

Rising to the challenge

A review of risk and
viability disclosures in
September 2015 annual
reports

January 2016

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1. Introduction

Since the Financial Reporting Council (FRC) updated the UK Corporate Governance Code (the '2014 Code') in September 2014, the new provisions on risk management and viability have been the subject of widespread discussion.

In particular, and unsurprisingly, the new viability statement has taken centre stage. With its roots in the findings of the Sharman Inquiry, this new requirement represents a shift in the way companies and their boards need to publicly articulate their view of the company's prospects and, for some, in the way they think about and prepare for the future.

Although a handful of companies chose to adopt some of these new provisions early, annual reports and accounts (ARAs) of premium listed companies with 30 September 2015 year-ends are the first that are officially required to 'comply or explain' under the 2014 Code. We have conducted a review of the risk and viability disclosures of a sample of these ARAs to assess how companies have risen to these new challenges set by the 2014 Code and to draw out trends and leading practice.

Our sample of 14 ARAs is relatively small as we reviewed only those FTSE 350 companies that had published their ARAs by 6 January 2016.¹ We scoped our review in this way in the interests of providing our observations as quickly as possible, so that they may be of help to premium listed companies with December 2015 year-ends as they finalise their processes to comply with the 2014 Code and draft their ARA disclosures.

Our review focused on the disclosures companies made, but as we have emphasised previously,² the viability statement is the end product of much internal activity. The processes underpinning the statement are key and these should offer benefits that extend beyond simply complying with reporting requirements. Embracing the spirit of the new viability requirements should bring additional opportunities through encouraging a better understanding of risk appetite, enhanced business resilience and, ultimately, the potential for improved financial performance.



¹ In total, there are 22 FTSE 350 companies with 30 September year-ends.

² EY, *The viability statement: Finding opportunities in the new regulatory challenge*, March 2015.

2. Our 'acid test'

As we conducted this review, we found that reading risk and viability disclosures in isolation was difficult. The importance of reviewing key related and relevant narrative disclosures e.g., business model and strategy, was brought to the fore. In our September 2015 report, *'Reflections on the past, direction for the future'*, we included an 'acid test' – a set of key questions that preparers or reviewers should be able to answer clearly having drafted the narrative within their ARAs.

We include our acid test here again to help preparers and reviewers put all disclosures in context. The questions with the most relevance for risk and viability reporting are highlighted in grey. We believe that investors too should view the new disclosures with these same questions in mind.

Business model:

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

Strategy:

- ▶ What is the company's competitive advantage?
- ▶ How does the business model help deliver and sustain this over time?

Key performance indicators (KPIs):

- ▶ What are the key metrics the board uses to measure progress against its strategic objectives?
- ▶ How has the company performed against these metrics and how are these linked to the remuneration of key executives?

Risk appetite:

- ▶ What levels of risk are the board willing to take in pursuit of its strategy?

Principal risks:

- ▶ What are the risks to the successful delivery of the strategy and operation of the business model?
- ▶ In addition, given the latest changes to the Code, what are the risks that pose the greatest threat to the viability of the company i.e., solvency and liquidity risks?

Risk management and internal control disclosures:

- ▶ How are the principal risks mitigated and controlled by the company's systems of internal controls and risk management?
- ▶ How does the board monitor material controls on an ongoing basis to gain assurance that principal risks are being effectively managed and to take corrective action if they are not?
- ▶ What did the board's review of the effectiveness of these systems encompass?
- ▶ Has the board identified significant failings or weaknesses?
- ▶ What was the basis for determining what is 'significant'?
- ▶ Is it clear what actions have been or will be taken to address significant failings or weaknesses?

Viability statement:

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

Governance:

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

3. Have companies improved their risk disclosures?

2014 Code Provision

C.2: Risk Management and Internal Control

Main Principle

The board is responsible for determining the **nature and extent of the principal risks it is willing to take** in achieving its strategic objectives. The board should maintain sound risk management and internal control systems. (Emphasis added)

C.2.1 The directors should confirm in the annual report that they have carried out a **robust assessment of the principal risks** facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated. (Emphasis added)

The viability statement is underpinned by the board's responsibility for risk. Companies must establish their risk appetite, identify the principal risks that are specific to their company and explain how these relate to viability.

We consider it good practice to explain the risk assessment process and the various roles and responsibilities for risk management in the company as succinctly as possible. See Shaftesbury plc (Figure 1) for an example of this:

Figure 1. Extract from Shaftesbury plc 2015 Annual Report (page 59)

Responsibilities	
Board	Overall responsibility for risk management. Reviews principal risks and uncertainties regularly, along with actions taken, where possible, to mitigate them.
Audit Committee	Assurance of the internal controls and risk management process.
Executive management	Day-to-day management of risk. Design and implementation of the necessary systems of internal control.

It is also useful to describe the overall context or risk environment in which the company operates before delving into specifics. Shaftesbury plc's description illustrates leading practice (page 59) because a reader can then 'benchmark' the risk management activities, processes and controls against this context:

"Important factors in the relative low risk of our business include:

- ▶ The Group invests only in London's West End, where there is a long history of resilience, stability and sustained occupier demand for our principal uses of retail, restaurants and leisure
- ▶ With a diverse tenant base, there is limited exposure to any single tenant
- ▶ The nature of our portfolio does not expose us to risks inherent in major speculative development schemes
- ▶ We have a small and stable management team, based in one location, close to all our holdings
- ▶ The Board manages our balance sheet on a conservative basis with moderate leverage, long-term finance, a spread of loan maturities, good interest cover and with the majority of interest costs fixed."

Our review found that some companies have enhanced their risk disclosures, but many could do more to help readers understand the company's approach to principal risks and their management or mitigation.

Explanations of risk processes could be improved

Every company in our sample confirms clearly, as required by the 2014 Code, that the directors have carried out a robust assessment of principal risks. However, only a few are completely transparent about what that robust assessment specifically involved and whether new activities or processes were introduced in response to the 2014 Code requirements.

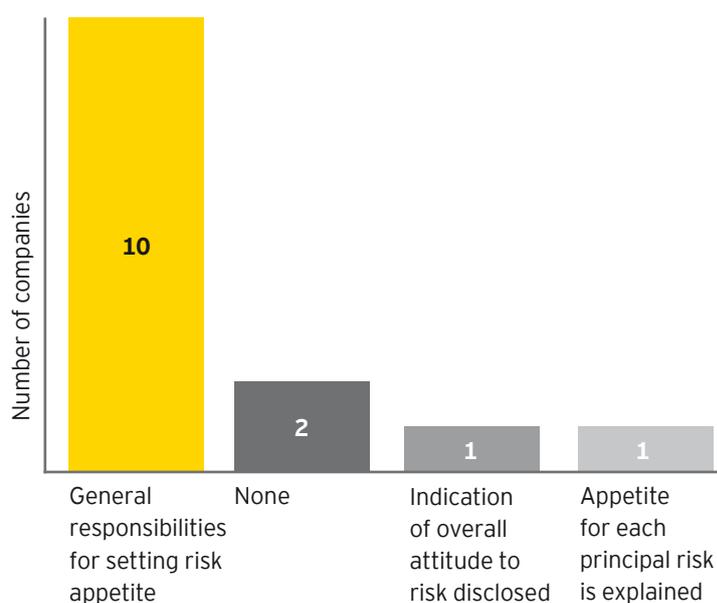
Examples of companies that do disclose enhancements to their risk processes include Sage plc and Grainger plc. Sage plc (page 37,39) explains that they have expanded the remit of their Audit Committee into an Audit and Risk Committee, introduced a Global Risk Committee, introduced risk appetite statements for each principal risk and metrics for committee meetings. They also revised their Code of Ethics in an effort to put more focus on the relationship between culture, behaviours and risk.

Grainger plc also lists 'Future developments' in the risk management space (page 29) – a commendably forward-looking approach. These include a plan to revise their risk appetite statements, evolving to a three lines of defence model, and building software to further facilitate the visibility and reporting of risks within projects and across the business.

Whether these companies made the changes specifically because of the 2014 Code or were planned changes that the company would have implemented anyway is unclear from the disclosure. However, either way, the improvements to risk management processes are welcomed and in the spirit of the 2014 Code.

Boards have increased their focus on risk appetite

Risk appetite disclosures



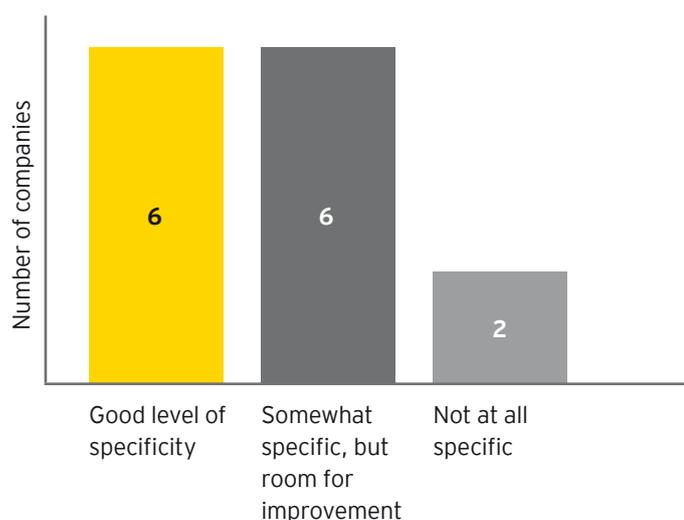
The FRC defines risk appetite as 'the nature and extent of the principal risks faced and those risks which the organisation is willing to take in achieving its strategic objectives'.³ The FRC highlights the determination of the company's risk appetite as a core board responsibility. From our review, we gleaned that boards have increased their focus on risk appetite this year, with more evidence of boardroom discussion taking place and agreement being reached being included in the ARAs (e.g., Sage plc, page 36-38 and TUI Group plc, page 97-101).

Although there is no Code requirement to explain the conclusion the board has come to in respect of risk appetite, a few do take this extra step. One company in our sample (Shaftesbury plc, page 59) provided an indication of the company's overall attitude to risk and one company, Grainger plc (page 27-29), goes substantially further, explaining the company's appetite for each of its principal risks – a new addition to their ARA this year.

³FRC, *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, September 2014, paragraph 24.

Companies could be more specific when identifying principal risks

How specific to the company are the risks disclosed?



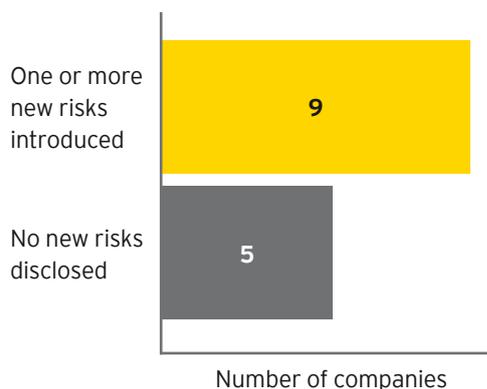
Echoing recommendations we made in our annual review of ARAs published in September 2015,⁴ the principal risks that boards identify should be specific to the company. In our view, less than half of the ARAs in our sample disclose principal risks with a sufficient level of specificity and two companies identify risks that are not at all specific to the company.

A simple check is to ask whether the list of principal risks could apply to any company; if it could, the risks identified are not specific enough.

Many companies in our sample show by way of an arrow whether a risk has increased or decreased during the year. The best disclosures accompany this graphic with some narrative to explain the change. Mitigation activities should also be clearly described, i.e., what does the company have in place to mitigate its principal risks?

New risks should always be explained

How many companies introduced new principal risks?



Although the average number of principal risks disclosed has remained the same as last year, over half of the companies within our sample report at least one risk that is new or changed. When describing principal risks, we consider it good practice to highlight or identify the new risks and to explain why they have been added or changed. Amongst companies in our review, Sage plc (page 39-43) does this effectively. Another good example is Enterprise Inns plc (page 34), which explains that a new risk was identified following the announcement of the company's new strategy (see Figure 2 below). Not all companies are as helpful, some being vague about the reason behind a new principal risk and whether, for example, it results from a more robust assessment or a change in the business.

Figure 2. Extract from Enterprise Inns plc 2015 Annual Report (page 34)



This is a new risk to the business this year following the announcement of the new strategy.



The Group has started developing the necessary infrastructure to support the new strategy, including the recruitment of high quality, experienced individuals into areas of the business such as retail operations, concept development, change programme management and systems and financial reporting. The Group also uses outsourced resources where required.

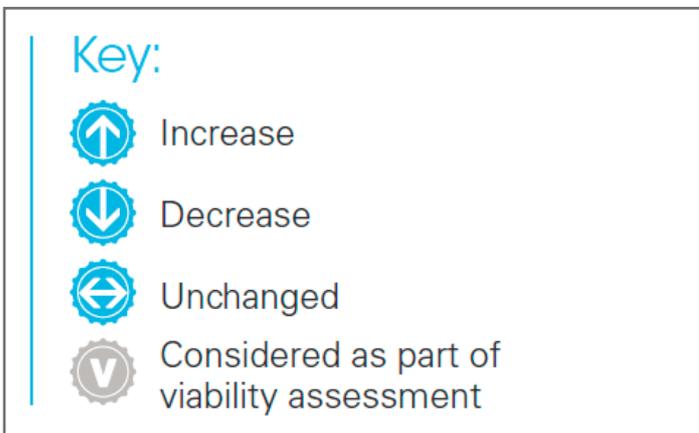
The Group strategy includes a diverse portfolio of operating approaches, including ensuring that we utilise external specialist operating experience, for example in the partnership "Expert" model, where their retail flair and capability in pubs with retail complexity and exceptional profit potential will allow us to optimise the value of such sites.

⁴EY, *Annual reporting in 2014: reflections on the past, direction for the future*, September 2015.

Specifically identifying the risks which most impact viability is good practice

Although not a Code requirement, identifying which principal risks (generally the solvency or liquidity risks) have most potential impact on the company's viability is helpful to readers. Enterprise Inns plc used a 'V' symbol in its table of principal risks (page 33-37) to clearly indicate which risks were most relevant to its viability assessment (see Figure 3).

Figure 3. Extract from Enterprise Inns plc 2015 Annual Report (page 33)



Lonmin plc also clearly explains (page 32) which principal risks directors focused on as part of the viability assessment:

"For the purpose of assessing the group's viability, the directors focussed their precise attention on the following principal risks:

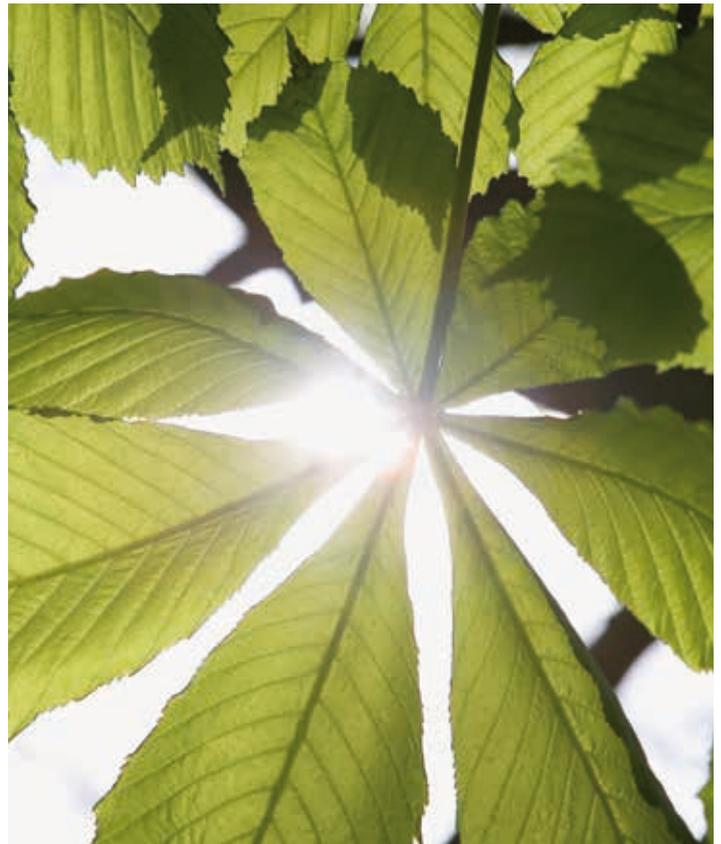
- ▶ Inadequate liquidity levels
- ▶ Failure to deliver the required operational performance
- ▶ Metal prices and currency volatility"

So we have seen companies create the link between the principal risks and viability by using a key in the principal risk disclosures or by explaining within the viability statement itself which risks are considered most relevant to viability and have been stress tested.

Bringing disclosures to life using visual aids

Visual aids such as heat maps or risk matrices (mapping each risk for impact and likelihood) help to make disclosures more easily understood. TUI Group plc illustrates good practice by providing a heat map (page 102) and informative detail on the quantifiable measurements on which the likelihood and impact judgements are based (page 100).

Taking this a step further and to make the disclosures more coherent, there should then be a clear flow between the disclosures captured in such graphics and the identification of the 'severe but plausible' risks against which viability is assessed.



4. Have boards risen to the viability statement challenge?

2014 Code provision

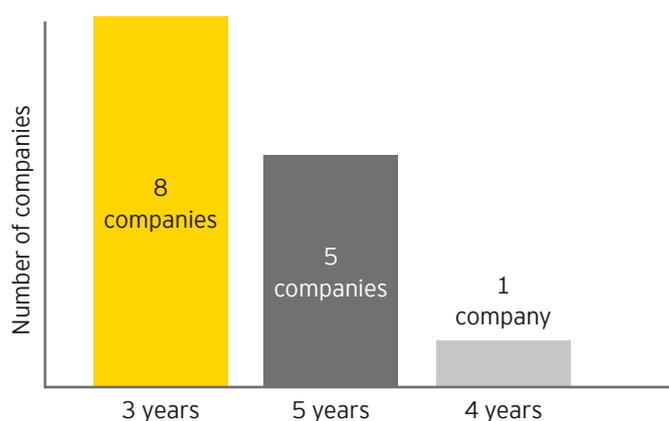
C.2.2 Taking account of the company's current position and principal risks, the directors should explain in the annual report **how** they have assessed the prospects of the company, over **what period** they have done so and **why** they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, **drawing attention to any qualifications or assumptions** as necessary. (Emphasis added)

The viability statement poses a new challenge to boards. They must apply judgement when selecting an appropriate time period, assessing their viability against different severe but plausible risks or scenarios and finding a way to explain their actions and the resulting outcomes clearly. **In our view, this first wave of companies has indeed risen to the challenge.**

Many make useful disclosures on the processes they have gone through in order to assess their prospects and viability and, encouragingly, some companies also include details about their stress testing and assumptions. However, we believe there is scope for disclosures to improve in the area of stress testing and quantifying assumptions in particular and expect this to happen as market practice evolves, investors provide feedback and companies learn lessons from year one.

Three years is the most common time period for assessment

Time period chosen



Three years is the most popular time period for the viability statement amongst companies in our sample, chosen by over half. Five years is the second most common time period, whilst one company chose a period of four years.

It was encouraging to see that companies did not default to the lowest common denominator. For example, Enterprise Inns explains effectively (page 38) why its viability statement covers a five-year period even though three years is the period of its normal forecasting cycle:

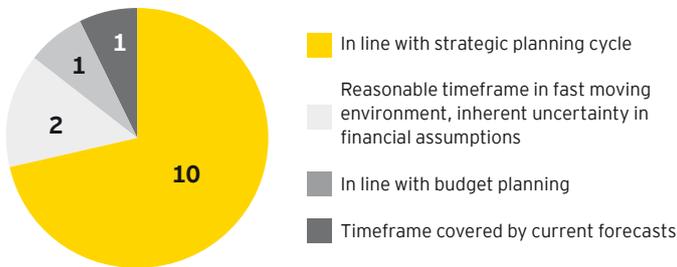
"The Board has concluded that the most relevant time period for this review should be the three year period of the normal business forecasting cycle, however given that the Group is in the early stages of a strategic plan that will evolve over a five year period and the occurrence of specific financing events over that same period, the assessment this year has been carried out over the five year period to 2020."

Chosen periods align closely with strategic planning cycle

Although some rationales for chosen time periods could be improved, companies generally outline their reasons well. As we expected, most companies (71%) chose the period because it aligns with the company's strategic planning cycle – a logical approach. In our view, the better reporters go even further – by explaining why the strategic plan covers that particular number of years. A good example of this is from the viability statement of Victrex plc (page 68):

“The board consider five years to be an appropriate time horizon for our strategic plan, being the period over which the Group actively focuses on its development pipeline. Whilst there are projects within the portfolio which will take longer to reach this point, a period greater than five years is considered too long given the inherent uncertainties involved.”

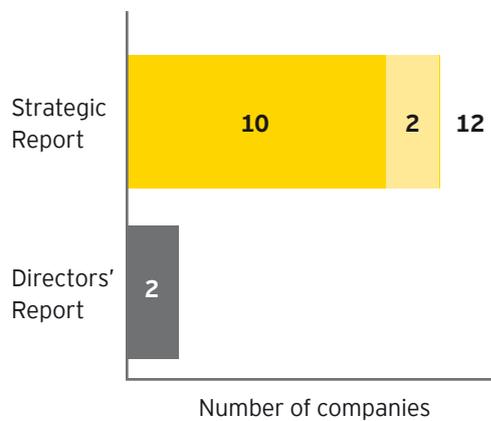
Reasons for chosen time period



Number of companies

Most companies include their viability statement near their principal risk disclosures

Where in the ARA is the viability statement located?



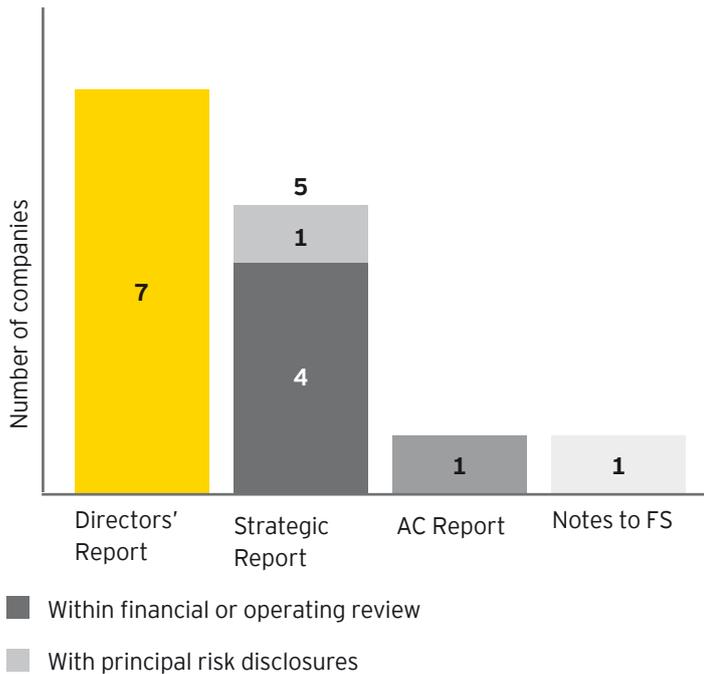
- With principal risk disclosures
- Within financial or operating review

Most companies place their viability statement within the Strategic Report and in close proximity to the disclosures on principal risks and uncertainties; although a couple locate it in the Directors' Report.

In our view, positioning the viability statement after disclosures on principal risks improves the ARA's flow and helps reader understanding.

Should the viability statement and going concern statement be placed together? In our view, going concern relates to the basis of preparation of the financial statements, so the going concern statement should be made within those financial statements. However, there may be some merit in placing the two statements together or cross referencing between them particularly if there was some overlap in the process to arrive at the two conclusions or certain assumptions were assessed on a different basis.

Where in the ARA is the going concern statement located?



Companies generally explain stress testing well

Overall, companies in our sample explained their stress-testing activities relatively well. Those that particularly stand out tell the reader exactly, in a quantifiable manner, which risks or scenarios they have tested their viability against. A good example is demonstrated by Grainger plc (page 29):

“The first scenario modelled a short term crash, greater in both severity and duration than the correction experienced in 2008-9. The valuation assumptions used in this analysis were for two full years (eight quarters) of decreasing prices, with year-on-year falls of 15% p.a. – a total decline of c.27.5%. There then follows one subsequent year where 0% growth is forecast and one further year at 5% annual growth. The second scenario modelled a long-term decline in house prices of 2.0% p.a. over the life of the model with no recovery.”

In addition, Lonmin plc (page 33) is an example of a company which, although they have not been quantified, explains the key downside risks which were subject to stress testing:

“The financial forecasts from the Working Capital Model are then subjected to stress testing using the key downside risks listed below:

- ▶ Weaker USD PGM prices
- ▶ A stronger Rand/US Dollar exchange rate
- ▶ Lower than planned production
- ▶ Higher than planned cash costs”

Others are demonstrating leading practice by explaining the actions available to them in an event where their solvency or liquidity is compromised. For example, Grainger plc (page 29) states:

“The Group would remain viable even in the event of very severe and sustained house price deflation as it would be able to accelerate the natural conversion of our assets to cash and suspend acquisition activity.”

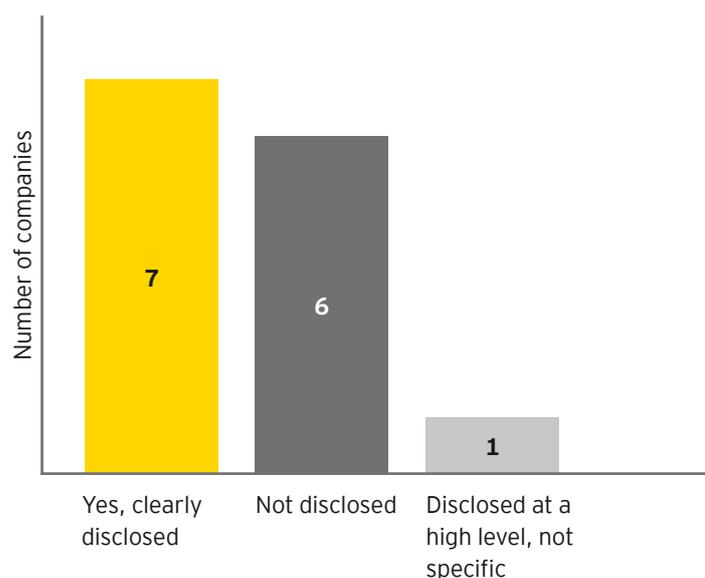
Less positively, some viability statements fail to make clear whether the scenarios being tested are considered plausible or not. We encourage companies to think about how they could make their disclosures more useful. For example, readers gain assurance from knowing that a company has tested certain scenarios and can still make the viability statement. But it would also be helpful to elaborate on the situations that would actually threaten the business especially in circumstances where the Board considered such situations to be plausible. Grainger plc (page 29) goes some way in explaining this:

“Only an unprecedented and long-term lack of liquidity in UK residential property markets would cause any threat to the Group.”

Most companies in our sample do not do this, although they may consider such disclosures to go beyond the intention of the 2014 Code or to be commercially sensitive.

More detail could be given on qualifications and assumptions

Are assumptions clearly disclosed?



Viability statements are underpinned by certain assumptions made by the board. The companies in our sample provide some information on these assumptions, but in varying levels of detail. Some companies simply state that the viability statement is based on 'certain' assumptions in a few areas. In our view it is leading practice to quantify assumptions (e.g., that prices would not fall below a stated value).

Enterprise Inns (page 38) states the following:

"This evaluation has included consideration of the likelihood and impact of refinancing the £350.5 million corporate bonds, that are due for repayment in 2018, and the directors draw attention to the key assumption that there is a reasonable expectation, based on the refinancing that occurred during the year, that the Group will be able to refinance these bonds."

Whilst not quantified, Easyjet plc (page 22) also goes some way in explaining the assumptions underpinning their viability statement:

"In making this statement, the Directors have also made the following key assumptions:

- ▶ **Funding for capital expenditure in the form of capital markets debt, bank debt or aircraft leases will be available in all plausible market conditions**
- ▶ **There will not be a prolonged grounding of a substantial proportion of the fleet**
- ▶ **In the event that the UK votes to leave the European Union, the terms of exit are such that EasyJet would be able to continue to operate over broadly the same network as at present."**

Disclosures on assumptions are a key component of the viability statements.

In our view, if companies are silent about assumptions they have made, this implies there are no plausible threats to solvency or liquidity.

Readers need to understand the qualifications that apply to the viability statement. For these reasons, proper disclosures on assumptions provide more information than simply stating that testing has been undertaken.

Links and cross-referencing could be improved

Most companies we reviewed could improve their reporting by making clearer links between their viability statement and other related areas of the ARA.

We consider it leading practice to cross-refer from the viability statement to risk management and internal control descriptions, and any other relevant disclosures in the financial statements that relate to certain financial assumptions. Shaftesbury plc provides a good example, referring in its viability statement (page 66) to relevant sections of the Finance Review.

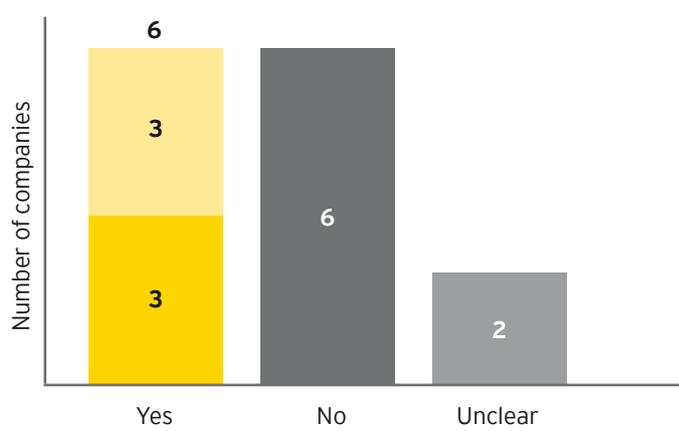
Significant improvement is needed in making risk disclosures – which in most ARAs are dotted around several pages in different sections – more cohesive.

Could these disclosures be grouped to make life easier for readers? Can companies improve signposting, reduce repetition and ensure that they include only the most relevant risk disclosures within each section of their report?

We understand that there is a challenge here for companies as there are many overlapping regulations and rules (e.g Disclosure and Transparency Rules, Code, Companies Act) which govern risk disclosures. However, we suggest using a 'map' to show how these varying requirements have been covered off. Each section should focus first on what was actually done or changed during the year under review, before going into the often, unchanged, risk process disclosures. The governance section of the ARA should then distinctly focus on the directors' oversight and governance over risk management and internal control processes and systems rather than repeating the same risk related disclosures that feature elsewhere in the ARA.

Boards have sought support from audit committees

Did the audit committee provide support or advice on the viability statement?



- Viability statement listed as a significant issue considered by the AC
- Viability statement not listed as a significant issue considered by the AC

The viability statement is truly the responsibility of the full board. However, some companies in our sample explain that the audit committee's support was specifically sought. In such cases, some audit committees include the viability statement in the list of 'significant issues' considered. Whilst being broader than an issue related to the financial statements (Code Provision C3.8) we consider this good practice, and particularly appropriate when companies are facing significant issues (e.g., an emphasis of matter).

5. How well do companies explain their monitoring of risk management and internal control systems and the review of their effectiveness?

2014 Code provision

C.2.3. The board should **monitor the company's risk management and internal control systems** and, at least **annually, carry out a review** of their effectiveness, and **report on that review in the annual report**. (Emphasis added)

FRC Guidance paragraph 40

The board should define the processes to be adopted for its on-going monitoring and review, including specifying the requirements, scope and frequency for reporting and assurance. Regular reports to the board should provide a balanced assessment of the risks and the effectiveness of the systems of risk management and internal control in managing those risks. The board should form its own view on effectiveness, based on the evidence it obtains, exercising the standard of care generally applicable to directors in the exercise of their duties.

Source: FRC, *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, September 2014.

The board's ongoing monitoring of risk management and internal control systems is a vital activity underpinning the viability statement. Based on our findings, and in line with our earlier comment, we feel the focus has been on implementing the viability disclosure and companies should provide more information to explain board level monitoring activities clearly, and describe how they perform their annual review of effectiveness.

Companies should acknowledge the relationship between the viability statement, risk management and internal control

Some companies refer to the fact that relevant mitigation activities and internal control systems have been taken into account in arriving at their overall viability statement, such as Victrex plc (page 67-68) and Imperial Tobacco Group plc (page 30). We believe this should be standard practice – as articulated in our acid test – as the directors' view on viability should be the 'net' result of:

- ▶ Having assessed the risks robustly
- ▶ Understanding either the inherent risk mitigation activities or specific risk management processes to manage the risks via ongoing review and monitoring
- ▶ Gaining assurance from internal control testing that the risk mitigations and management systems are operating as intended

Explanations of ongoing monitoring and review vary in quality

Many companies in our sample seek to explain how their boards have carried out ongoing monitoring and review of risk management and internal control, with varying success. For example, saying that the board receives quarterly risk reports isn't good enough – reporting and monitoring are different.

What does the board do with those reports? How exactly does the board gain assurance on management information?

Boards do many things that, in totality, lead to monitoring, such as conducting site visits, receiving detailed presentations from specific departments or functions. Shaftesbury plc (page 60) gives a good description of the activities that make up ongoing monitoring of internal control in the company:

“The key elements of the Group's procedures and internal financial control framework, which are monitored throughout the year, are:

- ▶ Close involvement of the executive directors in all aspects of day-to-day operations, including regular meetings with employees to review all operational aspects of the business, including risks and controls
 - ▶ Clearly defined responsibilities and limits of authority
 - ▶ Defined schedule of matters for decision by the Board including significant acquisitions, disposals, major contracts, material refurbishment/development proposals and any other transaction outside the normal course of business
 - ▶ A comprehensive system of financial reporting and forecasting
 - ▶ The day-to-day management of the Group's portfolio is outsourced to three managing agents. The Group monitors the performance of each managing agent and has established extensive financial and operational controls to ensure that each maintains an acceptable level of service and provides reliable financial and operational information. The managing agents share with the Group their internal control assessments. The Group periodically uses the services of an external consultant to review the managing agents' operational processes and controls.”
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Boards should provide more information about their review of the effectiveness of the risk management and internal control systems

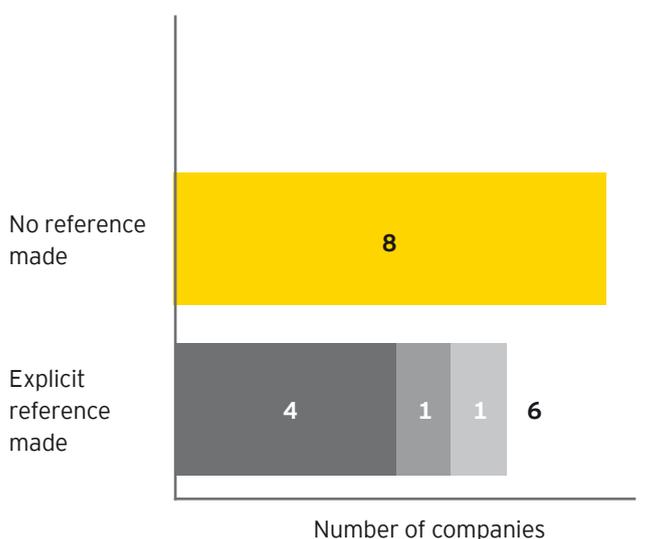
Boards are required under Provision C2.3 to provide some disclosure on what their annual review of the effectiveness of risk management and internal control systems encompassed. They should describe how the review was conducted or the process applied. We observe that most companies confirm that a review was undertaken but few provide the details of process. Easyjet plc (page 63) is one company that provided some detail in this area:

“To mitigate any significant risks identified, the Directors review the effectiveness of internal controls, including operating, financial and compliance controls, by the following:

- ▶ Review by management of controls, which mitigate or minimise high-level risks, to ensure that they are in operation. The results of this review are reported to the Audit Committee and the Board which considers whether these high-level risks are being effectively controlled
 - ▶ Discussions with senior personnel throughout the Company. This ensures key issues are escalated through the management team and, as appropriate, ultimately to the Board.”
-

Some companies go beyond 2014 Code requirements in disclosures about significant failings and weaknesses

Do companies explicitly mention significant failings and weaknesses?



- No significant failings or weaknesses found
- None found, but smaller, localised and specific issues were identified and actions taken as a result are explained
- Not specific either way whether any were identified

There is no explicit requirement under the 2014 Code to disclose significant failings or weaknesses in the company's internal control systems during the year. However, implicit in paragraph 58 of the FRC's Guidance which states, 'The board should explain what actions have been or are being taken to remedy any significant failings or weaknesses,' is that boards would have to disclose the significant failings or weaknesses in order to provide any meaningful disclosure of the actions taken to address them.

Despite the lack of any Code requirement to do so, just under half of companies (six) in our sample include a statement that they have considered the occurrence of any significant failings or weaknesses in the internal control systems during the year. Five of these companies say that no significant failings or weaknesses were found.

One company states that no significant weaknesses were identified but provides insightful detail on an irregularity including the actions taken to remedy the situation. The implication is that this weakness is localised and specific to the individual businesses and not generic or significant at group level. Such an approach is transparent, but if a company discloses a weakness, even one that it considers not to be significant, could its mere disclosure lead readers to think otherwise? The challenge here is for companies to determine what 'significant' means to them. They might then consider explaining their criteria for determining significance – a move we would see as leading practice.

6. Conclusion

Our review of the first viability statements from companies officially subject to the 2014 Code is encouraging. In this first year, companies are having to apply considerable judgement about how they satisfy the 2014 Code requirements and we feel that the companies in our sample have taken on the challenge and made a good start.

In particular, many companies provided useful disclosures on the processes that underpinned their assessments of their prospects and viability. However, we would hope to see more quantified detail on stress testing and more information on qualifications and assumptions in the future.

It will be interesting to see how December year-ends learn from the ARAs of these early reporters and consider how to further improve their own disclosures. We encourage December reporters to look for ways to help readers understand their approach to risk and viability assessments more clearly. By continuing to enhance the processes that support their viability statement they should also expect to reap the benefits of greater business resilience and improved financial performance.

7. Appendix

The 14 companies with financial years ending on or after 30 September 2015 that were reviewed for this report are:

- ▶ Compass Group plc
- ▶ Diploma plc
- ▶ Easyjet plc
- ▶ Enterprise Inns plc
- ▶ Euromoney plc
- ▶ Grainger plc
- ▶ Imperial Tobacco Group plc
- ▶ Lonmin plc
- ▶ Marston's plc
- ▶ Sage plc
- ▶ Shaftesbury plc
- ▶ TUI Group plc
- ▶ UDG Healthcare plc
- ▶ Victrex plc

8. Contacts

Get in touch with EY's Corporate Governance team for more information including:

- ▶ Perspectives and trends in governance including the views of investors
- ▶ Insights on board composition and effectiveness
- ▶ Leading practices in annual reporting including narrative and governance

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