that their interests are aligned with external shareholders.</td>
<td></td>
</tr>
<tr>
<td>2022 PERFORMANCE</td>
<td>Another record year for new business wins with an increase by value of 17.7% to £24.6m.</td>
<td>Total client attrition was 6.4% (2021: 7.9%) with Regretted attrition (not end of life) of 1.7% (2021: 2.6%).</td>
<td>Turnover of 8.0% at Group level (2021: 9.9%).</td>
<td>100% of permanent employees are owners of the business with staff holding c. 15% of issued share capital.</td>
<td></td>
</tr>
<tr>
<td>COMMENTARY</td>
<td>The ICS Division won new business with a total annualised value of £17.2m and the PCS Division won new business with an annualised value of £7.4m.</td>
<td>98.3% (2021: 97.4%) of revenues that were not end of life were retained in the period.</td>
<td>Our people are highly regarded in the industry and therefore this is a very good performance.</td>
<td>All new staff awarded shares at the end of probation as well as being enrolled in EBT.</td>
<td></td>
</tr>
<tr>
<td>TARGET</td>
<td>We aim to achieve at least a 10% increase in the annualised value of new business wins year on year.</td>
<td>We aim to keep regretted client attrition at less than 2.5% p.a.</td>
<td>We aim to keep annual staff turnover, as defined, at less than 10%.</td>
<td>100% of permanent employees to be owners of the business.</td>
<td></td>
</tr>
<tr>
<td>TARGET</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td>17.7%</td>
<td>1.7%</td>
<td>8.0%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>16.8%</td>
<td>2.6%</td>
<td>9.3%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>20.1%</td>
<td>3.4%</td>
<td>5.7%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

| TARGET | >10% | <2.5% | <10% | 100% |
## Performance against priorities

<table>
<thead>
<tr>
<th>Strategic priorities</th>
<th>Progress</th>
<th>Proof points for FY 22/23</th>
<th>Forward focus</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Grow by building on our different banners</strong></td>
<td>- First Europe’s home appliance retailer following successful launch of a new online channel</td>
<td>82</td>
<td>- Launch strategic investment in direct-to-consumer</td>
</tr>
<tr>
<td></td>
<td>- Continued expansion of online sales in the UK and Fanstore</td>
<td>5</td>
<td>- Enhancing our focus on sustainability</td>
</tr>
<tr>
<td></td>
<td>- Opened first two MEC home stores in the Middle East</td>
<td>18</td>
<td>- Leveraging our expertise in our current markets and diversifying across new geographies</td>
</tr>
<tr>
<td><strong>Accelerate e-commerce through speed and scale</strong></td>
<td>- Established a series of online-only concepts</td>
<td>91%</td>
<td>- Further rapid expansion of the online business through new marketplaces planned in the UK and France to create a total of 20 new stores for FY 23/24</td>
</tr>
<tr>
<td></td>
<td>- New online-only concept including a new home appliance retail store in the UK</td>
<td>24%</td>
<td>- Long-term focus on new markets, franchises and wholesale models</td>
</tr>
<tr>
<td><strong>Build a date-less customer experience</strong></td>
<td>- Establishing a central excellence centre with expertise in artificial intelligence (AI), machine learning, analytics and data platform engineering</td>
<td>20m</td>
<td>- Ambition to reach 20% e-commerce sales penetration</td>
</tr>
<tr>
<td></td>
<td>- Live, go-to-market strategy to engage with an e-commerce platform (EY)</td>
<td>c. 1bn</td>
<td>- Launching our scores to the customer’s own brand</td>
</tr>
<tr>
<td><strong>Differentiate and win through own exclusive brands (CEB)</strong></td>
<td>- CEB continuing to drive affordability, product innovation and sustainability and is offering a high-quality range on average to around 1.3% greater than 2021</td>
<td>45%</td>
<td>- Continue to develop innovative CEB ranges through a customer projects book</td>
</tr>
<tr>
<td></td>
<td>- Combined total of 220 new and existing CEB brands to drive differentiation between retail banners and exclusive ranges</td>
<td>56%</td>
<td>- Further embedding sustainability statements at the core of EY’s proposition</td>
</tr>
<tr>
<td></td>
<td>- New performance kitchens, bathrooms and storage and home products, including new product categories</td>
<td>18</td>
<td>- Establish CEB as the most affordable solution for customers</td>
</tr>
<tr>
<td><strong>Develop trade business</strong></td>
<td>- Accelerated trading efficiency in the UK &amp; Ireland and strong progress in developing new product categories</td>
<td>17</td>
<td>- Growth in sales of traded brands and services and O&amp;M brands</td>
</tr>
<tr>
<td></td>
<td>- Traded value (UK) 9% year-on-year, sales growth of 12.4%, super-immersive core category and both O&amp;M sales year on year</td>
<td>12</td>
<td>- Focus on generating sales in high-growth areas</td>
</tr>
<tr>
<td></td>
<td>- Launched new trade customer proposition across all other business lines, including trade zone programmes in the UK, Ireland, and Malta, and the introduction of new trade-focused services and O&amp;M brands and brand products ranges</td>
<td></td>
<td>- Continue to launch new products in the UK and Ireland</td>
</tr>
<tr>
<td><strong>Roll out compact store formats</strong></td>
<td>- High street concept tests (EY) in the UK, the UK and in France</td>
<td>47%</td>
<td>- Continue to develop O&amp;M brands in other areas of the country</td>
</tr>
<tr>
<td></td>
<td>- High-street and concept stores in the UK, France and Ireland</td>
<td>2.1</td>
<td>- Focus on urban, m-trip and white location formats</td>
</tr>
<tr>
<td></td>
<td>- Low-street and concept stores in the UK, France and Ireland</td>
<td>54</td>
<td>- New Mec Home compact store to launch by end of FY 23/24</td>
</tr>
<tr>
<td><strong>Lead the industry in Responsible Business practices and energy efficiency</strong></td>
<td>- Stronger for our core area and launched support for colleagues to help manage costs</td>
<td>17</td>
<td>- Increase in retail sales to double the current level</td>
</tr>
<tr>
<td></td>
<td>- Enhanced use of renewable energy to our operations</td>
<td>12</td>
<td>- Focus on cost management</td>
</tr>
<tr>
<td></td>
<td>- Developed more efficient and and value for our customers</td>
<td>6.6</td>
<td>- Continue to drive higher returns on our operations</td>
</tr>
<tr>
<td></td>
<td>- Launched new sustainable products and brand extensions for EY</td>
<td></td>
<td>- Focus on sustainable products and brand extensions</td>
</tr>
<tr>
<td></td>
<td>- Significantly reduced customers’ carbon footprint in 2021</td>
<td>52.7%</td>
<td>- Reduce carbon footprint for our own operations against FY 22/23 baseline year</td>
</tr>
<tr>
<td><strong>Human, agile and lean</strong></td>
<td>- Embedding a ‘test and learn’ culture across the Group, embedding key leadership</td>
<td>54</td>
<td>- Continue to embed our ‘test and learn’ mindset</td>
</tr>
<tr>
<td></td>
<td>- Strengthening talent and capability in key areas, including technologies, data and analytics</td>
<td></td>
<td>- Prioritise agile and efficient technology</td>
</tr>
<tr>
<td></td>
<td>- Accelerating cost reduction across businesses continues to help our bottom line</td>
<td></td>
<td>- Continuing to challenge costs and inventory</td>
</tr>
</tbody>
</table>
5. **Evolving strategy**

- Is there clarity on both short-term and longer-term market/industry trends impacting the business?
- How is the company’s strategy responding to these market trends? How are they influencing principal and emerging risks?
- Is it clear how sustainability commitments support the delivery of strategic objectives?
- What is the directors’ approach to capital allocation beyond shareholder distributions?

**Response to market trends**

The January 2023 EY CEO Outlook Pulse\(^2\) found almost all CEOs (97%) have altered their strategies in response to geopolitical challenges. For instance, 41% have reconfigured their supply chains, 34% are exiting businesses in certain markets and 32% have halted a planned investment.

Under the medium-term section of the proposed RS, companies in scope will need to provide a summary of long-term trends and factors which could represent a threat to the company’s business model or operations and explain any plans in place or adaptations that the company is proposing to make to its business model or operations to meet the long-term challenges identified. This is discussed in Chapter 3, on the business model too.

Many companies include a section on market trends, but the better reporters, such as AstraZeneca (Figure 5.1) illustrate how their strategy is responding to global trends.

**Integration of sustainability strategy with business strategy**

For a commitment to sustainability to ring true, it needs to be both integrated into the business model as demonstrated by Mondi (Figure App1.1) and form part of the overarching strategy. Where the ‘sustainability strategy’ touches on the same themes as its ‘core strategy’ but is presented as something separate (and there are separate ESG metrics reported outside the KPI section), readers might infer that the company is paying lip service to the achievement of E&S objectives.

**Capital allocation**

The draft secondary legislation includes a proposed distribution policy statement which, among other matters, will require in-scope companies to “describe the directors’ approach to capital allocation including decisions on investment, capital expenditure, research and development, distributions and purchase of own shares”.

Whilst it is very common for companies to reference a ‘rigorous’ or ‘disciplined’ capital allocation policy, less than half provide any insight into that policy beyond the approach to dividends. Of those that do (for example LSEG, 2022 ARA, p72), less than a quarter provide a robust narrative that explains the approach to, and choices made around allocation. Even of those, a fair few are focussed mainly on how capital was allocated during the year as opposed to forward looking policy statements. These findings suggest that in-scope companies may have to evolve their reporting significantly to address the requirements of the 'distribution statement' being introduced by the draft legislation.

There is increasing expectation that climate-related capital allocation decisions (i.e., investment to transition to a low-carbon economy) are reported – through both transition plan and broader TCFD disclosures. Whilst there is an increase in the number of

\(^2\) Quarterly study of 1,200 CEOs globally
companies that reference capital allocation as part of their TCFD disclosures, other than in the extractives sector, this is very seldom acknowledged within the narrative that discusses the actual policy.

Aside climate transition, any investments needed to sustain a company’s competitive advantage (maintenance capital); implement aspects of its current strategy (either maintenance capital or growth capital to drive future value) or evolve its business model (growth or investment capital) together with the rationale for these choices and how they are weighed up against shareholder returns ought to be reported clearly.

The recent situation at some water companies where critics argue that dividends (including intra-group) and loan interest have been paid with money that could have been spent on improving infrastructure and service, only underlines this message. In March 2023, the regulator, Ofwat announced changes to water company licences to require that when making dividend payments, directors take account of service delivery for customers and the environment, as well as current and future investment needs and long-term financial resilience. Such regulation over capital allocation decisions emphasises the importance of clear capital allocation policy disclosures.

**Rolls Royce** (Figure 5.2) presents its new capital allocation framework which shows both the criteria against which projects will be considered for investment purposes and the prioritisation of how available cash will be used.

**Howdens** (Figure 5.3) also explain its objective to be able to operate through the annual working capital cycle without incurring bank debt and its expectation to return surplus cash to shareholders if year-end cash is in excess of £250m.

**discuss capital allocation beyond dividend policy**
Science & Innovation

Our focus areas
> Creating the next generation of therapeutics using an array of drug modalities, for example, advanced biologics, nucleotide-based and cell therapies.
> Leading in convergence of science, data and technology.
> Advancing our pipeline.

How our strategy responds to global trends
To ensure we are able to respond to the increasing burden of disease and incorporate advances in science and digital technologies, we are:

> Advancing our understanding of disease biology to help uncover novel drivers of disease, through genomics, functional genomics and knowledge graphs.
> Progressing an early pipeline consisting of numerous new drug modalities, including ADCs, cell therapy, epigenetics, gene therapy, oligonucleotides, radio-immuno conjugates (RicOxs) and self-amplifying mRNA (saRNA).
> Creating humanised models to better predict the success of our molecules in the clinic.
> Pioneering new approaches to engagement in the clinic and beyond, incorporating patient insights to improve experiences and outcomes.
> Embedding AI across our R&D activities, from target identification to clinical trials, to understand where we can harness new technologies and further automate processes.

How we progressed in 2022
> Achieved 72 regulatory events: 38 NME and major LCM submissions and 34 approvals in major markets (US, EU, China and Japan).
> Secured 29 pipeline progression events: six NME Phase II starts/progressions and 23 NME and major LCM Phase III investment decisions.
> Our pipeline includes 179 projects, of which 155 are in the clinical phase of development.
> At the end of the year, we had 15 NME projects in pivotal trials or under regulatory review covering 26 indications (2021: 16).
> 27 projects were discontinued.

Focus for 2023
> Drive innovation opportunities across our global R&D sites.
> Continue transforming the way we discover and develop new medicines using AI and machine learning.
> Continue attracting the brightest minds to create an environment in which science thrives.

For more information, see "Therapy Area Review" from page 18 and "Business Review" from page 24.

Key Performance Indicators
Our science strategy prioritises the development of NMEs and the maximisation of the potential of existing medicines. Pipeline progression events (Phase II NME starts/progressions and Phase III investment decisions) measure innovation and sustainability. Regulatory events (regulatory submissions and approvals) demonstrate the advancement of this innovation to patients and the value to the Group.

For more information on performance against the Group average, see page 14.
**Investing wisely**

Capital allocation is critical to generating the right returns from our business. Our first priority is to reduce our debt, accelerating progress to an investment grade credit rating. We also recognize the importance of shareholder returns, both from investing in high return opportunities and from shareholder payments, which we aim to resume as our balance sheet improves.

We have strict criteria that we follow when considering investments. Firstly, any investment must be aligned to our strategy, taking us in the right direction to achieve our goals and vision. Linked to this are our strict criteria on sustainability and carbon impact, where investment opportunities must demonstrate alignment with our decarbonisation ambitions. Secondly, it needs to have a risk and reward profile that generates value. Our investments aim to generate a combination of near, medium and long-term returns. We are looking to strike a balance of protecting and growing our established businesses and pursuing long-term growth opportunities.

As we focus on strengthening our balance sheet we will be vigilant with our capital allocation decisions. In 2022, we spent £1.3bn on research and development, £59m of which was paid for by funding from third parties. Investments made in 2022 included engineering to increase time on wing for our in-service engines, leading to better aftermarket margins as well as longer-dated investments in new products. Not all of our capital allocation decisions are based purely on commercial returns. The health of our people and the safety of our processes and products remain the top priority, where investment will be made to ensure our people can be at their best in a safe environment. In 2022, we approved an investment to replace one of our ageing Defence test beds with a state-of-the-art facility, ensuring on-going health and safety standards are met.
Figure 5.3  Howdens – Explanation of the uses of cash and approach to capital structure (2022 ARA, p32-33)

How we make cash and how we spend it

Cash generation and use

| Year | Tax paid | Dividends paid | Share buy back | Interest paid | Wages and salaries | Rent, rates and insurance | Raw material and purchases | Operating profit before exceptional items | Operating profit | Other activities | Cash in

Uses of cash

| Year | Wages and salaries | Rent, rates and insurance | Raw material and purchases | Operating profit before exceptional items | Other activities | Capital investment | Cash in |

Capital allocation and returns to shareholders

With its definition of surplus capital, the Group’s objective for the Group to be able to operate through the annual working capital requirements without securing any external capital, noting that there is a possibility in which capital balances through the year, particularly in advance of our peak trading period in the second half. We also take into account that the Group has a significant property lease exposure for the asset network, and a large defined benefit pension scheme. Our policy remains that when year end cash is in excess of £55m we expect to return surplus cash to shareholders. This provides sufficient headroom to support organic growth, our seasonal working capital requirements and ongoing investments in our strategic initiatives, while maintaining a strong balance sheet.

Dr. Hines also notes that the Group will undertake further £50m share buyback programme. A £50m share buyback programme was completed this year.

Tangibles into account the Group’s purpose in achieving financial condition. In July 2022 the Board approved paying financial dividend of 4.7p per ordinary share (2021: 4.4p per ordinary share). The Board is recommending a final dividend for 2022 of 1.5p per ordinary share (2021: 1.6p per ordinary share), resulting in a total dividend of 6.2p per ordinary share (2021: 6.0p per ordinary share). The total dividend represents a year-on-year increase of 6.2% and the final dividend will be paid on 30 May 2022 to shareholders on the register on 11 April 2022.

Howdens’ approach to capital structure

- Progressive ordinary dividend growth
- Significant shareholder value creation
- Modest investment in adjacencies

Investing in organic growth:
- Open new and reviving existing outlets
- Disciplined range management
- Optimize working capital and logistics
- Grow digital platform

Return surplus cash to shareholders:
- After organic investment needs
- Seasonal working capital movements
- Fund pension scheme
- Distribute cash (£55m)

Acquisitions

In February 2022, Howdens acquired Timba Furniture Ltd. for a consideration of £13m, including £5m for the purchase of the assets, shareholdings in dividend receiving industry specialists for the manufacture, fabrication, laser cutting and installation of premium worktops. The acquisition supports our ambition to develop our Howdens Titan Surfaces (HTS) operations as the market leading supplier and fit business. We are continuing to invest in expanding our productivity and have committed to HTS to achieve and deliver surface capacity units and the efficiencies on the other site.

Pensions

At 24 December 2022, the defined benefit pension scheme was in a funded position of £24m on an IAS 19 basis compared to a surplus of £24m on 24 December 2021. The movement from a surplus to a deficit was primarily a result of an increase in the annual discount rate resulting in a reduction in the liabilities of £19m, once increased in service contributions of £6m. The adverse market volatility in September 2022 led to changes in the plan’s investments to meet collateral requirements and higher inflation experience through 2022 which raised the liabilities. The defined benefit pension scheme is classified for future years.

The pension scheme has already returned to a small deficit on a technical provision basis as of 24 November 2022 and, as a result, deficit contributions of £2.5m are being made. In January 2023, it is possible that the scheme could return to a surplus position on a technical and cash-flow basis. It is likely that the surplus in the scheme is expected to last for more than two consecutive months and any deficit contributions would cease. The next full deferred valuation of the scheme will be carried out as of 31 March 2023.
6. Stakeholder engagement and s172

► Is there a compelling explanation of who the identified key stakeholders are and how they have been grouped?
► How did management, and separately the directors, seek to understand the views of and seek input from stakeholders?
► Does the board articulate the feedback received or the insights gained from such interactions in the current year and any actions taken?
► How did the board take such feedback and insights into account when making principal decisions?

Disclosure evolution

Our analysis of reporting in the year before MRR came into force indicated that whilst most companies were explaining who their key stakeholders were, disclosures on how the board engaged with these key stakeholders, the issues covered and, most importantly, the impact of engagement (if any) on the board’s discussions and decisions were nascent.

This has evolved and improved significantly since. Companies appear to take the requirement seriously, recognising the benefits of demonstrating how they consider the interests of all those who play a part in their success. As discussed in the ESG and sustainability appendix (Appendix A), increasingly, the stakeholder narrative is being linked to sustainability-related disclosures.

Stakeholder engagement

Whilst the disclosure has matured, room for enhancement remains. For example, some stakeholders are disclosed on an amalgamated, homogenous basis. Yet it is evident that there are distinct sub-groups with potentially varying significance to the company and hence differing engagement methods as well as issues that matter. A common example of this is combining easily substitutable suppliers with strategic business partners that are integral to the business model. Similarly, not separating out a controlling shareholder from other investors might not adequately portray the differences in the intensity and topics of engagement.

Unlike Ocado (Figure 6.1) and Spirax-Sarco (Figure 7.1) many companies still fail to provide meaningful disclosures of outcomes and actions arising from the feedback received.

Stronger reporters continue to innovate their stakeholder engagement narratives. This year, we have seen examples of companies setting out future priorities (e.g., Taylor Wimpey, Ocado), challenges they faced (e.g., NatWest) and including metrics of engagement effectiveness (e.g., Barratt Developments - Figure 6.2, Taylor Wimpey).

Principal decision reporting

The July 2021 FRC Lab report recommended principal decision reporting. However, just a little over half of companies within our sample included, like Rentokil (Figure 6.3) clear disclosure of their principal decisions in the year, with a further 10% interweaving important decisions with other board activities. Typically, companies gave three to four examples, some provided just one illustration with the maximum being eight.

Most common disclosure topics related to the ESG/sustainability strategy, core strategy and shareholder distributions, with many companies referencing the reinstatement of dividend payments. Major acquisitions and disposals as well as director appointments and succession plans were also frequently cited. Another theme that emerged was workforce-related decisions, more than half of which related to supporting people through the cost-of-living crisis. It was rare for companies to reference decisions not to proceed with a course of action, something quite common during the COVID-19 pandemic when boards were deciding to pause dividends.
Good principal decision reporting – like done by Mondi (Figure 1.2) – setting out how stakeholder interests were considered and the trade-offs that were required, will be an important element of addressing the requirements in the proposed new Principle D (of the draft revised Corporate Governance Code).

This states that reporting on governance activity should focus on outcomes so as to demonstrate the impact of governance practices. Annotating board activity disclosures with cross references to both principal decisions and other engagement outcomes could help achieve this.
Figure 6.1 Ocado – Setting out engagement outcomes and priorities for the following year (2022 ARA, p.16-22)
Figure 6.2  Barratt Developments – Metrics of stakeholder engagement effectiveness (2022 ARA, pp40-41)

Significant decisions

The main activities and decisions of the Board are set out on page 79. The following are examples of some of the more significant decisions made by the Board, how they were made and, where applicable, how conflicts between different stakeholders were managed.

Acquisition of Radiation Developments Limited

On 27 January 2002, the Group acquired the business of the entire issued share capital of Radiation Developments Limited, a strategic real estate business, for a consideration of £23m on a debt free and earn out free basis. The acquisition was seen as a good opportunity to support the Group’s volume growth aspirations and reduce pressures on its own operations.

Committed to Growth

As Britain’s largest housebuilder, we are committed to playing a key role in terms of UK housing shortage. During the year the Group has put in place additional building blocks to support disciplined growth to build 21,586 homes over the medium term. The Group opened two new sites in Sheffield and Anglia, expanding our Northern and Eastern regions, with effect from 1 July 2022. In addition, a continuation of our strategy to move more of our production to timber frame, we will open a new factory in Kent to complement our existing factory in Bedfordshire. This new timber frame manufacturing facility near Wiltshire will add significant capacity to our timber frame output from 2023.

Stakeholders considered:

• Customers,
• Shareholders,
• Employees, and
• Local communities.

Stakeholders considered:

• Customers,
• Employees,
• Shareholders,
• Sub-contractors and supply chain,
• Local communities, and
• Government, opposition parties, and regulators.

How the Board made its decision:

Management prepared detailed reports to the Board setting out their recommendations and supporting information in respect of each proposed new decision as well as the near term home manufacturing facility. These enabled the Board to understand the rationale for each. For the two new factories that Barratt considered, amongst other factors, current developments and growth in housing in the areas and the current capacity of existing factories to expand and land opportunities. For the new factory, the Board looked into and the current lender home capacity from Devon in Scotland, the cost of taking over an existing factory, building or other building and converting it to meet our needs against building our own factories. For the specific solution and site required by current customers and potential future demand. The Board was also mindful of the employment opportunities that each of these recommendations would bring for increasing employment for a new plant and reducing cost for the near term.

How the Board made its decision:

Management presented detailed reports to the Board setting out their recommendations and supporting information in respect of each proposed new decision as well as the near term home manufacturing facility. These enabled the Board to understand the rationale for each. For the two new factories that Barratt considered, amongst other factors, current developments and growth in housing in the areas and the current capacity of existing factories to expand and land opportunities. For the new factory, the Board looked into and the current lender home capacity from Devon in Scotland, the cost of taking over an existing factory, building or other building and converting it to meet our needs against building our own factories. For the specific solution and site required by current customers and potential future demand. The Board was also mindful of the employment opportunities that each of these recommendations would bring for increasing employment for a new plant and reducing cost for the near term.

Customer Engagement:

We reiterate regular feedback from our customers through direct and through Trustpilot and the survey with the Barratt Development’s Customer Experience and Relationship Management System (CEGR) which enables us to address any of the customer issues and concerns. We conduct quarterly webinars with a database of over 50,000 customer feedback that is published on our website and social media and also in our annual report. We continue to enhance our customer research and support our programme to further deliver action-based insights. We listen to our customers in our research to understand their perceptions and priorities. We look forward to our continued programme of building and the opening of the new homes in Bedfordshire and Anglia and also to the development of new lender home manufacturing facility near Devizes.

Satisfaction of customers is an important part of our operations. The Board is appraised of the feedback received and takes this into account when making decisions that may impact our stakeholders either collectively or individually.

Customers

Link to Strategic Priorities

Customer first

Great places

Why we engage

We use different methods of engagement with our customers, depending on the information that we are trying to gain.

Company Engagement

We use regular feedback from our customers through direct and through Trustpilot and the survey with the Barratt Development’s Customer Experience and Relationship Management System (CEGR) which enables us to address any of the customer issues and concerns. We conduct quarterly webinars with a database of over 50,000 customer feedback that is published on our website and social media and also in our annual report. We continue to enhance our customer research and support our programme to further deliver action-based insights. We listen to our customers in our research to understand their perceptions and priorities. We look forward to our continued programme of building and the opening of the new homes in Bedfordshire and Anglia and also to the development of new lender home manufacturing facility near Devizes.

Board Level Engagement

The Group Customer and Change Director, Jeremy Hampson, updates the Board annually on the actions taken to engage with customers and the outcomes of such engagement. The Board also seeks to gain insight into what should or could be done, and intends to make changes to the way in which we engage with our customers.

Metrics – How we measure effectiveness

The following metrics are reported to the Board by the Chief Executive and/or the Group Customer and Change Director or another executive and/or senior manager, if any, changes to make in how and what we engage with our customers.

• Barratt Homes National New Homes Customer Satisfaction Ratings – a 4-star rating for the 1Km homes in our year.
• Barratt Homes National New Homes Survey rating – included as a metric in the PFI bonus scheme.
• Residential indicator – number of open homes and the total number of visits.
• Trustpilot scores – for 2019 both Barratt and Barratt Homes scored 4.9/5 (4.9 and 4.9 respectively).
• We strongly encourage all employees to take part in our annual engagement survey, which is held every year.

Interests and concerns

During FY22, we also engaged with customers and customers of our homes on various occasions, including the safety of our homes building in a residential setting and affordability.

Outcomes from engagement

We continue to enhance our customer research and support the programme to further deliver action-based insights. We listen to our customers in our research to understand their perceptions and priorities. We look forward to our continued programme of building and the opening of the new homes in Bedfordshire and Anglia and also to the development of new lender home manufacturing facility near Devizes.

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Figure 6.3  Rentokil – Explanation of how principal decisions are defined, along with their examples (2022 ARA, pp86-88)

Principal decisions of the Board

We consider the principal decisions of the Board to be those direct decisions taken, rather than delegated to management or a Committee of the Board, unless considered and approved in principle by the whole Board first, and which may have a potentially material impact on the Company’s strategy, a stakeholder group or the long-term value creation of the Company. We group the Board’s principal decisions into nine categories: financial results; capital allocation; funding; strategy (including ESG strategy); M&A activity; supplier and customer contracts; Board changes; Company statements; and other matters reserved to the Board. Within these categories, some matters are considered less material or strategically significant, such as the approval of the Board governance manual (including changes to the Group Authority Schedule), or the issue of new shares to satisfy our executive share plan. An overview of the Board’s activities during 2022 can be found on pages 81 to 85.

This contains details of the most materially significant principal decisions made during the year. In addition, examples are provided below to illustrate how the Directors have had regard to the matters set out in section 172(1) of the Companies Act 2006 when making principal decisions in 2022 (these include consideration given to key stakeholders, including employees, communities and commercial counterparties but are set out in full in the key operational). Relevant Board papers for deliberation or decision by the Board are drafted to include an appendix clearly settling out the potential impact on stakeholder groups to aid the Board’s consideration.

The section 172(1) statement can be found on page 45. More information on the Board’s engagement with stakeholders and the impacts on the Board’s considerations during the year can be found on pages 88 to 90.

Completing a transformational combination

Following the announcement to the market on 14 December 2021 that the Company intended to acquire Terminix, a significant amount of time was spent by the Board over the ensuing months to oversee and progress the required steps towards completion. Due to the scale of the acquisition shareholder approval was needed by both companies and this, therefore, included the consideration and approval of UK and US filings. Further information on the Board’s activities in 2022 in relation to this transaction can be found on pages 81 to 85.

Directors’ consideration of factors in accordance with section 172(1)

- **Long-term results**
  - The strategic considerations for supporting the transaction as set out in the 2021 Annual Report remained materially unchanged. The Board concluded that the transaction would accelerate business growth and competitive positioning by building on the Group’s business leadership through substantially increased scale in North America. The combined Group would have the opportunity to increase net operating margins through cost reductions, organic growth and operational efficiencies.

- **Colleagues**
  - The combination presents opportunities for colleagues to develop rewarding long-term careers with a clearly communicated set of commitments to colleagues from the Company. The North America business would be underpinned by the Group’s focus to develop and retain a best of breed team as part of its Employer of Choice programme, with a strong joint leadership and high-performance culture.

- **Our business relationships**
  - The business synergies identified in 2021 were regularly reviewed. The complementary combination provides an enlarged platform to serve existing customers with a shared commitment to providing the highest levels of customer satisfaction and to developing new, innovative ways to better serve our customer base.

- **Communities and the environment**
  - Terminix has scale and deep presence in the US and the combined Group would continue to offer job opportunities. Terminix has a clear focus on supporting charitable organisations that align with Rentokil Initial’s mission of supporting people and enhancing lives.

- **Our reputation**
  - The Board has taken time to identify, understand and assess the operational risks in Terminix particularly in relation to termite services including the management of customer claims.

- **Fairness between our shareholders**
  - The transactional documents produced provided the necessary information for both sets of shareholders to make an informed decision when voting on the transaction.

**Outcome**

The Board approved the publication of the transactional documents and general meetings were held in October 2022 where shareholders of both companies provided overwhelming support for the transaction to proceed. The acquisition of Terminix completed on 12 October 2022. The acquisition elevated the Company’s FTSE ranking and saw it listed on the New York Stock Exchange. A new mission, vision and values were launched for the combined Group. The addition of Preserving our Planet to our mission statement reflects an enhanced focus on becoming more sustainable and supporting customers’ sustainability plans.
7. Workforce diversity and engagement

► How has the board engaged with the workforce, what feedback or insights did it receive and how was this considered in the boardroom?
► What actions are being undertaken to address low employee engagement scores, high turnover, culture misalignment or other relevant employee related indicators?
► How successful are initiatives aimed at improving workforce diversity, equity and inclusion and how do these support the achievement of strategic objectives?
► Does the workforce narrative tell a fair and balanced story of how the company has performed against its people commitments?

Companies are dedicating increasing space in their ARAs to workforce related narratives. This includes both workforce engagement, (including as part of s172) and DEI.

Workforce engagement

The results of the 2022 Engage for Success UK employee engagement survey indicates that employee engagement significantly dropped during the pandemic. It also highlights that post-pandemic, the challenges of recruitment, retention, and productivity have become central issues again and that people's expectations have shifted towards more flexibility and choice at work as well as their employers' focus on inclusion, wellbeing and supporting them. In a supply driven labour market, this means that organisational success depends on people being more at the centre of the business agenda.

ARAs indicate that companies are responding to these trends:
► Spirax-Sarco (Figure 7.1) set up a Colleague Engagement Committee in 2019, to create a more formal and regular, two-way, direct dialogue between the Board and colleagues. Its 2022 ARA provides a clear summary of engagement activities, the feedback received and the resulting actions.
► A number, like Metro Bank (Figure 7.2) included a call out or letter from the designated non-executive director for workforce engagement (DNED) emphasising the importance of understanding the views of the workforce.

Workforce challenges are set to continue – whilst flexibility remains in high demand across the talent pool, companies are starting to re-evaluate remote and hybrid working amidst rising concerns about productivity and risks to cyber security and staving attacks. An increasing number of high-profile employers are requesting that people return to the office and ‘remote-washing’ is quickly becoming the new catch phrase.

Against this backdrop and with around 77% of companies disclosing a talent-related principal risk, we do not expect the engagement narrative to be contracting in the near-term.

Diversity, equity and inclusion

The 2023 Hiring and Workplace Trends Report points out that DEI will remain top of mind, as employees continue to deeply care about these initiatives, as well as the progress employers are making, or not. Considering employee sentiment, alongside the increasing

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4 Indeed Hiring Lab and Glassdoor Economic Research team, 2023
Emphasis on human rights, the recent announcement that the Taskforce on Inequality-related Financial Disclosures (TIFD) and the organisations preparing a Taskforce on Social-related Financial Disclosures (TSFD) are consolidating their efforts into a single initiative, investor guidelines and the new diversity listing rule which sets targets for board diversity, it is hardly surprising that the volume of the DEI narrative is expanding. However, its quality is not necessarily improving. In a May 2023 ECGI Working Paper on DEI, the authors argue that DEI initiatives have two motivations - financial (i.e. that DEI improves a company's long term financial performance) or social (the belief that companies have a responsibility to contribute to societal goals).

The focus of the narrative in ARAs seems to be the latter, with companies detailing often numerous, narrow initiatives that lack a clear or cohesive link to the organisation's strategic objectives and instead seem to play into political agendas. Companies struggle to articulate how the actions they are undertaking to improve diversity are translating into opening up opportunities, reducing barriers and building the best teams that future-proof the organisation.

They also struggle to demonstrate how they are moving beyond diversity to meaningful inclusion, where people with dissenting views are embraced and debate, which is so often the precursor to innovation, encouraged.

Better narratives, like Rolls-Royce (Figure 7.3) are able to evidence the impact activities are having, e.g., demonstrating how outreach activities are inspiring future talent.
Figure 7.1  Spirax-Sarco – Colleague Engagement Committee report providing a clear link between feedback received and action taken (2022 ARA, pp116-117)

Board leadership and Company Purpose continued

Colleague Engagement Committee Report continued

Focus groups held in 2022

January
- EY, Chronicles, Odiyan - a follow-up focus group with some colleagues that we had in 2019 to assist with the planning of the next event.
- Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

April
- EY, Chronicles, Odiyan - a follow-up focus group with colleagues that had attended the previous event.
- Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

June
- EY, Chronicles, Odiyan - a follow-up focus group with colleagues that had attended the previous event.
- Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

October
- EY, Chronicles, Odiyan - a follow-up focus group with colleagues that had attended the previous event.
- Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

December
- EY, Chronicles, Odiyan - a follow-up focus group with colleagues that had attended the previous event.
- Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

Looking forward
We look forward to hearing more about the feedback from our colleagues and working with the team to implement action.

Team focus for 2023
- EY, Chronicles, Odiyan - a follow-up focus group with colleagues that had attended the previous event.
- Our typical slide included giving colleagues and understanding of the relationship between the Board and the Committee. It is important to have a clear link between the feedback received and action taken.

We look forward to hearing more about the feedback from our colleagues and working with the team to implement action.

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We look forward to hearing more about the feedback from our colleagues and working with the team to implement action.
I am very pleased to set out my letter to Metro Bank's stakeholders, in the role of designated Non-Executive Director for Colleague Engagement. I would like to draw your attention to the recent communication from the head of colleague engagement, our designated Non-Executive Director for Colleague Engagement (NHED) who due to take this opportunity to thank colleagues, who went above and beyond in 2022, for their efforts in the role during the first half of the year. I am delighted to have been able to support in meeting even more colleagues and hearing their views, which I have gathered to the Board throughout this year.

The Board continues to be of the opinion that appointing a NHED is the most appropriate engagement mechanism for Metro Bank to ensure there are effective two-way engagements between stakeholders. The Board is conscious of the requirements of the Pensions Act 2021, and has held discussions with colleagues regarding engagement, including executive remuneration, with an appropriate, independent and diverse board.
The Board has continued to promote a culture of supporting and informing Board decision-making. I have seen how essential multi-colleague sessions are to our culture at the start of three Metro Bank careers. Graduation events have also been significant in building colleagues and ensuring transparency as an essential factor in this success.

Figure 7.2 Metro Bank – Call out or letter from the designated non-executive director for workforce engagement emphasising the importance of understanding the views of the workforce (2022 ARA, pp115-117)

I am also pleased to report on the number of colleagues who have responded to our call out or letter from the designated non-executive director for workforce engagement, emphasizing the importance of understanding the views of the workforce.

The letter from the designated non-executive director for colleague engagement

Our Board continues to welcome our colleagues’ views, recognising that the bedrock of our business model, ensuring we can deliver over and above for our customers, the communities we serve and for each other.

Hayley Wman
Independent Non-Executive Director for Colleague Engagement

Looking forward

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Figure 7.3 Rolls Royce – Explaining how STEM outreach positively impacts future recruitment possibilities (2022 ARA, pp38-39)

Diversity and inclusion
We believe that a diverse, equitable and inclusive workplace makes us a stronger company, enables us to hire the best talent, creates high performing teams where our colleagues can reach their full potential and be at their best. In 2022, we focused on inclusion and belonging through our ‘Being’ campaign, where colleagues volunteered to participate in ‘people like me’ stories, celebrating them as a person and what makes them unique (see page 52).

We accelerated our efforts to attract and retain diverse talent and we embedded new inclusive hiring processes. We delivered our goals through four key pillars: lead, attract, retain, develop.

In 2022, we continued our focus on increasing the diversity of our external hires, with 23% of all global hires being female compared with 19% in 2020. Additionally, 17% of hires in the UK and 26% of hires in the US were of ethnic minority backgrounds. We were recognised externally, winning a variety of awards, including first place in the Times Top 100 Engineering Graduate Employers, Best Engineering Employer for both males and females in the Unisversal Rankings and Best Diversity Initiative in the Engineering Talent Awards.

To support the growth and development of our under-represented populations, we introduced two new learning programmes: Connect & Belong, aimed at ethnically diverse talent; and Thrive, aimed at gender minorities. Both feature internal mentoring and skill development workshops. Forty-eight participants took part in Connect & Belong and 91 participated in our Thrive programme.

We give full and fair consideration to all employment applications from people with disabilities. If an employee becomes disabled whilst working for us we take steps to support their continued working including, wherever possible, making adjustments to ways of working.

While we have work to do to meet our stretching 2025 diversity targets (see page 40), we continue to refresh our approach against our diversity and inclusion pillars, to expand the global reach and impact of programmes, while driving accountability through continued measurement.

Inspiring future talent
We refreshed our approach to early careers attraction this year through embedding inclusive hiring. We also focused on employee advocacy as a powerful tool to reach diverse talent pools. Our approach has centred on creating an authentic narrative, provided through people’s stories, utilising social media and digital platforms. Partnerships became a key lever for attracting diverse talent into our internship and graduate roles. We sponsored three undergraduate of the year awards and converted 89% of the finalists into internship offers across our male, social mobility and neurodiversity categories (76% female, 42% ethnicity). We have also grown our i-Accelerator insights programme to support 60 ethically diverse students across both STEM and business programmes. Through holistically redesigning our end to end careers approach, enhancing digital engagement and refreshing our assessment methods to focus on values and behaviours the diversity of our intake significantly increased. Our female graduate hires increased globally from 19% in 2021 to 40% in 2022.

In 2022, a new skills academy was opened in the UK to 200 apprentices as part of our strategy to inspire the next generation of future engineers. Creating and maintaining this pipeline of talent is crucial for industry growth in the UK Defence, alongside providing jobs and opportunities for individuals across the UK. Working in partnership with the National Skills Academy for Nuclear (NSAN), Rolls-Royce SMR also developed a nuclear skills programme for colleagues who are new to nuclear within the nuclear industry framework.

Community and STEM outreach
We believe that we have a responsibility to invest in and engage communities, to inspire the next generation, enable opportunities for our people and reflect the diversity of the communities that we operate in, by building a pipeline of future talent.

We work with local partners to identify issues, define objectives and evaluate impacts within a global framework. Together, we develop activities to meet local needs and particularly focus on groups that are disadvantaged by social and economic factors.

In 2022, global community contributions totalled £5.1m (2021: £2.73m), with £2.99m in cash donations, which included our response to the Russia-Ukraine conflict. Funds received as a result of a share for future programme were not spent during 2022 but will be allocated in the future.

Together with our people, we contributed at least £1m to help the people of Ukraine. Contributions included a global matched giving scheme in partnership with Habitat for Humanity. We also matched employee time contributions with our Works Council and made cash and in-kind donations to local agencies supporting refugees arriving in Germany. Our Power Systems business donated gennets to maintain power to hospitals in Ukraine.

Our people remain at the heart of all our programmes and contributed 48,547 hours (2021: 26,427) to community programmes. In 2022, at least 80 teams across the Group completed practical projects in their local communities ranging from improving facilities to maintaining natural environments.
8. Environment

► How well is the company's sustainability strategy integrated into the overall business strategy and are environmental and social factors incorporated into the assessment of principal and emerging risks?
► Does the narrative strike the right balance between providing insights into the business strategy versus sustainability strategy?
► Does the narrative provide a fair and balanced overview of the company's impact on the environment and explain how changes to the environment are impacting the business model? Are these impacts quantified?
► Is it clear which metrics and targets are materially important for managing environment-related risks and opportunities? Are these metrics relevant and meaningful?
► What level of assurance was obtained over these metrics?

Current climate reporting landscape in the UK

The UK’s climate-related reporting landscape has evolved rapidly in recent years. Since the introduction of Streamlined Energy and Carbon Reporting (SECR) in 2018 and the requirement to report under MRR on how directors had considered various stakeholders and the environment to discharge their s172 duties, a flurry of climate-related requirements has been introduced.

In 2020, the FCA’s Listing Rule mandated premium (followed by standard) listed companies to report on a comply or explain basis on the 11 recommendations of Task Force on Climate-related Financial Disclosures (TCFD). This was followed in 2022 by the government introducing climate regulations mirroring TCFD to capture a wider scope of entities.

International Sustainability Standards Board (ISSB) Standards

IFRS S1 and S2 are the first IFRS Sustainability Disclosure Standards developed by the ISSB.

► IFRS S1 ‘General Requirements for Disclosure of Sustainability-related Financial Information’ covers the overall requirements for disclosure of sustainability-related risks and opportunities over the short, medium, and long term.
► IFRS S2 ‘Climate-related Disclosures’ sets out specific requirements for the identification, measurement and disclosure of climate-related financial information. It is designed to be used in conjunction with IFRS S1.

IFRS S1 and S2 incorporate the recommendations of TCFD and as a result, the IFRS Foundation will take over the monitoring of climate-related disclosures from 2024.

IFRS S1 and S2 also include additional detail that is not required by the TCFD, including disclosures regarding industry-based metrics, the planned use of carbon credits, and financed emissions. The metrics are not limited to greenhouse gas emissions and include for example, water withdrawn and consumed in water stress regions or metrics related to supply chain management.

The International Organization of Securities Commissions (IOSCO) has already endorsed the standards. The UK government aims to make an endorsement decision on IFRS S1 and S2 by July 2024. Following endorsement, decisions to require disclosure will be taken independently by the FCA for UK listed companies and by government for UK registered companies and limited liability partnerships.
Other international developments

Demand from investors and other stakeholders for more standardised and comparable information about how climate-related risks and opportunities are being addressed continues to grow. The UK is therefore not the only country where the climate reporting landscape is in flux.

The US Securities and Exchange Commission (SEC) is developing rules to enhance and standardise climate-related disclosures closely aligned to the TCFD recommendations. Under this proposal companies will be required to disclose their direct and indirect greenhouse gas emissions, and climate-related risks.

Companies that have developed transition plans, conducted scenario analysis, or set public climate-related targets or goals will also be subject to specific disclosures. The effective date is currently unknown, with the rules expected to be finalised in 2024.

The Corporate Sustainability Reporting Directive (CSRD) is a new EU directive that will require large companies and certain other organisations to report on their sustainability performance across ESG topics. CSRD requires companies to use a common set of standards: the European Sustainability Reporting Standards (ESRS) which were finalised in July 2023. There are two cross-cutting ESRS (ESRS 1 and 2) and 10 topic-specific ESRS covering climate change, water, biodiversity, workforce and business conduct among others.

Other than ESRS 2 (General Disclosures), disclosure requirements and data points within the 10 topic-specific ESRS will be subject to a materiality assessment. The materiality assessment process will be subject to external assurance in line with the CSRD.

CSRD has a staggered implementation approach with some EU companies having to apply ESRS from January 2024. The final issued standards were adopted in July and clarify that, in line with ISSB standards, financial materiality focuses on investors as primary users. An explanation is also required if climate change is not considered to be a material topic.

Some UK groups with substantial activity in the EU market are also caught by the requirements and will have to report as of January 2028 (refer to Appendix C for more detail). They will however be subject to a specific set of non-EU ESRS standards that are yet to be developed.

EY’s overview comparing the various approaches to climate reporting and disclosures can be found here.

Quality of TCFD reporting in UK plc ARAs

There has been an overall improvement in the quality of TCFD reporting in the second cycle, although disclosure of actual or potential financial impacts remains lacking, as does therefore the connectivity to financial statements. Similarly, principal or emerging risks relating to climate are not always consistent with what is included in the TCFD section of the ARA.

Another area that requires further refinement is moving away from generic industry or sector-based statements to company specific disclosures. The better reporters, like ABF (ARA 2022, p85), explain which parts of the organisation are impacted by material climate-related risks and opportunities, and disclose a wide range of metrics to measure and manage these. Such an approach helps the reader understand how climate change is influencing the business model, strategy, and financial planning processes of the company.

The FRC’s July 2023 Thematic review of climate-related metrics and targets also found that many companies are struggling to present a clear message to investors about which metrics and targets are materially important for managing climate-related risks and opportunities and their transition plans.

A growing number of companies are independently assuring some of their climate metrics. However, companies are also highlighting limitations, with scope 3 emissions recognised as the most challenging area.

For further insights into the global state of climate-reporting, look out for the 5th edition of EY’s Global Climate Risk Barometer - a comprehensive analysis of disclosures made by c.1,500 companies globally - due to be published this autumn.
Oversight of climate reporting

Proposed changes to the Code are expanding the responsibilities of ACs beyond their traditional role of overseeing financial reporting to include non-financial reporting. Requesting clarity on this matter is sensible given that, similar to last year, only around 60% of companies were explicit about who has oversight of TCFD reporting.

It is less obvious, however, that the oversight should lie with the AC by default. In 72% of cases, the AC was responsible but in 13% it was a committee that had an ESG/sustainability-related remit. As many companies have specific committees in place to cover E&S topics, boards need to consider which committee(s) may be best placed to oversee particular aspects of non-financial reporting.

From green washing to green hushing?

In recent years, companies have made bold promises about achieving their environmental ambitions and targets such as achieving net-zero within a certain timeframe or only working with suppliers who have made their own commitments. Meeting these targets requires significant investment in new technologies or more fundamentally for some, a shift in in business model.

Many of these ambitions have turned out to be unsupportable or unachievable - at least not in the original timeframes envisaged - which has led to a backlash against companies and accusations of greenwashing. Given the backlash and the reduced confidence companies have in meeting targets, more recently, the pendulum seems to be swinging towards ‘green hushing’ i.e., staying quiet about their climate strategies and related goals, as well as suppressing or downplaying information about environmental impacts.

Transition plans and adaptation

This is why transition plan disclosures are essential i.e., translating strategic climate objectives into concrete short- and medium-term steps setting out plans and actions to contribute to and prepare for a rapid transition towards a low-carbon/net zero economy.

In the UK, the Transition Plan Taskforce (TPT) has been tasked with developing a ‘gold standard’ disclosure framework. Following a consultation which ran in early 2023, a finalised framework is expected by the end of 2023, with a progress update issued in July 2023.

The UK government intends to consult on transition plan requirements for the UK’s largest companies in the final quarter of 2023. As per Primary Market Bulletin 45 of August 2023, the FCA plans to consult in 2024 on guidance that will set expectations for transition plan disclosures at the same time as its consultation on the adoption of IFRS S1 and S2.

Even with commitments to cut emissions and transition to a low carbon or net zero economy, global temperatures are on the rise. Therefore, the need for adaptation solutions including new technologies and infrastructure is also growing as it is essential to protect lives, assets, and to ensure the economy can continue to function. We expect increasing emphasis on companies to disclose not just their transition but also their adaptation plans.

Beyond climate

Some companies are already reporting on other environmental areas beyond climate such as their water use and impact on biodiversity. BAT (Figure 8.1) does this as part of its ‘Strategic Management’ section, Unilever (ARA 2022, pp 32) does this as part of its ‘Planet and Society’ section.

Extending the scope of environmental reporting beyond climate is likely to become more prevalent once the Taskforce on Nature-related Financial Disclosures (TNFD) framework is finalised, regardless of whether it becomes mandated in the UK. On one hand the framework will provide companies with a clear and consistent way to report on their nature-related risks and opportunities, on the other it will drive investor expectations in this regard. Kao (Figure 8.2) has already applied the TNFD framework to its biodiversity report, which sets out how the relationship between Kao’s business and nature varies across three different scenarios.
As noted in the UK government’s 2023 Green Finance Strategy, it will explore how best the final TNFD framework, due to be published in September 2023, should be incorporated into UK policy and legislative architecture.

Review of UK’s non-financial reporting framework

Whilst non-financial reporting helps create transparency on companies’ and boards’ approaches to managing their non-financial risks and their policies and actions to set strategy and allocate resources, thereby enabling more informed investment decision making, there is also recognition of the growing burden and cost especially given the steady and incremental growth in requirements over recent years.

The Department of Business and Trade (DBT) is therefore conducting a review of the UK’s non-financial reporting framework to look at opportunities to refresh and rationalise it so that it is fit for purpose and delivers decision-useful information to the market. A recently concluded call for evidence is the first phase of this review. Government will use outputs from this phase to develop detailed proposals for public consultation in 2024 before then considering any legislative changes.
Figure 8.1  BAT – Evaluating the company’s impact on biodiversity and water stewardship (2022 ARA, pp 52-53)

Strategic Management

Excellence in Environmental Management

We have a global footprint and rely on natural resources to run our business. Sourcing resources in a climate-resilient, sustainable manner is key to delivering our business strategy. We are driving environmental excellence for a greater tomorrow.

Environmental Policy

Our Environmental Policy is adopted by our Core Climate program, which is defined by our commitment to high standards of environmental protection, adhering to the principles of sustainable development and operational excellence.

Tackling Climate Change

Our ambition is to be a climate neutral Group by 2040, as supported by a range of operational targets. Already, we are making significant progress in 2021, reducing our net greenhouse gas emissions against our 2021 baseline.

We also recognize the importance of being beyond the operation with a focus on reducing our greenhouse gas emissions. This is why we are committed to implementing the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement to reduce our greenhouse gas emissions.

We have implemented a range of initiatives to help our stakeholders understand the impact of climate change and how they can contribute to reducing it. Our priority is to minimize our carbon footprint and transition to a low-carbon economy.

We have conducted studies to map the greenhouse gases emitted from our operations, and we have set ambitious targets to reduce our emissions. We are working towards achieving these targets by implementing best practices and adopting innovative solutions to reduce our carbon footprint.

Evaluating water stewardship

We have a robust system for evaluating water stewardship in place at our sites. We assess water use and quality, and we have set targets for reducing water consumption, improving water efficiency, and minimizing our impact on water resources.

We also have a system in place to monitor and report on water-related risks and opportunities, including identifying areas where we can improve our water management practices.

We are committed to improving our water stewardship performance, and we have set targets for reducing our water consumption and improving water efficiency. We are working towards achieving these targets by implementing best practices and adopting innovative solutions to reduce our water footprint.

Biodiversity and Afforestation

We believe that biodiversity management is essential for the health and resilience of our business. We have established a biodiversity management plan to identify and protect biodiversity hotspots, and we are working to restore degraded areas.

We are committed to protecting and preserving biodiversity, and we are working towards achieving these targets by implementing best practices and adopting innovative solutions to protect and enhance biodiversity.

In summary, we are committed to implementing the principles of our environmental program to achieve sustainable development and operational excellence. We are working towards reducing our environmental impact and improving our environmental performance.
Figure 8.2  Kao – Application of the TNFD Framework, *(Biodiversity Report Based on the TNFD Framework, pp8-9)*

**Executive Summary**

The results found that the relationship between business and nature would differ by scenario, and that differences may lead to diversified products (origins of dependence and impact) and different degree of concentration or dispersion in the supply chain.

- **Scenario (I)-A**
  - Nature/Corporate
  - TNFD/ESG
  - Natural/naturalistic growth both realized by strong regulation and technological innovation
  - Mass who are environmentally conscious

- **Scenario (I)-B**
  - TNFD/ESG
  - Small-scale A (e.g., emerging)
  - Small scale, part of which choose nature conservation as a life value

- **Scenario (II)**
  - TNFD/ESG
  - Markets divided due to protective trade
  - Mutual influence of economy and environment
  - Mass with mass consumption

As limited high quality/environment-friendly products take over the market, supply chain become concentrated

As locally produced products are popular with short Lead Time, supply chain become decentralized

As protective trade and natural disasters interface, supply chain is heavily hampered

**Executive Summary**

For each biodiversity-related risk defined by TNFD, we assessed the 1) probability of occurrence based on the direction of macro environment changes, and 2) type of impact of each risk based on the state of nature degradation and dependence on nature, both of which were found in the Evaluate section, in order to identify higher priority risks in each scenario.

The results confirmed that for Scenario (I), stricter regulations for nature conservation and stakeholder negotiation risks such as brand damage and animosity from NGOs are important, and for Scenario (II), procurement of raw materials is exposed to risks including decreased protective functions, rising costs and destabilization, are high priority.

**Priority Risks**

1. Priority Risks* shared across multiple scenarios

2. Priority Risks* with high impact and probability of occurrence in each scenario
9. Risks and viability

► What are the principal risks to the successful delivery of the strategy and how might these manifest in the company?
► What levels of risk is the board willing to take and how does this align with the related mitigating actions?
► Are changes in the likelihood or impact of principal risks explained, together with the evolution of mitigating actions?
► Which of these pose the greatest threat to the viability of the company?
► Is the rationale for the timeframe over which the board has considered the viability of the company robustly explained?
► What specific scenario and sensitivity testing has been performed on the model(s) supporting the viability statement and what was the outcome of this testing?

Current risk reporting practices

There are numerous sources of risk disclosure requirements and good practice guidance. Applicability varies depending on whether a company is UK incorporated, its listing status and size, with additional expectations of financial services companies. It is not surprising that practice is therefore varied too.

Common practice is for companies to list their principal risks in a tabular disclosure. Some also provide a brief explanation/nature of the risk, including risk drivers. Few disclose the owner of each principal risk, or the specific governance oversight. This strengthens the narrative about accountability.

Mitigating actions are typically disclosed in a generic manner, not specifying whether actions were undertaken in the year or whether they are available but had not necessarily been activated in the year.

Additionally:
► 90% disclose impact, of which 60% provide only a qualitative explanation
► Around a third disclose likelihood, mainly using a heat map and sometimes using a risk radar, like Rotork (Figure 9.1).
► Over 80% disclose changes to risks, although it can sometimes be unclear whether this is compared to the prior year, or whether this is an outlook. Only around 30% discuss changes to mitigating actions to some extent.
► Less than a third disclose the level of risk appetite for each of the principal risks, with a few providing a risk appetite statement per risk.

► Very few companies disclose risk velocity or interconnectivity. Only 11% annotate risks with a link to the viability statement, something that might be helpful in addressing the requirements of the RS.
Viability statement

Based on the sample of companies we analysed, the average viability period was 3.6 years, with 3 years being most common and 7 years being the longest. Whilst the narrative supporting the rationale for choice of period is meaningful in around 43% of cases, the narrative about longer term prospects is seldom insightful, with Persimmon (2023, pp75-76) being one of the few exceptions.

Only around a third of companies clearly link viability scenarios back to principal risks. The FRC has repeatedly emphasised that viability statement disclosures need to provide sufficient qualitative and quantitative detail in respect of the inputs and assumptions used, like done by Severn Trent (Figure 9.2).

The detail and quality of disclosure increased significantly in early 2020 in response to investor demands in the context of the COVID-19 pandemic. This was however a temporary.

One conclusion that might be drawn from the swift contraction of reporting on viability and liquidity under COVID-19 is, that despite investor and wider stakeholder interest in the topic, companies prefer not to be overly transparent about their modelling and its outcomes if they can help it, potentially being worried about a negative market reaction that ‘oversharing’ might bring in a business-as-usual environment. It remains to be seen whether the introduction of a RS by draft secondary legislation will make a difference.

Looking forward

Under the FRC’s draft revised Code, companies will need to disclose their emerging risks. Presently only 23% of companies do so, with a further 20% providing only a few examples.

There will also likely be changes to risk reporting arising from the RS. The RS will require the following disclosures with respect to principal risks: likelihood, impact (either qualitative or quantitative), timeframe and mitigating actions alongside changes to all these categories. It will also emphasise the linkages between risk reporting and the viability assessment and introduce a requirement to perform and disclose a reverse stress test in the medium-term section.

Currently 37% of companies from outside financial services make reference to having conducted a reverse stress test within their viability statement but across all sectors including FS, there is very little to no detail beyond this reference. Abrdn (Figure 9.3) is a notable outlier.

Based on the limited information that is provided and our conversations with companies, it appears that understanding and practice on what constitutes a reverse stress test differs significantly between financial services and non-financial services companies. In the latter case, assumptions are successively flexed downward to “break the company” or a prolonged deterioration in trading is modelled as opposed to - in financial services - starting from the assumption that the company is non-viable/has failed and qualitatively assessing the extreme scenarios/circumstances that could have led to this.

It will be important that the FRC’s guidance underpinning the RS clarifies expectations in this respect.
Figure 9.1 Rotork – Likelihood and impact disclosed using a radar visualisation. Tabular disclosure provides clear links to strategy, viability scenarios and sets out the risk trend. It also provides a risk appetite statement and focus areas for the upcoming year, including changes to mitigating actions (2022 ARA, pp91-97)

Focus for 2023

In 2023 we will continue to build on the work performed in 2022. We will focus on the development of our emerging risks, developing the level of detail of our measurement of those risks. We will continue to develop the business continuity management system and the emergency management within the new programmes associated with the Secure Growth Strategy. We will monitor the effectiveness of our response to our key risks using our risk appetite dimensions.

Economic and market conditions

1. Decline in market confidence

Risk owner: Chief Executive Officer

Link to strategy

1. Revenue decline

Description

A decline in government and private sector confidence and spending will lead to cancellations of expected projects or delays to existing expenditure commitments. This lower investment is a traditional sector issue, which could result in a smaller addressable market, which in turn could result in a reduction in revenue (USD).

Key mitigating actions

- Niche development and innovation to address new markets and new applications in existing markets.
- Geographic and end sector diversification provides resilience to a reduction in any one programmatic area but may not fully mitigate a change in the larger end markets.
- Small to medium orders are generally less likely to cancel under pressure during economic times, however, estimates that 40% of Rotork orders by value are small to medium sized, i.e. less than £100K.
- Increased focus on service offerings, particularly increased demand for product maintenance.

Risk appetite statement

We will set a long-term move to increase the addressable markets which we serve.

Focus for 2023

As outlined in our Growth+ strategy, we will:

- Continue our investment in innovative products and services.
- Focus on key account management.
- Continue to deliver growth from existing key programmes such as: net reduction, global transformation and profit ambition.
- Work with our supply chain partners to build strategic partnerships.
- Reduce our delivery to customers to ensure buying forward with our trust strategy.
Figure 9.2  Severn Trent – Details of risks and scenarios tested, including the stress tests applied (2023 ARA, pp81-83)

The table below sets out the potential impacts of the stress tests and the mitigating actions that were available to address the impacts.

### Stress Tests Applied

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Stress Tested A</th>
<th>Financial Impact on Solvency and Capital Adequacy</th>
<th>Mitigation Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>An extreme one-off event</td>
<td>Increased loss of income from customers, service failure due to high water levels, or severe weather events</td>
<td>Material impact on solvency and capital adequacy</td>
<td>Carry out additional stress tests and scenario analysis, ensure adequate buffer levels.</td>
</tr>
</tbody>
</table>

### Key Risks and Scenarios Tested

- **Operational Risks**: Threats to the safety of employees, contractors, or members of the public as a result of what we do.
- **Customer Risks**: Catastrophic failure of a large reservoir or treatment works, service failure due to increased operating expenditure.
- **Geographical Risks**: An extreme event in a single location or a large area where treatment works are located.
- **Non-Compliance Risks**: Our performance is below customer expectations in terms of delivery of services.
- **Key Priorities and Objectives**: Significant increase in capital expenditure. Treatment works, including increased operating expenditure or failure to meet performance commitments.
- **Cyber- and Technology Risks**: A cyber-attack on our systems, including loss of personal data leading to regulatory action.
- **Regulatory Risks**: A breach of law or regulations resulting in significant one-off penalty.
- **Pension Risk**: Increasing pension deficit leading to higher deficit reduction contributions.

### Combined Scenario

- **Operational Risks**: Unforeseen events, including extreme weather conditions.
- **Customer Risks**: Service failures due to increased operating expenditure.
- **Geographical Risks**: An extreme event in a single location or a large area where treatment works are located.
- **Non-Compliance Risks**: Our performance is below customer expectations in terms of delivery of services.
- **Key Priorities and Objectives**: Significant increase in capital expenditure.
- **Cyber- and Technology Risks**: A cyber-attack on our systems, including loss of personal data leading to regulatory action.
- **Regulatory Risks**: A breach of law or regulations resulting in significant one-off penalty.
- **Pension Risk**: Increasing pension deficit leading to higher deficit reduction contributions.

The mitigating actions available are described in more detail below.
Reverse stress testing involves exploring the quantitative and/or qualitative impacts of extreme scenarios which could threaten the viability of our business model. For this year’s exercise, we investigated possible economic conditions that could lead to non-viability. This involved exploring more extreme versions of the scenarios developed under the stress testing and scenario analysis programme, focusing on increasing the size of the equity market shock in Q1 2023.

The reverse stress testing exercise highlighted how the Group’s risk appetite monitoring processes, including defined escalation processes, support the early identification of possible issues and provide time for actions to be taken before these issues crystallise.

The exercise found that equity market falls required to threaten viability were viewed as being very remote. This, and the Group’s range of mitigants in place to respond to the scenario, supports the assessment of viability and no qualification is considered necessary.

Over recent years the Group has also explored reverse stress tests including the failure of a critical third party administrator in the Investments vector, the loss of critical staff and a significant cyber attack. The work performed concluded that these events had a low likelihood of occurrence and were not
10. Risk management and internal control

► How is the effective management of risks and monitoring of the risk profile of the business embedded across different levels in the organisation? What are the key steps within the risk management cycle/process?

► How does the board monitor the systems of risk management and internal controls on a regular basis during the year? Is the description of the process for their annual effectiveness review comprehensive?

► What are the outcomes of this review? Has the board identified weaknesses or inefficiencies and are the resulting actions clear?

► Has the company explained its definition of emerging risks and stated the procedures in place to identify them and how these differ from those relating to principal risks?

Risk management reporting

Disclosing a risk management framework is a common means of explaining how risks are managed. Additionally, some companies like Weir (Figure 10.1) provide an overview of the process itself, commonly including steps like risk identification, assessment, monitoring and response.

When the 2018 Code introduced the requirement for boards to extend their assessment of risks to also cover emerging risks and to set out procedures in place to identify them and explain how they are managed or mitigated, many companies tended to add on ‘and emerging’ to existing disclosures on their approach to principal risks. Reporting has since evolved, but only around 27% of companies include a robust narrative about emerging risk identification. Companies like Balfour Beatty (2022 ARA, p88) or National Grid (2023 ARA, p19) provide more detail on the process, including how they define emerging risks, the timeframe over which they may become significant and specific aspects of the process relating to their identification, like utilising future scenarios and horizon scanning.

In its November 2022 Review of Corporate Governance Reporting, the FRC provided a reminder of reporting expectations on monitoring and reviewing the effectiveness of the risk management and internal control systems, emphasising that “Good reporting should include details on how the board monitors these systems on a regular basis, in addition to a formal annual review. The annual report should describe any actions that companies have taken during the year to improve or strengthen the risk management and internal controls systems, even when the annual review of these has found no weaknesses or inefficiencies.”

The issue of enhancing risk management and internal control systems has been much debated in the UK over the last four years as a result of corporate collapses and the various ensuing government-initiated inquiries and reviews. In May 2022, the government decided that a more incremental approach to strengthening these would be appropriate and invited the FRC to revise the Code to do so.

The FRC’s proposals retain the existing requirements but expand them to include a declaration of whether the board can reasonably conclude that the company’s risk management and internal control systems (covering operational, compliance and reporting controls) have been effective throughout the reporting period and up to the date of the ARA. It will also need to set out the basis for that declaration, thereby implying...
the need for both greater transparency on what the board did to reach its conclusion and supporting evidence for what is being reported. Boards will need to describe in the ARA any material weaknesses identified and the remedial action being taken, and over what timeframe.

This will be a significant reporting step up for many companies which today confirm that monitoring takes place and that an annual review has been carried out, but, unlike Rentokil (Figure 10.2) provide little to no detail about these activities or their outcomes.

**Forward look**

DTR 7.2.5 already requires companies to describe the main features of their internal control and risk management systems in relation to the financial reporting process, although these are seldom robust disclosures. We expect that FRC's proposals will influence risk management and internal controls reporting ahead of the revised Code becoming effective, with granularity of disclosures increasing across all aspects of risk management and internal controls.

Some companies, like Rolls Royce (2022 ARA, p43-47) already set out the key entity level controls over specific risks. Such disclosures are likely to aid with making the declaration and may provide a link to assurance considerations. We expect more companies may start providing such information.
Figure 10.1 Weir – Key roles and responsibilities for risk management mapped against a three lines of defence model, along with a disclosure of the risk management cycle (2022 ARA, pp62, 64)
Figure 10.2 Rentokil – Risk management and internal control narrative, with reference to controls beyond financial reporting and transparency on issues identified (2022 ARA, pp94, 101-102)

Risk management and internal control

The Board’s approach to managing risk and ensuring that an effective internal control environment is maintained is set out in the risks and uncertainties section on page 63. The Board’s statement on internal control is set out in the Corporate Governance Code. The Board believes that the principles and objectives of effective internal control are also achieved through the implementation of the Group’s values, the corporate culture and the way the Group is managed.

The Board is responsible for ensuring that the Group has adequate internal controls in place. The Group’s internal control structure is built on a three-level risk management system:

- First level – the Group’s senior management, comprising the Chief Executive and the Board.
- Second level – the Group’s internal audit function.
- Third level – the Group’s management and employees.

During 2022, the Audit Committee was updated on the risk and control environment at each business, as well as the Regional Heads of Risk, Directors’ assessment of the quality and prudence of the Finance function, the environment of the parent company. The Audit Committee members received reports from the Regional Finance Directors for the UK & Ireland businesses and the Asia region respectively during the year. Other regional updates were provided as part of the Board agenda. This provides a heightened awareness for the Audit Committee to put in place an effective control environment.

The Audit Committee continues to evaluate cyber incidents and trends throughout the year and, although there is no indication that the specific targets, we remain alert to the number and nature of controls cyber attacks in the year, with reported distributed denial of service (DDoS) attacks and identified weaknesses in our IT environment and awareness initiatives. Our clear technology and resilience have continued to allow us to detect and prevent real threats before they are able to incur any material impact on our operations. This is an area we will continue to develop and expand as we integrate in our IT capabilities in our combined North American business.

The number of control issues across the Group remains relatively low, with those that do occur resulting in a material impact on Group performance. Nonetheless, some significant control issues were experienced including:

- A significant rise in the number of new control issues identified, expected to continue.
- A cyber attack on a non-integrated acquisition in our North American business and a DDoS attack in our IT environment.
- A significant rise in the number of new control issues identified, expected to continue.
- A cyber attack on a non-integrated acquisition in our North American business and a DDoS attack in our IT environment.
- A cyber attack on a non-integrated acquisition in our North American business and a DDoS attack in our IT environment.
- A cyber attack on a non-integrated acquisition in our North American business and a DDoS attack in our IT environment.

Internal audit

As part of the Group’s transparent and rigorous approach to internal audit, the Board has reviewed and approved the 2022 Audit Plan, which sets out the areas of materiality and significant risk identified during the risk assessment process.

During 2022, the Audit Committee was provided with an update on the progress of the Audit Plan. The Audit Committee was also provided with an update on the progress of the Audit Plan. The Audit Committee was also provided with an update on the progress of the Audit Plan. The Audit Committee was also provided with an update on the progress of the Audit Plan.

The Board of Directors reviews the progress of the Audit Plan at least twice a year, and the Audit Committee reviews the progress of the Audit Plan at least once a year.

Figure 10.2 Rentokil – Risk management and internal control narrative, with reference to controls beyond financial reporting and transparency on issues identified (2022 ARA, pp94, 101-102)
11. Governance

► What did the board and its committees actually do in the year to govern the company – what specific governance issues arose and how were they addressed?
► What, if any, changes were made to governance arrangements during the year and why?
► What areas for improvement were identified from the board and committee evaluations and what progress was made against actions from the previous evaluations?
► How is board and committee composition and succession planning being managed, giving due regard to the evolving strategy of the company, skills, experience, diversity, time commitment and tenure?
► Has the fair, balanced and understandable (FBU) assessment adequately considered environmental and social aspects of the front half narrative?

The 'governance section'

While not dictated by law or regulation, it is standard practice for a set of UK plc accounts to have a separate governance section which more often than not, is part of the Directors’ Report under law. This section typically has a very different feel to the Strategic Report: it is much more text heavy; often has a different tone; and is dominated by a passive voice.

This year there were quite a few ARAs, where the Strategic Report was in landscape format, whilst the governance section in portrait, creating an even greater divide between the two.

Over recent years an increasing number of companies have started to disclose graphically the time allocated by the board on different activities (e.g., Hikma 2022 ARA, pp84-85); a skills matrix (e.g., Henry Boot 2022 ARA, p108); and the process followed to appoint directors (notably CEOs) in a fairly extensive way, (e.g., RS Group 2022 ARA, p101).

During the COVID-19 pandemic, companies presented very detailed timelines of their meetings and topics covered. As boards moved to a ‘business as usual’ cadence, the level of detail has rightly reduced.

One aspect that has remained largely unchanged, despite the increasing volume of environmental and social (E&S) content within the Strategic Report, is the description of the process supporting the board’s assessment of whether the ARA is fair, balanced and understandable (FBU). This continues to focus on the financial statements and the consistency of the front half narrative with the financials.

Given the active and continual debate around determining what non-financial information is material for inclusion in the ARA this is a missed opportunity to explain disclosure choices, for example to omit certain TCFD recommended disclosures. We would go a step further and suggest that all of the board committees should comment on the FBU considerations relating to disclosures in their areas of remit.

Comply or explain

The FRC has continually emphasised the 'comply or explain' nature of the Code and proposes to include it as a Principle in the body of the draft revised Code rather than just in its preface. A common approach is for the Code compliance statement and explanations of non-compliance to be provided at the outset of the governance section, with Admiral (Figure 11.1) being an exception, weaving this throughout the governance section, therefore increasing the connectivity.
of this disclosure with the rest of the governance narrative.

A research paper commissioned by the FRC on the influence of proxy advisers and ESG ratings agencies notes that all interviewed proxy advisors stated that the Code is one of the main sources for their respective UK benchmark policies (para 52). At the same time however, proxy advisors were perceived as taking a ‘box-ticking’ approach which failed to take into account individual companies’ specific circumstances which is inconsistent with the ‘comply or explain’ approach (para 28).

This is concerning especially as the Code is becoming increasingly prescriptive with some of its Provisions and it is likely that more companies will provide explanations for non-compliance in the future.

In order to meet the spirit of the Code, such explanations should clarify whether a departure is temporary (i.e., it is the directors’ intention to comply with the Provision in the near term) or whether the departure is more permanent in nature. In the latter case, the explanation should explicitly set out why the alternative governance mechanism(s) that has been adopted is more appropriate in the specific context of the company.

### The board’s agenda

In September 2021 our Soaring to new heights series of reports focussed on what could be gleaned about board governance practices from narrative reporting. Although a lot has happened in the two years since, the themes we discussed in the publications remain relevant, even if some root causes may have changed (e.g., from the COVID-19 pandemic to a cost-of-living crisis) or the emphasis on certain aspects has shifted.

For example, issues related to the workforce haven’t reduced in significance since the pandemic but have taken a different slant (see Chapter 7), underlining even further the importance of embedding the right culture across the organisation and board-level workforce engagement.

The rapid acceleration in the use of artificial intelligence (AI) is creating another burning platform for employee and broader stakeholder engagement. Getting a handle over its use will be fundamental for boards in the next few years. The Institute of Directors business paper “AI in the Boardroom” advises that impact assessments must be undertaken for all stakeholder groups including customers, suppliers, partners and shareholders. It advocates for an ethics committee which includes employee representatives to oversee AI proposals, including an evaluation of the transparency of the AI’s decision-making process.

Environmental and social matters remain a societal priority, but boards face an increasingly complex dynamic in light of shifting investor sentiment on these matters in the USA (see Appendix A ESG and sustainability) and the slow development of UK government climate-related policies according to the June 2023 report from the Climate Change Committee.

The one new theme that has clearly emerged relates to geopolitical volatility and tensions – with many boards dealing with resulting supply chain security issues, greater cyber threats from state-sponsored bad actors and increasingly restrictive regulatory environments in key markets.

In a June 2023 survey organised by the Global Risks Initiative within the World Economic Forum’s Centre for the New Economy and Society, of the five areas where they were asked to gauge volatility, on average, chief risk officers expect the highest levels in geopolitical and geoeconomic relations, with a majority expecting upheavals on a global scale.

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5 Analytical report: The influence of proxy advisors and ESG rating agencies on the actions and reporting of FTSE350 companies and investor voting; research conducted by Durham University and Morrow Sodali

6 March 2023 paper produced by the Institute of Directors Science, Innovation and Technology Expert Advisory Group
Reporting on processes, activities and outcomes

With so much on the board’s agenda and therefore clearly plenty to talk about, the FRC’s view (as noted in paragraph 18 of its Code consultation) that governance reporting still lacks in disclosing activities and outcomes, might seem counterintuitive.

The narrative in governance section has traditionally been process oriented. Partly this has been driven by the current and predecessor Codes requiring narrative on “how” the board or its committees undertook a certain activity.

In some cases, it does follow that a robust description of the how i.e., the process undertaken by the board, will give the reader confidence in the strength of the governance mechanisms. To a great extent, the proposed directors’ declaration on the effectiveness of risk management and internal control systems will likely lead to companies having to provide a more robust narrative about the process of monitoring and review (see Chapter 10) especially given the requirement to disclose the basis of the directors’ declaration.

For reporting to be meaningful, it is not enough to describe a process in a passive manner – it needs to be translated into activities undertaken during the year along with their results (e.g., actions taken or decisions made), which we interpret to be ‘governance outcomes’ referenced in the proposed changes to the Code. Those companies that continue to provide a calendarisation summary could, for instance, expand the disclosure by linking it to principal decisions and stakeholder engagement outcomes.

What is most important however is for the governance reporting to demonstrate the directors’ active involvement in material matters across the year, like done by Johnson Matthey (Figure 11.2).

One of the topics that the Code consultation seeks to address is the issue of director overboarding – a director sitting on an excessive number of boards potentially leading to insufficient time and attention to adequately discharge of their duties. It proposes that the ARA describes how each director has sufficient time to undertake their role effectively in light of commitments to other organisations. It is hard to see how this would not result in a boilerplate disclosure. Setting out the directors’ activities and their results is probably a better way for investors to get comfort about the level of attention being given.

Role of the audit committee (AC)

With the ever-expanding remit of the AC, overboarding might become an especially pressing issue for its members.

The vast majority of AC reports in our sample talked about either monitoring or starting to take action in anticipation of secondary legislation to implement the government’s reforms on audit and corporate governance and/or changes to RM and IC requirements of the Code. In addition, the draft revised Code allocates responsibility for narrative reporting, including sustainability matters to the AC. This is despite many companies, like Severn Trent (Figure 11.3) already having different governance structures over E&S matters fit for their organisations and around a third of companies having a committee with a dedicated role related to E&S matters.

In our view, whilst ACs may be best placed to assess the effectiveness of a company’s internal controls over non-financial reporting and monitor the accuracy of non-financial metrics, other committees may be better placed to oversee the accompanying narrative and feed into the overall FBU assessment.

According to the 2022 UK Spencer Stuart Board Index, FTSE150 ACs already meet 5.4 times on average a year. So, it will be interesting to see to whether these additional responsibilities will result in longer meetings with fuller agendas; or an increased number of meetings.

Already in recognition of the importance and complexity of the AC’s role, and the likely increased focus by ACs on overseeing the external auditor, Institutional Shareholder Services’ (ISS) December 2022 Proxy Voting Guidelines, stated that for FTSE 350 companies, it will note where four or fewer AC meetings had been held during the reporting period.
Board diversity

The introduction of the Diversity Listing Rule has effectively codified the targets promulgated previously through the Hampton-Alexander/FTSE Women and Parker Reviews. Around 50% of companies within our sample included early disclosure against this LR in their December 2022 ARAs. Although, as noted in our publication from April 2023, these disclosures were seldom fully compliant with the new requirements.

The ‘G’ in ESG

In the FRC’s research report about AC Chairs’ views on, and approach to ESG activities and reporting conducted by independent research agency YouGov, many AC chairs agreed that governance is the foundation of good business practice, encompassing company performance, risk, social and environmental activities. Importantly therefore, even though the outcome of the Code consultation is only expected around the end of 2023, boards and company secretaries could take the opportunity now to review their governance mechanisms and related reporting irrespective of the final outcomes of the Code consultation. There could be certain ‘no regret’ actions on key aspects of the proposals that enhance existing good practice and that are therefore worthwhile taking now. We had highlighted some of these in Part 2 of our Soaring to new heights series.
Figure 11.1  Admiral – Compliance against Code Principles integrated across the governance section (2022 ARA, pp157, 171)
Figure 11.2   Johnson Matthey - Board and committee outcomes (2023 ARA, p82-83, 89)

<table>
<thead>
<tr>
<th>Matters considered</th>
<th>Stakeholders considered</th>
<th>How the Board received stakeholder feedback</th>
<th>Outcomes</th>
<th>Links to risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
| Governance is at the heart of the board agenda, including consideration of: | • Customers and strategic partners  
• Employees  
• Investors  
• Suppliers  
• Society  
• Communities | • Attendance and engagement at the AGM  
• Investor perception survey  
• Feedback following meetings and direct engagement with Investors  
• Review material news or regulatory announcements through the Disclosure Committee | • Progressed the actions from the last year's internally facilitated board effectiveness review and conducted another internal board effectiveness review  
• Reviewed the investor perception study and associated actions  
• Implemented changes to improve the Governance Framework and simplified committees at GLT level  
• Approved changes to simplify the Delegation of Authority Framework  
• Approved updates to policies to ensure alignment with best practice | 5 6 10 |
| People and culture |                         |                                             |          |               |
| The Board focused on: | • Employees  
• Communities | • Insights gained from site visit  
• Annual talent review by the Nomination Committee  
• People strategy and culture updates from the Chief Executive Officer and Chief HR Officer  
• Results and feedback from our internal engagement surveys | • Reviewed the feedback from employee engagement surveys and agreed an action plan  
• Reviewed progress on changing behaviours to support our cultural ambition through the transformation programme updates | 5 6 7 9 10 |
| Risk               |                         |                                             |          |               |
| The Board reviewed the group’s approach to risk management and completed deep dives of principal risks | • Customers and strategic partners  
• Employees  
• Investors  
• Suppliers  
• Society | • Board reports on the full-year and half-year risk reviews  
• Deep dive reports into certain principal risks and areas of emerging risks | • Considered any emerging risks as a result of the external environment  
• Reviewed each principal risk to ensure they remained appropriate  
• Approved the risk appetite for each principal risk  
• Reviewed mitigating activities | 1 2 3 4 5 6 8 9 10 |
The Committee’s role
Societal value covers a range of economic, social and environmental topics. Given the central role of sustainability to our overall strategy, the Committee was established to bring continued focus to this area. The Committee assists the Board in overseeing the group sustainability strategy, including net zero commitments and science-based greenhouse gas targets; driving a truly inclusive organisation; overseeing the group’s ethical conduct; and keeping up to date with societal value topics, including stakeholder expectations.

More information on the governance of sustainability matters beyond the Committee can be found within our TCFD disclosures.

<table>
<thead>
<tr>
<th>Sustainability</th>
<th>Climate change</th>
<th>Diversity and Inclusion</th>
<th>Ethics and compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>What we did</strong></td>
<td><strong>What we did</strong></td>
<td><strong>What we did</strong></td>
<td><strong>What we did</strong></td>
</tr>
<tr>
<td>• Overview plans and actions to execute the group sustainability strategy including 10 roadmaps to deliver on our 2030 target</td>
<td>• Challenged and validated increasing our ambition for GHG emission reductions onto SBTi’s 1.5°C pathway to net zero</td>
<td>• Reviewed our diversity and inclusion gender target for 2030 and actions to support its achievement</td>
<td>• Reviewed actions to continue promoting our ethical culture</td>
</tr>
<tr>
<td>• Discussed the results of an update to our third-party materiality assessment, validated our sustainability framework and refocused our 2030 targets</td>
<td>• Reviewed our strategy’s product portfolio alignment with our company purpose of catalysing the net zero transition and estimated GHG emissions avoided by our product sales by 2030</td>
<td>• Discussed the approach to employee engagement and areas for immediate focus</td>
<td>• Received updates on Speak Up themes and trends</td>
</tr>
<tr>
<td>• Challenged sustainability performance data</td>
<td>• Agreed the application of internal carbon pricing for capital decisions</td>
<td></td>
<td>• Discussed real examples of ethical dilemmas and how they were managed including actions on responsible sourcing</td>
</tr>
<tr>
<td>• Reviewed the approach to communication on sustainability</td>
<td>• Received updates on hydrogen geopolitics and legislative developments</td>
<td></td>
<td>• Received an external presentation on global human rights and legislative developments</td>
</tr>
<tr>
<td>• Reviewed the proposed approach on advocacy, including links with external organisations (e.g. trade associations)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Received regular horizon scanning updates, competitor analysis and ESG benchmarking</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Outcomes</th>
<th>Outcomes</th>
<th>Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Agreed the realignment of our sustainability goals to our strategy and recommended to the Board that our public targets for 2023 be refocused to 10 targets</td>
<td>• Confirmed support for our updated 2030 climate ambition in line with SBTi Net Zero Standard</td>
<td>• Challenged management on our diversity and inclusion target and provided feedback on ways to improve diversity, inclusion and belonging</td>
<td>• Reviewed and recommended that the Board approve the Modern Slavery Statement and Conflict Minerals Disclosure</td>
</tr>
<tr>
<td>• Agreed our new communications and advocacy approaches on sustainability</td>
<td>• Reviewed and recommended that the Board approve the TCFD report</td>
<td></td>
<td>• Approved a standalone Human Rights Policy</td>
</tr>
<tr>
<td>• Agreed and recommended to the Remuneration Committee sustainability targets for 2023 and the next three years for incorporation into our Performance Share Plan.</td>
<td>• Recommended GHG emissions targets be included within the Executive Directors’ Long-Term Incentive Share plan</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Our Climate Change Governance Framework

Strong governance of sustainability issues, including climate-related risks and opportunities specifically, extends below the Board to a number of Board and Committees, as outlined below.

**THE BOARD**

The Board's responsibilities include:
- overseeing the Group's sustainability strategy;
- protecting the Group's reputation and brand and measuring progress against these measures;
- ensuring the maintenance of an adequate risk management and internal control framework consistent with the Group's capital structure and risk appetite.

**THE BOARD CONSIDERS CERTAIN SUSTAINABILITY OVERSIGHT MATTERS TO ITS PRINCIPAL COMMITTEES.**

**SEVERN TRENT EXECUTIVE COMMITTEE (STECC)**

The Chief Executive oversees the Group's strategy and sustainability initiatives.独立性是指的开发和实施，以及对相关职能的评价。评估内容包括：

**STEC ELDELETS CERTAIN CLIMATE-RELATED RISK AND OPPORTUNITY OVERSIGHT MATTERS TO ITS MANAGEMENT COMMITTEES.**

**Figure 11.3: Severn Trent – Climate Change Governance Framework (2023 ARA, p41)**
Key questions to assess board and committee effectiveness

The board and all its committees
1. Do the board/committee's terms of reference reflect not just the mandatory responsibilities as specified in regulations and Code, but also the de facto ones?
2. Do directors feel they have enough time for their increasing responsibilities?
3. Is there an effective induction programme for new board/committee members and on-going training thereafter?
4. Are the number of meetings, time allocated to agenda items and content of the meeting pack sufficient to discharge the board/committee's responsibilities?
5. Is the meeting pack distributed with sufficient notice to allow the board/committee members to read and analyse the content and therefore have action-oriented meetings?
6. Does the way in which management present at the board facilitate effective debate and discussion on material issues?
7. Is there a clear framework for interaction between committees on overlapping topics, e.g., where human capital metrics impact executive remuneration?
8. Do directors oversee how targets (within their areas of remit) are being set and monitor progress against them? Do they ensure actions are being taken to address the root cause for unsatisfactory progress?
9. Does the board/committee have adequate, regular support from management committees or internal functions to discharge of its duties?
10. Does the board/committee obtain independent insights on specific topics e.g., from external advisers, to allow for robust challenge of management?
11. Does the committee oversee the transparency of ARA disclosures regarding the matters in its remit?

Board
1. Is there tangible evidence on how the organisation's purpose guides board decision-making? Are ethics or ethical considerations given airtime in the boardroom?
2. Is the board actively involved in shaping the company's strategy? Does the debate on strategy incorporate a discussion on how emerging risks may impact the business model and resilience?
3. Has the board engaged in defining or refining the risk appetite of the company in the year?
4. Is the board able to articulate the material environmental and social impacts of the organisation? Are these embedded within the broader strategy and not treated separately as compliance matters or as corporate social responsibility topics?
5. Does the board have reliable data to make decisions and measure strategic progress, including in relation to environmental and social matters?
6. Has the board established the appropriate committees with terms of reference that reflect the governance issues and opportunities that need to be addressed for the future success of the business?
7. Do the board dynamics enable dissenting views or is there an atmosphere of overwhelming consensus?
8. Has both the extent and topics of direct engagement between directors and stakeholders been purposefully determined, taking into account both strategic objectives and stakeholder materiality assessments? Does the board actively hold management to account for dealing with material stakeholder feedback?
9. With changes to cultural and working practice, is the board actively engaging in the debate on the future of work?
Audit Committee (AC)

1. Aside from meeting the composition requirements of the Code and DTR, is the AC considering and preparing for the future skills it will need for example, in light of changing circumstances of the company, its business model and the sector it operates in?

2. Where there is a separate risk committee, is the division of responsibilities between the two clearly defined?

3. Is the division of responsibilities regarding oversight of narrative reporting including on environmental and social matters clearly defined between the AC and any other relevant committee dealing with these topics?

4. Is the documentation provided by management to the AC of sufficient detail and quality to allow the AC to challenge management’s views? Is the AC’s review and challenge of this documentation adequately minuted to withstand future regulatory scrutiny?

5. Does the AC receive information with sufficient regularity to allow it to monitor the effectiveness of risk management and internal controls during the year?

6. Is the AC satisfied that activities undertaken by management are sufficient to allow directors to make a statement on the annual review of effectiveness of risk management and internal controls?

7. Does the AC have a complete and accurate picture of what assurance is obtained over disclosures in the ARA, the rationale for this and how this compares to the expectations of external stakeholders?

8. Is there a structured process in place to assess the audit quality throughout the year with appropriate reference to audit quality indicators?

9. Does the AC report in the ARA present a fair picture of the activities of the AC, including challenges raised and their resolution?

Nomination and remuneration committees

The practice for allocating responsibilities for oversight over human capital varies, and the remits of nomination and remuneration committees continue to evolve. The questions to assess effectiveness have therefore been structured to provide key questions regarding human capital oversight, remuneration and nomination considerations.

Oversight of human capital matters

1. Are directors challenging management on the appropriateness of the human capital metrics which are being monitored by reference to the link to overall business and sustainability strategy?

2. Are directors holding management to account for conducting adequate workforce engagement to explain human capital targets and progress, including but not limited to planned actions to close any gender, ethnic or other form of pay gaps?

3. Does the board/committee oversee the approach to surveys challenging their frequency, topics addressed and whether they provide insights that differentiate between engagement and culture? Does the board/committee challenge how surveys complement other forms of engagement?

4. Are the sources of cultural insights used by the board/committee for culture monitoring sufficiently broad to evidence how effectively the desired culture is embedded? Is the board/committee receiving adequate explanations of the interactions between the various insights and proposed actions?
**Remuneration matters**

1. Is the remuneration committee able to articulate to the workforce how the approach to executive pay is aligned with stated values and culture and how it promotes the right behaviours at the top?

2. Does the remuneration committee robustly debate the stakeholder experience when considering outcomes and the application of discretion? Are the remuneration committee's insights into that experience, independent from those shared by the executive, sufficient?

3. Is the remuneration committee confident that the pay structures do not create undue pressure to prioritise returns in the short-term and give adequate weighting to non-financial value creation? If non-financial metrics are included, are their link to strategy clear and transparently explained?

4. Has the remuneration committee comprehensively considered the range of potential consequences of remuneration structures on behaviours and decision making?

**Nomination matters**

1. Has the nomination committee debated the most appropriate allocation of new and evolving responsibilities across the board and its committees and accordingly reassessed the skills, diversity and capacity at both the board and individual committee level? Does the nomination committee have a clear approach for determining how best to address skills gaps (through new appointments, advisors or training)?

2. Has the committee considered how board and senior management composition helps bring the stakeholder voice into the boardroom? Are these considerations reflected in succession plans?

3. Does the committee assess the cognitive diversity and culture of the board? Does it understand how the make-up of the board and its culture impact decision making?

4. Does the committee look sufficiently deep into the organisation to identify future talent? Are steady-state succession plans regularly revisited? Is there a contingency plan for dealing with unexpected departures?

5. Is the committee satisfied about the nature and quality of DEI initiatives such as executive development programmes? To what extent have such initiatives been factored into succession planning?
Appendix A  ESG and sustainability

Corporate reporting

In its broadest sense, corporate reporting comprises information that a company publicly communicates about itself. With the annual report and financial statements at its heart, it includes, amongst others, RNS announcements, website disclosures and an increasing suite of stand-alone reports covering non-financial topics.

Narrative reporting and non-financial metrics

In its October 2020 Discussion Paper on the future of corporate reporting, the FRC noted that “non-financial reporting is becoming increasingly important and we expect this trend to continue in response to calls for responsible capitalism.” In May 2023, the Department for Business and Trade (DBT), working with the FRC, initiated a review of the non-financial reporting requirements.

We consider non-financial reporting to encompass:

- Narrative reporting - which often takes the shape of written ‘long-form’ reports - such as the front half of ARA, sustainability and climate reports
- Non-financial metrics - metrics based on financial information, but not derived directly from the financial statement (e.g., banking capital ratios) and metrics related to non-financial topics (e.g., greenhouse gas emissions) often referred to as ESG metrics

This makes sustainability and ESG reporting a sub-section of narrative reporting and non-financial metrics.

Changes to the Code are proposing to introduce explicit responsibilities for monitoring the integrity of narrative reporting, including sustainability matters; narratives within ARAs often refer to ESG and sustainability interchangeably - whilst these terms seem to have become almost synonymous, they deal with similar issues from very different viewpoints.

ESG - the outside-in perspective

ESG was first mentioned in the 2006 United Nation's Principles for Responsible Investment (PRI) report. ESG is primarily a risk management and investment framework used to evaluate the financial risks that environmental, social, and governance factors pose to the business and its shareholders.

The three dimensions are distinct and have measurable aspects. Reporting is a central feature - ESG metrics demonstrate how a company manages these risks to reduce their impact, increase economic resilience and protect the company's value.

The perspective is referred to as ‘outside-in’ as the focus is on the risks to the company, not on those the business creates for the outside world.

Sustainability - the inside-out perspective

Where ESG aims to minimise harm, sustainability relates to “doing well by doing good.”

Emphasis is on the so called “triple bottom line” (people, planet, profit), and governance is typically not a relevant factor.

When a company is operating ‘sustainably,’ it maintains an appropriate balance between making money and ensuring social and environmental wellbeing in the world today without compromising future generations.

Sustainability adopts an “inside-out” perspective as it focuses on the impact a company has on society and the environment. Companies are increasingly disclosing their contribution to United Nation Sustainable Goals (UN SDGs) as a means of evidencing their positive impact.
Purpose – sustainably contributing to society

Principles A and B of the Code stipulate amongst other things that the role of the board is to establish the company's purpose and promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.

It therefore makes sense that sustainability-related initiatives are used to provide examples of ‘purpose in action’.

What makes less sense however is the way the broader narrative, rather than being integrated across the front half, tends to be included in the form of a standalone section or insert.

Integrated reporting

The problem with inserts is that they lend themselves to providing too much irrelevant detail – discussing aspects that neither mitigate material risks nor have the potential to make a meaningful contribution to the triple bottom line.

Some inserts referred to as ‘ESG’ do not actually focus on risks but are used as a means to describe aspects of the company’s operations that are positively linked to the social dimension. A potentially more relevant alternative would be to link these themes to the relevant stakeholder within the s172 narrative. For example, both modern slavery and scope 3 emissions can be discussed in the context of suppliers. Modern slavery is a common topic being referenced in supplier engagement disclosures, including by Whitbread; some companies, like CCEP, tier their suppliers by reference to the level of their emissions.

For a commitment to sustainability to ring true, it needs to be both integrated into the business model as demonstrated by Mondi (Figure App 1.1) and form part of the overarching strategy. Where the ‘sustainability strategy’ touches on the same themes as its ‘core strategy’ but is presented as something separate, readers might infer that the company is paying lip service rather than being truly committed to doing well by doing good. Similarly, when, unlike Rio Tinto (Figure App1.2) companies present their contribution to all UN SDGs, as opposed to just the ones they can truly make a difference towards, credibility can be lost.

Rather than inserts, companies who want to demonstrate their commitments should integrate ESG risks into their principal risk disclosure and explain how their sustainability ethos contributes to delivering strategic objectives, as done by Rolls Royce (Figure 7.3).

This approach will drive a clearer story – on one hand demonstrating the level of investment needed to mitigate risks and improve ESG scores, on the other explaining why an evolution of the business model to make it more sustainable is the right thing to be doing.

If the changing investor sentiment and escalating political backlash against ESG investing in the US is anything to go by, getting the narrative right by focussing on what is of strategic importance and how social-impact initiatives contribute to broader value creation will become even more important.

Already, according to the November 2022 EY Global Corporate Reporting and Institutional Investor Survey, 80% of investors claim that “too many companies fail to properly articulate the rationale for long-term investments in sustainability, which can make it difficult for us to evaluate the investment.”
Figure App.1.1 – Mondi: Comprehensive business model overview with effective use of diagrams, cross referencing and integrated sustainability considerations (2022 ARA, pp14-17)
Our business model
Creating value through the Mondi Way

The Mondi Way connects purpose, strategy and culture to our business model

Our purpose is to contribute to a better world by making innovative packaging and paper solutions that are sustainable by design. We do this through the execution of our strategy by delivering value accretive growth in a sustainable way for all our key stakeholders. Our strategy builds on the competitive advantages we enjoy today and sets a clear roadmap embedding sustainability into operational and investment decisions into the future.

What we rely on
We build and maintain trustful relationships and manage our key resources responsibly to create value for our stakeholders.

- Long-standing relationships
- Responsible use of resources

What we do
As a global leader, we make a broad range of innovative and sustainable packaging and paper solutions to meet our customers’ growing needs.

- The value we create

Our Mondi Way

Purpose

Culture

Strategy

Why we are different
We leverage our distinct competitive advantages to create opportunities for our business and generate value for our stakeholders.

- Unique platform: As a leading paper and flexible plastic-based packaging solutions provider, we are well positioned to take a holistic view to meet our customers’ requirements with our unique range of sustainable solutions.
- Exiting market positions: Our leading market positions provide scale, reliability and the capability to serve key accounts and business with our customers and partners.
- Cash-advantaged assets: We have well located operations with access to cost competitive raw materials and in high quality, well-integrated asset base.

Managing our risks
Successfully identifying and mitigating the potential impact of risks on our business and appropriately setting our risk appetite is critical to ensure we continue to generate long-term value for our shareholders.

Recycling

Sustainable packaging and paper solutions

Managing our risks

What makes us different
We leverage our distinct competitive advantages to create opportunities for our business and generate value for our stakeholders.

- Unique platform: As a leading paper and flexible plastic-based packaging solutions provider, we are well positioned to take a holistic view to meet our customers’ requirements with our unique range of sustainable solutions.
- Exiting market positions: Our leading market positions provide scale, reliability and the capability to serve key accounts and business with our customers and partners.
- Cash-advantaged assets: We have well located operations with access to cost competitive raw materials and in high quality, well-integrated asset base.

Vertical integration
Our vertically integrated business reduces the group’s exposure to price volatility, providing security of supply and products and logistical optimization.

Focus on continuous improvement
We continuously drive performance along the value chain, focusing on efficiency and improvement across our processes.

Strong financial position
Our robust financial position and strong cash-generation provides us with strategic flexibility.

Sustainability
Sustainability is embedded in everything we do, making us a strong partner and employer of choice.

Entrepreneurial culture
Our entrepreneurial culture brings the best out of Mondi’s people to help develop an empowered and inclusive team that contributes to a better world.
Figure App1.2 – Rio Tinto: Contribution to UN SDGs clearly differentiated between two lead SDGs where the company makes the most substantial impact, and further eight supporting goals (2022 ARA, pp47, 50).

### The United Nations Sustainable Development Goals

Our approach to sustainability aligns with the United Nations Sustainable Development Goals (UN SDGs), which are recognised as the global blueprint for a sustainable future. The SDGs are a useful reference point to ensure our sustainable focus areas reflect society’s expectations and help us direct our efforts where they can deliver the most impact.

Our sustainability framework focuses on the two lead goals that we feel are most relevant to operating our business responsibly and where we can have the biggest impact: responsible consumption and production (SDG 12) and decent work and economic growth (SDG 8).

Our business operations also contribute to eight supporting SDGs (3, 4, 5, 6, 9, 10, 13, 15), while partnerships for the goals (SDG 17) reflects our approach to sustainability and is fundamental to the way we run our business.

For more information about our approach to the UN SDGs, see our website.
Appendix B  Acid Test

Purpose
► What is the company's purpose? Does it explain why the company exists?
► Is the purpose bespoke or could it be for any company?
► How did purpose influence any principal decisions the board has made?
► Are there tangible examples of purpose in action?
► Does the company's purpose clearly inform its strategy?
► Is it clear to a reader how strategy delivery helps with realising purpose?

Culture
► Why are the desired behaviours critical to the achievement of strategic objectives?
► How does the board measure and monitor the extent to which the culture is embedded?
► What actions are needed to close any identified gaps between actual and desired culture?
► Is a clear update provided on progress against any past initiatives to close the gaps?

Business Model
► How does the company generate revenues?
► How and where are the company's key assets and resources engaged in the process of value creation?
► What are the company's competitive advantages; does the BM differ from others in the sector?

► How are environmental and social risks and opportunities being addressed to ensure the BM is sustainable? How is the BM evolving in response?
► Is the BM adapting to long-term trends and factors?

Measuring strategic progress
► What are the company’s strategic objectives? Are they clear and measurable? Is it clear why key performance indicators (KPIs) and other metrics used to measure progress against them were selected?
► How did the company deliver against prior year goals and what are its priorities for the near and mid-term?
► Do the remuneration policy outcomes appropriately reflect prominent metrics and KPIs?
► Is the use of prominent financial and non-financial metrics balanced and reflective of their strategic importance?
► Is there clarity on the level of assurance obtained over each of the KPIs and other prominent metrics?

Evolving strategy
► Is there clarity on both short-term and longer-term market/industry trends impacting the business?
► How is the company’s strategy responding to these market trends? How are they influencing principal and emerging risks?
► Is it clear how sustainability commitments support the delivery of strategic objectives?
► What is the directors' approach to capital allocation beyond shareholder distributions?
### Stakeholder engagement and s172

- Is there a compelling explanation of who the identified key stakeholders are and how they have been grouped?
- How did management, and separately the directors, seek to understand the views of and seek input from stakeholders?
- Does the board articulate the feedback received or the insights gained from such interactions in the current year and any actions taken?
- How did the board take such feedback and insights into account when making principal decisions?

### Workforce diversity and engagement

- How has the board engaged with the workforce, what feedback or insights did it receive and how was this considered in the boardroom?
- What actions are being undertaken to address low employee engagement scores, high turnover, culture misalignment or other relevant employee related indicators?
- How successful are initiatives aimed at improving workforce diversity, equity and inclusion and how do these support the achievement of strategic objectives?
- Does the workforce narrative tell a fair and balanced story of how the company has performed against its people commitments?

### Environment

- How well is the company's sustainability strategy integrated into the overall business strategy and are environmental and social factors incorporated into the assessment of principal and emerging risks?
- Does the narrative strike the right balance between providing insights into the business strategy versus sustainability strategy?
- Does the narrative provide a fair and balanced overview of the company’s impact on the environment and explain how changes to the environment are impacting the business model? Are these impacts quantified?
- Is it clear which metrics and targets are materially important for managing environment-related risks and opportunities? Are these metrics relevant and meaningful?
- What level of assurance was obtained over these metrics?

### Risks and viability

- What are the principal risks to the successful delivery of the strategy and how might these manifest in the company?
- What levels of risk is the board willing to take and how does this align with the related mitigating actions?
- Are changes in the likelihood or impact of principal risks explained, together with the evolution of mitigating actions?
- Which of these pose the greatest threat to the viability of the company?
- Is the rationale for the timeframe over which the board has considered the viability of the company robustly explained?
- What specific scenario and sensitivity testing has been performed on the model(s) supporting the viability statement and what was the outcome of this testing?
<table>
<thead>
<tr>
<th>Risk management and internal control</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>► How is the effective management of risks and monitoring of the risk profile of the business embedded across different levels in the organisation? What are the key steps within the risk management cycle/process?</td>
<td>► What did the board and its committees actually do in the year to govern the company – what specific governance issues arose and how were they addressed?</td>
</tr>
<tr>
<td>► How does the board monitor the systems of risk management and internal controls on a regular basis during the year? Is the description of the process for their annual effectiveness review comprehensive?</td>
<td>► What, if any, changes were made to governance arrangements during the year and why?</td>
</tr>
<tr>
<td>► What are the outcomes of this review? Has the board identified weaknesses or inefficiencies and are the resulting actions clear?</td>
<td>► What areas for improvement were identified from the board and committee evaluations and what progress was made against actions from the previous evaluations?</td>
</tr>
<tr>
<td>► Has the company explained its definition of emerging risks and stated the procedures in place to identify them and how these differ from those relating to principal risks?</td>
<td>► How is board and committee composition and succession planning being managed, giving due regard to the evolving strategy of the company, skills, experience, diversity, time commitment and tenure?</td>
</tr>
<tr>
<td>► Has the fair, balanced and understandable (FBU) assessment adequately considered environmental and social aspects of the front half narrative</td>
<td>► Has the fair, balanced and understandable (FBU) assessment adequately considered environmental and social aspects of the front half narrative</td>
</tr>
</tbody>
</table>
Appendix C  Regulatory and legislative developments impacting narrative reporting

a. UK reporting requirements which are final and already effective

These impact September and December 2023 year ends for the first time.

<table>
<thead>
<tr>
<th>Reporting development and scope</th>
<th>Effective date</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022</strong> and non-binding guidance</td>
<td>Financial years beginning on or after 6 April 2022</td>
<td>This expands the non-financial information statement within the Strategic Report to a ‘Non-Financial and Sustainability Information Statement’ and requires in-scope companies, to publish climate disclosures similar to TCFD. Details of what is required are covered in the non-binding guidance. Companies that to date included their TCFD disclosures in a report other than the ARA will need to consider what material information will need to be brought into the strategic report in FY23. In June 2022 the FRC revised its ‘Guidance on the Strategic Report’ to reflect the above requirements.</td>
</tr>
<tr>
<td><strong>Scope</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK companies with more than 500 employees and which have either transferable securities admitted to trading on a UK regulated market or are banking companies or insurance companies (namely those UK companies that are currently required to produce a ‘Non-Financial and Sustainability Information Statement’).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK registered companies with securities admitted to AIM, and which have more than 500 employees.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK registered companies not included in the categories above, which have more than 500 employees and a turnover of more than £500 million.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FCA new Listing Rule (LR 9.8.6 (9)) and enhanced Disclosure, Guidance and Transparency Rule (DTR 7.2.8) in relation to diversity on boards and executive committees</strong></td>
<td>Financial years beginning on or after 1 April 2022</td>
<td>Three new ARA disclosures:</td>
</tr>
<tr>
<td><strong>Scope</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LR - UK and overseas issuers with equity shares, or certificates representing equity shares, admitted to the premium or standard segment of the FCA’s Official List, excluding open-ended investment companies and ‘shell companies’ but including closed-ended investment funds.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DTR - certain UK issuers with securities admitted to UK regulated markets and, through the Listing Rules, to certain overseas listed</td>
<td></td>
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</tr>
</tbody>
</table>

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### Reporting development and scope
<table>
<thead>
<tr>
<th>companies subject to existing exemptions for small and medium companies</th>
<th>Effective date</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 January 2025 - for in-scope companies with equity share capital admitted to trading on a UK regulated market for the whole of the financial year 1 January 2026 - for other companies in-scope</td>
<td>as age, professional/educational background). See further detail in EY’s April 2023 publication.</td>
</tr>
</tbody>
</table>

The FCA will review the rules in 2025 to make sure they are working and to check if the diversity targets are still appropriate.

### b. Impending UK developments subject to finalisation

<table>
<thead>
<tr>
<th>Reporting development. Scope and status</th>
<th>Effective date</th>
<th>Detail</th>
</tr>
</thead>
</table>
| **The Draft Companies (Strategic Report and Directors' Report) (Amendment) Regulations 2023** | 1 January 2025 - for in-scope companies with equity share capital admitted to trading on a UK regulated market for the whole of the financial year 1 January 2026 - for other companies in-scope | Four new disclosure requirements:  
► Triennial Audit & Assurance Policy Statement and annual implementation update  
► Annual Distribution Statement, with an accumulated realised profits figure, or minimum figure, to be shown as a note to the accounts.  
► Annual Fraud Statement  
► Annual Resilience Statement |
| **Scope** | | UK incorporated companies with a high level of employees and turnover (minimum of 750 employees and a minimum annual turnover of £750 million). The associated guidance notes provide additional information on scoping considerations. |
| **Status - Draft subject to approval** | | The regulations were laid before Parliament on 19 July 2023 with the expectation that they will come into law before the end of 2023. In the meantime, the FRC is developing guidance, informed by stakeholder outreach and a public consultation, to help companies in complying with the new reporting requirements. The FRC expects to publish the guidance no later than Q1 2024. |

<table>
<thead>
<tr>
<th>Revised UK Corporate Governance Code</th>
<th>1 January 2025</th>
<th>Details on the proposed reporting requirements for the UK Corporate Governance Code are set out in our publication. The revised Code will be supported by updated guidance, and work is currently underway to revise the ‘Guidance on Audit Committees’ and ‘Guidance on Board Effectiveness’ so they are aligned with the revised Code and Audit Committee Standard.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong></td>
<td></td>
<td>Premium listed companies (UK and non-UK incorporated) and companies voluntarily applying the Code.</td>
</tr>
<tr>
<td><strong>Status - Draft subject to finalisation</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The FRC's consultation closes on 13 September 2023 and a final version of the revised Code is expected to be issued by the end of 2023. The FRC is also planning to amend the ‘Guidance on Risk Management, Internal Control and Related Financial and Business Reporting’, so that it is aligned with the specific changes in the Code relating to risk management and internal control.

c. UK developments companies should keep a watching brief on - likely to impact reporting in the ARA

<table>
<thead>
<tr>
<th>Development</th>
<th>Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Green Finance Strategy 2023</strong></td>
<td>Examples of sustainability-related reporting developments include:</td>
</tr>
<tr>
<td>This does not, by itself, introduce new reporting requirements. It does, however, indicate specific initiatives, the outcomes from which are likely to impact environment related reporting for UK incorporated companies and financial institutions.</td>
<td>► Exploring explore how the final TNFD framework, due to be published in September 2023, should be incorporated into UK policy and legislative architecture;</td>
</tr>
<tr>
<td>► UK Green Taxonomy - to introduce mandatory company disclosures against a future green taxonomy; and</td>
<td>► ‘Call for Evidence’ in Q3 2023 on Scope 3 Emissions reporting, nature-related financial risks, dependencies, and effects.</td>
</tr>
</tbody>
</table>

| **TPT Framework and Guidance on 'gold-standard' climate transition plans.** | The final Disclosure Framework will be supported by sector-neutral Implementation Guidance and a suite of sector-specific guidance. Updated sector neutral guidance will be published alongside the Framework and then expanded in the coming months. Sector-specific work will be published for consultation later in 2023 and finalised in early 2024. |
| TPT was launched by HM Treasury in April 2022 and has a two-year mandate to develop a “gold standard” for private sector climate transition plans applicable to the UK. | Once the TPT framework is finalised, the UK government intends to begin a consultation on transition plan requirements for the UK's largest companies in the final quarter of 2023. As per the FCA will consult on guidance that will set expectations for transition plan disclosures at the same time as its planned consultation on the adoption of IFRS S1 and S2. |
| The TPT plans to publish the final Disclosure Framework and Technical Annex in October 2023. At the same time the TPT will publish an initial version of the Implementation Guidance, this will be updated further over coming months with a final version published by February 2024. |
International Sustainability Standards Board's (ISSB) two new reporting standards launched in June 2023:

- IFRS S1 ‘General Requirements for Disclosure of Sustainability-related Financial Information’ covers the overall requirements for a reporting entity to disclose its sustainability-related risks and opportunities over the short, medium, and long term.
- IFRS S2 ‘Climate-related Disclosures’ sets out specific requirements for the identification, measurement and disclosure of climate-related financial information and is designed to be used in conjunction with IFRS S1.

These two standards fully incorporate the recommendations of TCFD and as a result, the IFRS Foundation will take over the monitoring of climate-related disclosures from 2024.

The Secretary of State for Business and Trade will consider the endorsement of the standards, to create UK Sustainability Disclosure Standards (UK SDS) by July 2024. UK endorsed standards will only divert from the global baseline if absolutely necessary for UK specific matters. Following endorsement, decisions to require disclosure will be taken independently by the FCA for listed companies and by government for UK registered companies and limited liability partnerships.

As noted in Primary Markets Bulletin 45, the FCA's aim is to finalise its policy position by the end of 2024, with a view to bring new requirements into force for accounting periods beginning on or after 1 January 2025. It also expects to consult on moving from the current comply or explain compliance basis to mandatory disclosures for listed issuers.

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Large UK companies and LLPs are required to report (via a government portal) on their payment practices, policies, and performance every six months. The government is yet to decide whether to amend the expiry date of the current Regulations, so it is extended beyond 6 April 2024, or introduce legislative requirements for companies to include a summary of their payment practices in the annual report and accounts.

**Modern Slavery Bill**

The 2022 Queen’s Speech included the announcement of a Modern Slavery Bill. The intention is to build on the requirements of the Modern Slavery Act 2015. Among other things, the Bill if enacted may mandate and enhance the reporting to be covered in modern slavery statements. It may introduce a legal requirement for organisations to publish their statements on a government-run registry.
d. EU and SEC developments with potential relevance to certain UK companies

<table>
<thead>
<tr>
<th>Development</th>
<th>Effective date</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Sustainability Reporting Directive (CSRD)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Scope</strong> (as it applies to non-EU undertakings)</td>
<td>For non-EU undertakings: 1 January 2028</td>
<td>EU undertakings (this includes EU-incorporated subsidiaries of UK groups, or UK groups listed in the EU) caught by CSRD will be required to produce a sustainability report using European Sustainability Reporting Standards (ESRS) on a phased implementation basis. The ESRSs are intended to establish a framework that will bring sustainability reporting to the same level as financial reporting, and to facilitate the standardisation and comparability of sustainability information among companies. Annex I contains the final first set of twelve ESRS as adopted by the European Commission. Annex II includes a glossary and a list of acronyms. However, separate EU reporting standards (i.e., not the ESRSs referenced above) will apply to UK companies with substantial activity in the EU market that are not themselves EU undertakings. These are expected to be developed by June 2024, and they will focus on impact, not risks. The sustainability report produced by the UK parent, covering the EU operations, will require an assurance opinion.</td>
</tr>
<tr>
<td><strong>Securities and Exchange Commission (SEC) proposes rules</strong></td>
<td>TBC</td>
<td>In March 2022 the SEC proposed new climate-related reporting requirements. Under this proposal companies will be required to disclose their direct and indirect greenhouse gas emissions, and climate-related risks. Companies that have developed transition plans, conducted scenario analysis, or set public climate-related targets or goals will also be subject to specific disclosures. The rules are expected to introduce assurance over Scope 1 and 2 emissions only, first subject to limited assurance one year after emissions disclosures are required and 2 years later subject to reasonable assurance.</td>
</tr>
<tr>
<td>Development</td>
<td>Effective date</td>
<td>Commentary</td>
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<tr>
<td><strong>SEC has adopted new rules on the reporting of cyber security risks and incidents</strong></td>
<td>FPIs must comply with the requirements in Form 20-F beginning with annual reports for fiscal years ending on or after 15 December 2023.</td>
<td>The SEC announced in July 2023 that it will be adopting new rules to enhance and standardise disclosures regarding cybersecurity risk management, strategy, governance, and incidents by public companies that are subject to the reporting requirements of the Securities Exchange Act of 1934. EY’s summary of the rules sets out the risk management, strategy and governance disclosures as well as those related to incident reporting.</td>
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<tr>
<td><strong>Scope</strong></td>
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<tr>
<td>The rules apply to nearly all registrants that are required to file periodic reports (e.g., Form 10-K, Form 20-F) with the SEC, including smaller reporting companies (SRCs) and foreign private issuers (FPIs).</td>
<td></td>
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<tr>
<td><strong>Status - Final</strong></td>
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<tr>
<td>The rules were adopted in July 2023</td>
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<tr>
<td><strong>SEC is considering whether to adopt two new rules on human capital disclosure</strong></td>
<td>TBC</td>
<td>Whilst proposals from the SEC on human capital reporting were expected in April 2023, they had not been issued as of August 2023. The SEC has indicated its intention to introduce such disclosures such as human capital metrics (e.g., workforce turnover, skills and development training, compensation and benefits) and workforce demographics (e.g., diversity). A separate draft rule on corporate board diversity was also mooted, but its release is not expected until October 2023. Further information on the SEC’s considerations relating to new rules on human capital reporting can be found in the EY publication ‘SEC top four - What public companies, boards and investors should watch for in 2023.’</td>
</tr>
<tr>
<td><strong>Scope - TBC</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Status - Expected</strong></td>
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