



Business model reporting; Risk and viability reporting

Where are we now?

October 2018

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We thank all of the investors and companies who participated in the original projects, and the investors interviewed for this implementation study.

Introduction

The Lab has been undertaking a series of projects related to the strategic report which seek to explore the areas of most interest to investors, and consider where companies face challenges in deciding what disclosures to make and how best to present them.

Business model reporting (October 2017) was the first in this series, and it established that good business model disclosure provides the foundation for the strategic report as a whole, and in particular on how the company considers risk and viability. The second report in this series was ***Risk and viability reporting*** (November 2017), which examined the key attributes of principal risk and viability reporting, their value and use. The next project in the series was ***Reporting of performance metrics*** which was published in June 2018, and established that reporting of performance measures is central to questions about how companies demonstrate the value they create and how investors value companies. In 2019 the Lab will apply the findings and principles from these projects to two reporting areas: climate change disclosure and workforce disclosure.

The objectives of this report are to explore how reporting has progressed and examine how companies have responded to suggestions for good practice disclosure that were presented in the reports on business models, risk and viability.

Our process

We have conducted a desk-top review of a sample of more than 100 annual reports from 2017/2018 and looked for signs of change. Where change was indicated, we undertook further analysis and showed the resulting examples to some of the investors that participated in the original projects. We wanted to understand how they felt about the changes and gather their overall views on the usefulness of business model, viability and risk disclosures. We also approached some preparers and other stakeholders to understand their perspectives.

This report revisits some of the findings from the original project reports and considers how investors' expectations have changed. This report is designed to act as a conduit to once again highlight good practice and push for further improvements in the quality and usefulness of disclosures.

Our report highlights some examples of current practice which resonated with the Lab team and investors. Not all of the examples are relevant for all companies and all circumstances, but each provides an example of where the company has thought about and demonstrates how to enhance the value of their disclosures.

Highlighting aspects of good reporting by a particular entity should not be considered an evaluation of that entity's annual report as a whole.

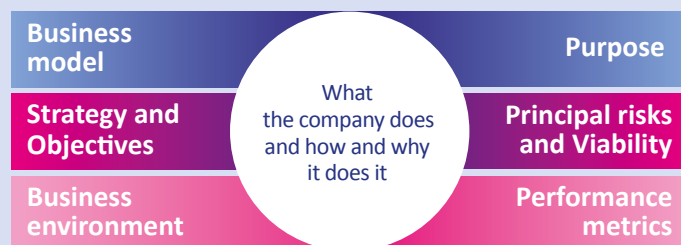
Quick read

Where we were then

When the Lab originally looked at how companies reported on business model, risk and viability it was clear that investors valued these disclosures as key components of their analysis. However, it was evident that they felt more could be done to improve their usefulness. Given the fundamental nature of these disclosures, the Lab considered that it was important to return to company reporting in this area and see how the approaches of companies have changed, reflecting both changes in legislation and views on best practice.

Where we are now

Our discussions with investors for this report confirmed the original findings. Investors still feel there is more that can be done to make business model, risk and viability disclosures more valuable. Whilst there have been some good developments, investors continue to emphasise the need for reporting to be more consistent and clearly linked throughout the annual report. In that sense, there is a suite of disclosures that help investors to understand what a company does and how and why it does it.



Business model reporting

The Lab's *Business model reporting* project showed that business model disclosures were a key starting point for investors when trying to understand how a company makes money and why that is sustainable over the longer-term. Investors desire information that is sufficiently broad to give them a good understanding of the overall business and in enough detail that it begins to provide evidence on the performance and position of the company in the context of its business model.

In the Lab's original report, investors highlighted certain types of information they wanted within a business model, such as how the company makes money, key sources of value and drivers of that value. Our discussions for this report revealed a more subtle message. Investors do not expect the information to always reside within the business model disclosure itself and appreciate the need for flexibility and for companies to structure their communications in a way that best meets their stakeholders' needs. They do, however, seek clear disclosure that builds understanding either directly or through cross-referencing and coherent, meaningful linkage.

Investors felt that successful business model disclosures often acted as a guide for the content of the rest of the annual report, and it is here that the disclosure of business models are falling short. Whilst there has certainly been some innovation, many of the changes across the sample of companies that we have reviewed add neither broad understanding nor company specific detail, and lacked connections to wider information within the annual report.

Questions for boards on business model disclosure

- Does your business model clearly communicate how you create value (both in terms of cash generation and non-financial value) over the longer-term?
- Is it clear for the reader as to what this longer-term period is?
- Is your business model disclosure comprehensive, covering all elements investors find useful that are relevant to your business, either in a single disclosure or through clear and meaningful cross-referencing?
- Does your disclosure include the business models of all your significant businesses, or refer to where that information is, and the value of combining them within one group?
- Are the key drivers of your business model(s) clear?
- Does your disclosure demonstrate how your business is unique?
- Does the business model graphic improve the understandability of the business model for those outside your organisation?

Quick read

Risk reporting

Understanding the risks that a business faces and what is being done to manage those risks continues to be an area of keen interest both to investors and other users of the accounts. Whilst risk reporting was already relatively well developed, the original Lab project did highlight some areas where improvement would be welcomed. This included more detail on risk tolerance, responsibilities and mitigating actions. Our review of risk reporting has seen a number of companies taking up some of these recommendations and therefore providing investors with more useful information.

However, there continues to be a lack of detail in certain areas, such as mitigating actions and links to the business model and key performance indicators (KPIs), and this lack of detail is heightened by overall changes in the risk environment. Disclosures around the UK's withdrawal from the EU were a particular focus for investors. Whilst many companies highlight that various Brexit scenarios create a principal risk, investors expect more detail on the level of preparedness, the current stage of implementation of mitigating activities and numerical breakdowns to help them assess the impact. This type of disclosure was rare, although more detailed disclosure is to be expected in the current period as the Brexit arrangements become clearer.

Questions for boards on principal risks

- Does the description of principal risks identify how they are specific to the company?
- Are the risk disclosures detailed and specific enough to understand why the risk is material and over what time period?
- Is it clear to the reader how the company categorises and prioritises principal risks?
- Are movements in principal risks, including movements into and out of the principal classification, explained?
- Do the mitigating activities include specific information that allows the reader to understand the company's response and current stage of mitigation?

Viability reporting

Our original project noted that, whilst the introduction of the viability statement enhanced the focus on risk at the Board level, the disclosure tended to be boilerplate and not deliver as much useful information as it could. The report suggested some ways to enhance disclosure on viability.

There are some promising developments with companies separating the viability statement into an assessment of prospects then an assessment of viability, providing more disclosure on both. This two-stage disclosure works best where each element is supported with sufficient detail and linkage to the rest of the report. Investors also seek more disclosure on scenario and sensitivity analysis that supports the statement, and reasoning behind the period selected. However, because of the lack of consistency in application, viability statements are not always seen as providing useful information to investors. Continued focus is needed on the quality of disclosure if the viability statement is to become universally useful.

Questions for boards on the viability statement

- Does the disclosure differentiate between the directors' assessment of long-term prospects and their statement on the company's viability, and clarify why different time horizons are used?
- When disclosing long-term prospects has the board considered their stewardship responsibilities, previous statements they have made (especially in raising capital), the nature of the business and its stage of development, and its investment and planning periods?
- Does the viability statement disclose any relevant qualifications and assumptions when explaining the directors' reasonable expectation of the viability of the company?
- Is the link between the viability statement and principal risks clear to the reader, particularly in relation to the scenario analyses?
- Are the stress and scenario analyses disclosed in sufficient detail (and quantification) to provide investors with an understanding of the nature and potential impact of those scenarios, and the extent and likelihood of mitigating activities?

Quick read

An opportunity to reconsider reporting

The updated Guidance on the Strategic Report and the UK Corporate Governance Code are likely to be core drivers of reporting change for most companies over the next few years, and as with any change, this provides an opportunity to rethink investor communication.

Lab reports give some insight into disclosures that demonstrate good communication. Investors value disclosures that tie business model, strategy, risk and viability together and provide investors with the information that allow them to assess progress against strategy and management of risks through the use of KPIs.

With our reports on business model, risk and viability (and more recently on performance metrics) the Lab has tackled not just some of the core components of the strategic report but, more importantly, of a company's story. Moreover, while in both the original reports and the implementation study we found some examples of good practice, improvement is a continual and iterative process; what was good practice becomes expected, what is seen as good moves forward. For those wishing to take up the challenge that change provides, we draw attention once again to the Lab's [Towards Clear & Concise](#) report, which provides a set of steps (plan, manage, do, evaluate) that companies might wish to take as a process of change towards continuous improvement. An extract is included in Appendix A.

Questions for boards on linkage

- Is it clear to the reader how the business model, strategy and business environment link to the principal risks identified, and how the overall risks impact the viability of the business?
- Are the strategy, risks and mitigations clearly linked through to the KPIs so that the reader can clearly monitor progress?
- Do the disclosures represent what stakeholders want to know now, or are they just rolled forward?

Practice examples in the report

Our report highlights examples of current practice that demonstrate where companies have enhanced the value of their disclosures. These examples resonated with the Lab team and investors, however not all of the examples are relevant for all companies and all circumstances.

Disclosure Area	Page	Company
Business model	8	Intermediate Capital Group Plc
	9	Howden Joinery Group Plc
	10	Drax Group Plc
	11	Dairy Crest Group plc
	12	Land Securities Group plc
	12	SSE plc
Principal risks	15	SSE plc
	16	Vodafone Group plc
	17	Essentra plc
Viability statement	19	Informa plc
	20	Tyman plc
	21	Croda International plc
	21	Burberry Group PLC
	22	Hastings Group Holdings plc
	22	Nationwide Building Society
	22	Superdry Plc

Section 1

Business model reporting

Section 1: Business model reporting

Project background

Project initiation

Our October 2016 report, [Business model reporting](#), involved 20 companies and 27 investors and sought to answer one simple question: how could business model reporting be made more useful to investors? The project was first proposed by companies who wanted to understand what disclosure on business models is valuable to investors, and how that information is used.

What we found

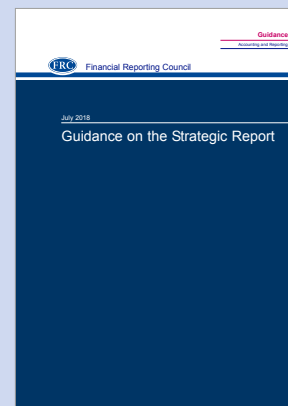
Our project found that investors use business model information in their initial investment appraisal process, for monitoring the investee company's performance and fulfilling their own stewardship responsibilities. Investors were unanimous that business model information is fundamental to their analysis and understanding of a company and its prospects. The key findings of the report were:

- Improvement could be made in linking business model reporting to other areas of the annual report.
- Investors wanted more detail in the business model disclosure, such that it forms a basis for their understanding on the performance and position of the company.
- Clarity of disclosure could be improved. Language should be plain, clear, concise and factual, and disclosure should be fair, balanced and understandable.
- Investors wanted more detail on what makes a business unique. They believe companies can balance commercial sensitivity with providing sufficient disclosure to enable them to understand what differentiates the company and how the board is responding to emerging risks.

Fundamentally, investors' views on areas of improvement have not changed. Our review of business model reporting for this report continues to show that the above findings need ongoing focus and we have identified some additional areas that require further development.

The regulatory context

Since the introduction of the strategic report in 2013 business model disclosures have been seen as a core content element for the delivery of information. However, what has changed more recently has been the expectation on the role that business model disclosure should play to provide context for and linkage to other information throughout a company's strategic report.



The [2018 Guidance on the Strategic Report](#) encourages companies to consider more fully how they generate and preserve value over the longer-term as part of their business model reporting. It challenges companies to think about how environmental, employee, social, community, human rights, anti-corruption and anti-bribery matters might impact their business models.

The Guidance also highlights the importance of aligning the KPIs presented in the strategic report with the key sources of value and risks identified in the business model, something that the participants in the Lab's recent [Reporting of performance metrics](#) project also noted.

Further information on the Guidance can be found on the FRC's [website](#).

Business model reporting

Location of the disclosure

Investors seek information that is sufficiently broad to give them a good understanding of the overall business and in enough detail that it begins to provide evidence that helps them understand the performance and position of the company in the context of its business model.

Whilst there has certainly been some innovation, many of the changes across the sample of companies we have reviewed add neither broad understanding nor company-specific detail and connections to wider information within the annual report are often missing or difficult to follow.

Since the publication of the Lab’s report, there has been a trend for companies to move elements that have previously been included in the business model into other areas of the strategic report. Examples of these include:

- a short and simple description of what the company does;
- a high level description of how the company is structured; and
- a high level description of the markets in which it operates.

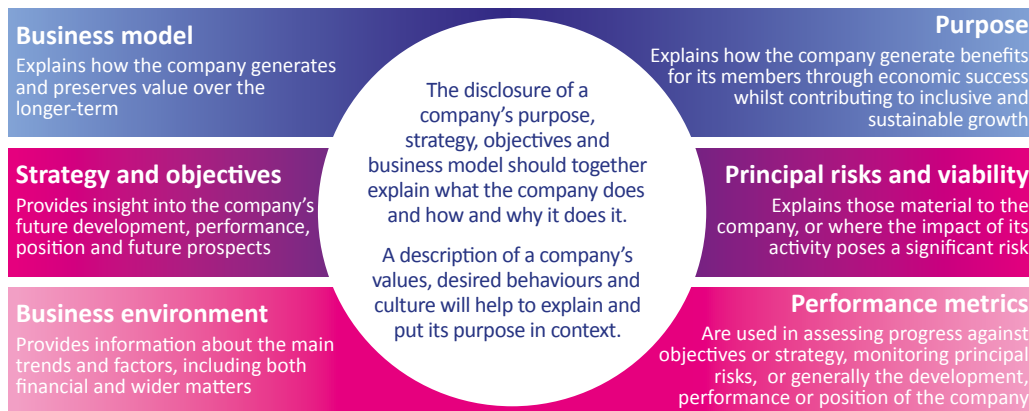

Our review showed that these separate elements can work well where they are clear and concise, and appropriate linkage and signposting to other information within the report is included.

The Lab’s original report highlighted certain information that investors wanted to know about a company from the business model disclosure, such as:

- what it does;
- where it sits in the value chain;
- key inputs, and how they are maintained and enhanced;
- key revenue and profit drivers;
- key divisions, markets and market segments.

However, our discussions for this report revealed a more subtle message. Investors do not expect the information to always reside within the business model disclosure itself, and appreciate the need for flexibility for companies to structure their communications in a way that best meets their stakeholders’ needs. Therefore, clear disclosure that builds understanding, either directly or through cross-referencing and linkage, will provide investors with the information that they want. Linkage and cross-referencing are useful only where they add value. Too often linkage appears to be relatively superficial, referencing material that does not enhance understanding.

The suite of disclosures that allow investors to understand a company:

KEY POINT: Disclosures across the strategic report should provide investors (and other users of the annual report) with an understanding of the company, what it does, and how and why it does it.

Practice example

Business model



What is useful?

ICG highlights on the contents page where key disclosures related to their business model can be found which quickly draws focus to these disclosures.

What is useful?

Their 'How we create value' disclosure provides high level details of their main activities, including how they measure performance for each with reference to further information, and an indication of where the activity sits within their overall business structure. ICG also includes a description of how each activity contributes to profit – investors are also supportive of disclosures highlighting how business activities generate cash, as well as how profits are distributed.

HOW WE CREATE VALUE		
BUSINESS ACTIVITY	Raising new assets under management	Investing capital
WHY DO WE DO IT?	We generate fee income from our managed funds	Investing the capital raised generates investment returns for our fund investors and shareholders
HOW DO WE DO IT?	<ul style="list-style-type: none"> We size our fundraising requirements by the market opportunity to invest the capital, developing investment strategies that meet the requirements of institutional fund investors We use our global in house distribution team who are embedded in the business to attract suitable investors for our funds 	<ul style="list-style-type: none"> Our specialist and experienced investment professionals identify opportunities to invest capital using long standing networks and relationships We provide borrowers and investee companies with flexible capital to meet their needs; this is supported by our nimble operating model with its efficient decision making processes
HOW DO WE MEASURE PERFORMANCE?	<ul style="list-style-type: none"> We have a target of raising an average of €6bn of new third party funds (gross inflows) per annum on a three year rolling basis We monitor the weighted average fee rate on fee earning assets under management (AUM) to ensure that AUM is profitable. Weighted average fee rate and AUM are alternative performance measures as defined on page 16 <p><small>Read more about how we performed on pages 16 to 19</small></p>	<ul style="list-style-type: none"> For closed end funds it is important for the capital to be deployed over the investment period. We monitor this against a straight line deployment basis throughout the investment period For open ended funds we ensure investors' capital is being deployed in an appropriate manner
HOW DOES IT CONTRIBUTE TO PROFIT?	<ul style="list-style-type: none"> We earn management fees on AUM once they are committed or invested depending on the fund. Fees contribute to profit in the year in which they are earned Raising new AUM generates a foreseeable income stream of between 3 and 12 years, depending on the life cycle of the fund 	<ul style="list-style-type: none"> We earn management fees on invested capital until the underlying investment is realised. In addition, the balance sheet earns a return on its investment in funds
OPERATING MODEL COMPONENT		

Intermediate Capital Group Plc, Annual Report & Accounts 2018 p8

Business model reporting

Content

Overall there has been a trend for the business model to be presented in an ‘inputs, business activities, outputs/outcomes’ format. This approach can often be a good way of making a complex business easy to understand, particularly where it is attempting to communicate to a wide range of stakeholders. It does, however, run the risk (if done poorly) of over-simplifying the business model. Such minimal disclosures can lead to basic questions going unanswered, all of which investors want to understand from the disclosure. These include:

- What does the business do?
- How does the company actually make money?
- How is the business model likely to evolve?

While investors report that they may already have a good picture of a company’s business model from their meetings with management and other interactions, the presentation and clarity of the business model in the annual report is important for credibility.

Questions for boards on business model disclosure

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OUR BUSINESS MODEL

Howdens is a trade-only business, selling kitchens and joinery to local builders and trade professionals from our 660 local depots. Each local depot operates on an in-stock basis and is normally only a short drive away, allowing the builder to plan and start a job without delays.

A typical depot occupies around 10,000 square feet, is located on an industrial estate and costs a fraction of high street retail properties. Depots cost on average £450,000 to fit out and typically break even by year 2 at c.£700,000 sales.

We design and manufacture all our own cabinets (approximately 4 million per year) in our own factories in Yorkshire and Cheshire. Other products, including some cabinet doors and our own-brand appliances, are made to our specifications and bought in from suppliers with whom we have built long-standing relationships. We make what it makes sense to make, and we buy what it makes sense to buy.

Howden Joinery Group Plc, Annual Report 2017 p17

What is useful?

Investors commented positively on Howden’s business model for its clear, plain and concise overview of what the business does and how it operates. They commented that the statistics provided add to their understanding of the business. This example shows that disclosures do not need to be complex.

Practice example

Business model

PELLET PRODUCTION

A LEADING PRODUCER OF WOOD PELLETS FROM SUSTAINABLE LOW-VALUE COMMERCIAL FORESTRY RESIDUES.

Manufacture and supply of good quality wood pellets to our Power Generation business for use in the generation of low-carbon electricity.

Revenues £136m

822,000t pellets produced

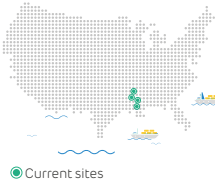
Employees 258

Our assets:

- 2 x 525k tonne pellet plants (operational)
- 1 x 450k tonne pellet plant (commissioning)
- 2.1m tonne throughput export facility

Our focus:

- Operational excellence – good quality, low-cost pellets
- Continuous improvement and leverage benefits of asset portfolio
- Increase in wood pellet production capacity



POWER GENERATION

GENERATES 6% OF THE UK'S ELECTRICITY AND 15% OF ITS TOTAL RENEWABLE ELECTRICITY.

Produces reliable, flexible low-carbon electricity from sustainably sourced wood pellets and provides system support services to the electricity grid from biomass and coal generation.

Revenues £2.7bn

Generation 20.0TWh

65% Renewables

Employees 804

Our assets:

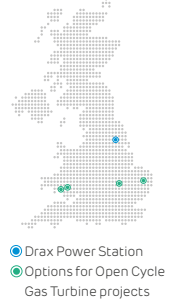
- 3 x 645MW biomass generation and system support, with plans to convert another coal unit to biomass
- 3 x 645MW coal generation and system support

Developing options:

- 4 x 299MW Open Cycle Gas Turbines (OCGT)
- 3.6GW coal-to gas repowering and 200MW battery

Our focus:

- Optimise returns
- Expand to support low-carbon future and system support
- Options for long-term efficiencies



B2B ENERGY SUPPLY

A LEADING SUPPLIER OF LOW-CARBON ENERGY SOLUTIONS TO INDUSTRIAL AND BUSINESS CUSTOMERS.

Supplier of power, gas and value-adding services to industrial, corporate and small businesses. Our assets represent 10% of the B2B power market.

Revenues £2.0bn

Customer meters >375k

Power sales 20.1TWh


Employees 1,311

Our assets:

- Opus Energy
- Haven Power

Our focus:

- Profitable B2B energy supply business
- Innovative customer propositions
- To be customer-centric
- Make sustainability simple



AMBITION FOR 2025

EBITDA >£75m

- Targeting 30% self-supply capability

...➔ Page 10

AMBITION FOR 2025

EBITDA >£300m

- Includes the development of four OCGTs if successful in capacity market auctions

...➔ Page 11

AMBITION FOR 2025

EBITDA >£80m

- Growth in market share whilst maintaining margins

...➔ Page 11

What is useful?

Drax’s business model provides detail of each of its core activities, including the assets for each and statistics to support understanding of the relative size of the elements.

Investors respond positively to disclosure that indicates how the company believes the business model will evolve, and this disclosure of Drax’s ambition for each element over the longer-term gives some useful context. It also links to additional content.

Drax Group Plc, Annual report and accounts 2017 p2-3

Practice example

Business model

OUR BUSINESS

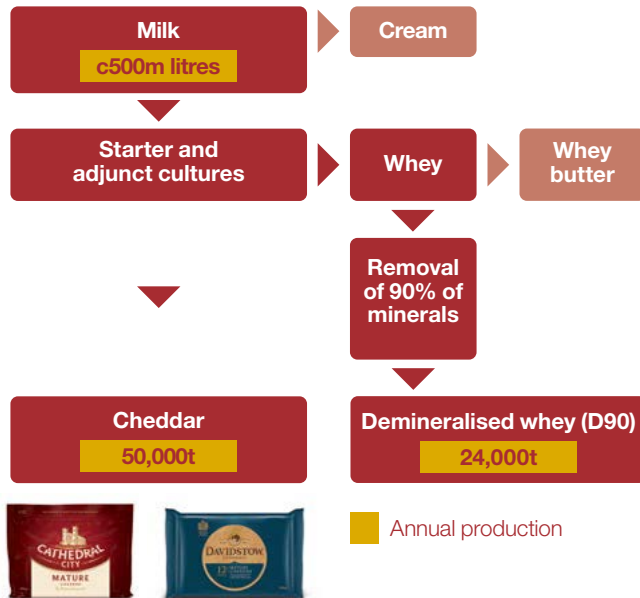
Dairy Crest manufactures and markets branded food products and value-added ingredients. We have two product groups – Cheese & Functional Ingredients and Butters, Spreads & Oils.

Cheese & Functional Ingredients

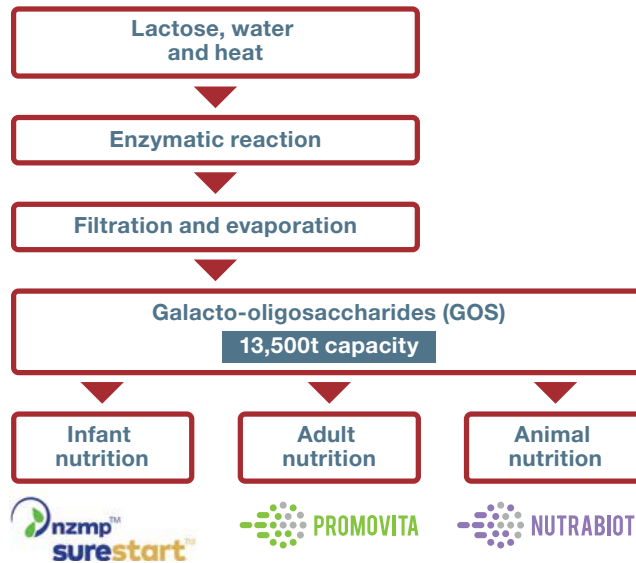
We produce Cathedral City, the UK's number one cheese brand, and the premium Davidstow cheddar brand at our highly automated creamery in Davidstow, Cornwall. Our functional ingredients operation produces ingredients for the high-growth global infant formula market – demineralised whey powder,

a by-product from the cheese-making process, and galacto-oligosaccharides (GOS), a lactose-based prebiotic. Dairy Crest is well positioned to produce premium demineralised whey due to its high quality, traceable milk supply.

Cheddar and demineralised whey



Galacto-oligosaccharides



What is useful?

Dairy Crest's disclosure has a short description of what they do and a more detailed overview of each of their markets, supported by information on the contribution of revenue and profits to the overall group.

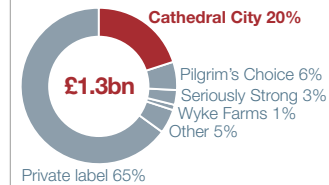
Our retail markets



Cheese

The UK cheese market generates £2.7 billion of sales each year, approximately half of which are cheddar. Cheddar volumes grew by 2% last year. Cathedral City is the largest cheddar brand, accounting for 20% of total cheddar sales but 55% of the branded market. With retail sales of approximately £280 million, Cathedral City sells more than all of the other cheddar brands combined, and is three times larger than the number two brand. Private label still dominates, however, which presents us with further

UK cheddar market*



opportunities to expand both in the UK and abroad.



Functional Ingredients

Dairy Crest has made a significant investment at its Davidstow creamery to manufacture demineralised whey for use in infant

Global infant formula market

\$47bn**

formula products. This is a global market that is expected to grow at a compound annual rate of 9% from 2015 to 2020. The Asia Pacific region is the largest consumer of infant formula as population growth and urbanisation fuel demand. Consumers are willing to pay for safety and quality more than ever before.

Dairy Crest also manufactures GOS, a prebiotic derived from the lactose in cow's milk, which is used in infant formula. We are exploring additional uses for GOS as an ingredient in the adult food market and in animal feed.

Dairy Crest Group plc, Annual Report 2017/2018 p4

Business model reporting

Purpose disclosure

An increase in disclosure of purpose and its greater prominence in annual reports reflects changes both in guidance and in demands from stakeholders. The [2018 UK Corporate Governance Code](#) states that a company's purpose, values and strategy should be established by the board and aligned with its culture. We have heard from companies that purpose is a useful tool to communicate why the company exists, for both internal and external stakeholders.

Investors are supportive of purpose statements that communicate what the company does and why it does it, and emphasise that this can be done successfully in a succinct way. However, it can impact credibility when the purpose stated is difficult to connect with the business model disclosed and the rest of the strategic report. While some examples of succinct and coherent purpose disclosure exist, this is still a developing practice.

Welcome to Landsec

What we do

We buy, sell, develop and manage real estate. That includes contemporary office, retail, leisure and residential space in London, and retail and leisure destinations across the UK.

Why we do it

Our purpose is to provide the right space for our customers and our communities – helping businesses to succeed, the economy to grow and people to thrive.

How we create value

Applying our expertise, we provide a great experience for everyone we rely on, from our customers to our communities, partners and employees. We believe that's the best way to create long-term sustainable value for shareholders. We aim to provide dependable dividend income and grow our share price by increasing revenues and asset values.

What is useful?

LandSec's short description of what they do and why had a positive response from some investors, who commented that it is a clear and simple explanation that is aligned to the business model disclosure and it also connects how the value created for stakeholders also benefits investors in a credible way.

Land Securities Group plc, Annual Report 2018

Providing the energy people need to create and share value

SSE does not operate in isolation; it has a deeply interconnected relationship with the society it serves, operates within and is part of. SSE relies on society to be able to serve its customers in a reliable and sustainable way, and in return puts back into society through paying tax, creating sustainable employment and investing in national energy infrastructure. By creating and sharing value with the communities in which it operates SSE fulfils its role as a responsible member of society.

What is useful?

Some investors responded positively to SSE's disclosure, which highlights how its purpose creates value for other stakeholders and links through to relevant statistics.

Investing in infrastructure	Supporting and creating sustainable jobs	Paying a fair share of tax
SSE helps maintain and invest in the energy infrastructure society needs. In 2016/17 SSE invested around £1.7bn in energy assets and services, part of the £9.3bn and £779m contribution SSE made to UK and Irish economies in the same year.	As a responsible member of society, SSE believes in supporting and creating high quality long-term jobs. In 2016/17 SSE employed 21,157 people directly and supported a total of 108,440 jobs across the UK and Ireland.	SSE believes it should contribute to the cost of the services on which it depends. It does this through the payment of tax. SSE seeks to be transparent and open about its tax disclosures. It has been an accredited Fair Tax Mark company since 2014.
Capital investment 2016/17	Employees 2016/17	Total tax paid including on profits, property, and employment and environmental taxes
£1.7bn +6.6%	21,157 +0.2%	£385m -15.2%
Providing public services	Lending human capital	Giving the right to pay dividends
The public services society provides are crucial for SSE to function and thrive. SSE relies on emergency services, public infrastructure, health and education services to fulfill its core purpose of providing energy in a reliable and sustainable way.	SSE's success depends on its employees and their innate abilities and learned knowledge. It depends on society to make the first investment in that human capital, through education and training.	Energy was once owned and operated by central government in the UK and so SSE depends on society for the right to pay dividends to shareholders. To attract and support investment in energy infrastructure, SSE has paid increasing dividends each year since it was formed.
Contribution to the UK economy 2016/17	Investment in people development 2016/17	Full-year dividend price per share 2016/17
£9.3bn +5%	£18.9m +9.8%	91.3p +2.1%

SSE plc, Annual Report 2017 p8-9

Section 2

Risk and viability reporting

Section 2: Risk and viability reporting

Project background

Project initiation

Investors have always been interested in the risks that companies face and the impact of those risks on the longer-term viability of the companies and their business models. This interest was bought into sharp focus with the 2008-09 financial crisis where the disclosures around how boards of companies manage risk and assess their viability were shown to be lacking. Regulators responded by enhancing risk and viability reporting requirements via the UK Corporate Governance Code and the Guidance on the Strategic Report. Whilst the new regulation created new requirements for preparers, it was not clear if the resultant disclosures were valued by investors. It was this question that the Lab sought to answer in our original project on risk and viability reporting.

What we found

After interviews, roundtables and surveys with 21 preparers, 15 institutional investors and 191 retail investors the answer we received to our question of whether these disclosures were valued by investors was sometimes but not always. Our November 2017 report [Risk and viability reporting](#) highlighted what investors wanted from risk and viability reporting.

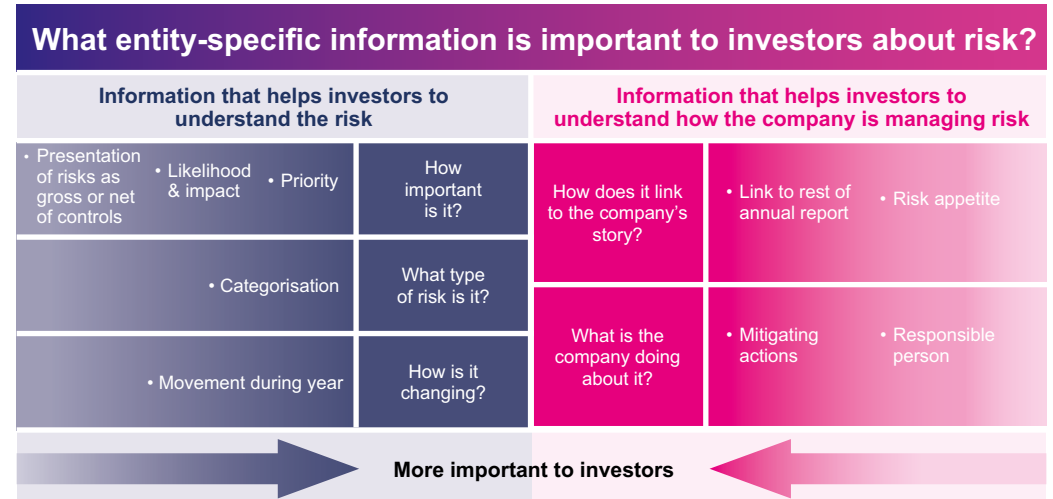
Risk reporting

Investors are looking for principal risk reporting that is specific to the company, which avoids boilerplate disclosure and jargon. Investors seek to understand both the principal risks identified by the company and how the company is managing those risks. They gain confidence in management when risks are linked to the business model, show any changes in risk year on year and give some indication of the potential impact of risks occurring. The graphic summarises key information that investors told the Lab they are looking for companies to provide in their principal risk disclosures.



KEY POINT: Assessing risks and viability are, and always have been, fundamental to the decision making of companies and investors.

Attributes of good principal risk disclosure:



Questions for boards on principal risks

- Does the description of principal risks identify how they are specific to the company?
- Are the risk disclosures detailed and specific enough to understand **why** the risk is material and over what time period?
- Is it clear to the reader how the company categorises and prioritises principal risks?
- Are movements in principal risks, including movements into and out of the principal classification, explained?
- Do the mitigating activities include specific information that allows the reader to understand the company's response and current stage of mitigation?

Risk and viability reporting

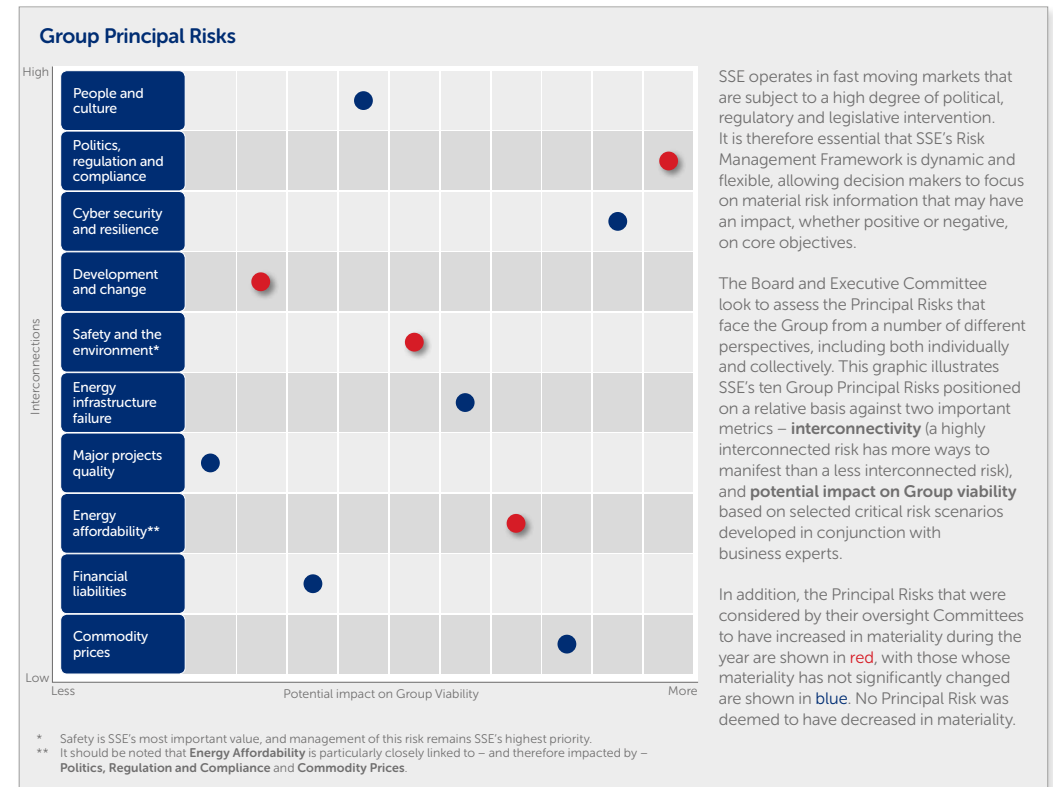
Principal risk reporting

One of the findings from our original project was that investors considered that risk reporting was already in a relatively good position and had undergone visible improvement since the financial crisis. That being said they did identify that there were possible areas for improvement, especially around the level of detail of risk disclosures.

Our review of risk reporting for this study identified some positive developments, particularly disclosure that helps investors understand the risk. Key areas we identified included extra disclosure on:

- How the risk is changing throughout the year, and year-to-year.
- Further detail on the prioritisation of principal risks, or clarification that the presentation is not in order of priority.
- Better linkage between the process of managing risk and the rest of the annual report, such as linking each risk to one or more strategic objective, and in some cases the principal risks being referenced in the business model or viability disclosure.

However, while investors valued the increased disclosure, in many cases the information was not felt to be significant or detailed enough to provide the desired level of understanding. Often investors questioned what the specific classification of risks or linkage to strategy meant. This was particularly the case where no definition was given or required the follow through of information using icons. Additionally, a lack of information on the timing and impact of the mitigating actions also generated questions from investors that they either hoped that the rest of the annual report would answer or that they would raise with management.



SSE plc, Annual Report 2017 p27



KEY POINT: Companies should put themselves into the shoes of users of the strategic report. Do the disclosures provide enough detail to allow them to be easily understood either in themselves or through clear cross-referencing?

What is useful?

In this disclosure SSE highlights the interconnectivity of the principal risks, and notes how interconnectivity then affects their approach to the assessment of viability. They have also included information on whether the risks are increasing, unchanged or decreasing.

Practice example

Principal risk reporting

Our principal risks

Key changes in the year

The principal risks have been updated to reflect developments in our strategic priorities as well as progress made in managing them.

Key changes:

- **Disintermediation** – (risk 5) has been separated from market disruption (risk 3) as the potential causes for these risks are managed differently.

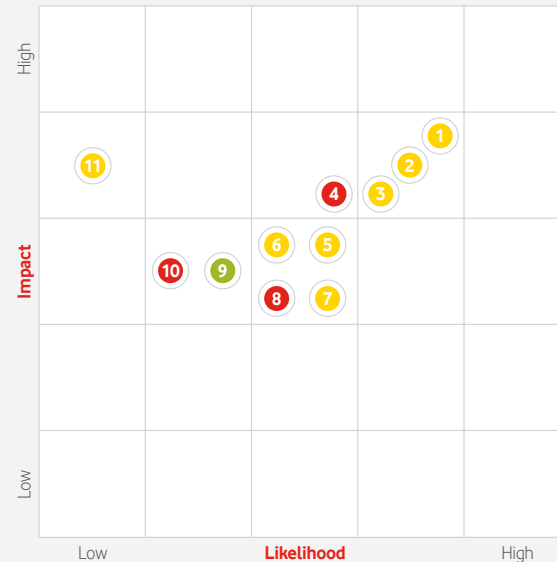
New risks:

- **Effective digital and technological transformation** – this risk has increased due to the importance of delivering the “Digital Vodafone” agenda to transform the core business, drive efficiencies and explore new growth areas. It continues to address the associated risk of failing to deliver a differentiated customer experience and has been expanded to include the risk of an IT transformation failure (a separate principal risk in 2018).
- **Effective data management** – this newly formulated risk reinforces the importance of General Data Protection Regulation (GDPR) as a business transformation programme and also recognises the strategic value of effectively managing our data assets in a digital economy.
- **Allocation of the Group’s capital** – this risk covers failure to deliver long-term value to shareholders if we were unable to manage our capital effectively and successfully integrate strategic acquisitions and disposals.

Risks removed:

- The **Convergence and Enterprise profitability** risks have dropped below the materiality level for principal risks due to positive trends in 2018.

Principal risks



Risk movement

- Risk increased
- Risk stable
- Risk decreased

What we do with our principal risks

Accountability

Assign ownership for risks and mitigations

Tolerance

Set tolerance for risk taking and benchmark against our current position

Risk reduction

Identify and track actions when out of tolerance

Informed decisions

Inform budget and strategic decisions

Oversight

Focal point for Executive Committee and Board deep dives

Assurance

Audit and Compliance teams use the risks to inform assurance planning and test how effectively risks are being managed

Market disruption

What is the risk?

New entrants to markets or competitors with lean models could create pricing pressure. As more competitors push unlimited bundles, it might impact profitability in the short to medium term through price erosion.

What is the impact?

Our market position and revenues could be damaged by failing to provide the services that our customers want at a fair price.

What is our target tolerance position?

We will evolve our offer and adopt an agile operating model to mitigate competitive risks. We will do this through targeted offers, smart pricing models and differentiated customer experience.

How do we manage it?

We monitor the competitor landscape in all markets, and react appropriately; working to make sure each market has a fair and competitive environment.

We will continue to improve our Consumer and Enterprise propositions using our digital strategies and our ability to create personalised offerings.

Risk movement:
Stable

Risk category:
Commercial

Link to core programmes:



Key risk indicators

- Trends in new technologies
- Level of customers actively using our new products and services

Changes since last report

This risk was previously managed as part of the wider Market Disruption risk but has now been split out to ensure appropriate consideration is given to our product and service offering. Over the last 12 months, we have seen the strengthening of OTTs message and voice platforms, the boom of digital assistants powered by AI and the continuing growth of Enterprise OTTs.

Vodafone Group plc, Annual Report and Financial Statements 2018 p38, p40-41

What is useful?

In their top level disclosure, Vodafone clearly highlights the risks that have changed and why, and notes how principal risks are considered within the business. This highlights for investors the key movements and changes. The detailed risk disclosure goes further by providing a concise description of the risk, its impact, and the organisation’s tolerance, which allows investors to identify their overall importance and potential for impact. The identification of the risk owner and key risk indicators also help investors to understand how the organisation is monitoring and managing the risk.

Risk and viability reporting

Brexit, cyber security and climate change

The FRC has previously highlighted the need for companies to consider a broad range of factors when determining their principal risks, for example cyber security, climate change and Brexit, and the 2018 UK Corporate Governance Code emphasises that boards should assess a company's emerging risks. The intention was for such risks to be part of the consideration for determining a company's principal risks.

As part of our review, we have seen companies responding with annual reports overall giving greater detail on Brexit and cyber security in the risk disclosure sections. There is also greater discussion on climate risk, although the overall level remains low. Where there is discussion on climate risk, the industries where it is most prevalent include materials (including mining), financials and consumer products.

Investors note that all risks are not equal – as the time horizon on risks or the likely mitigations become shorter, the level of information they want increases. This view was particularly noted for Brexit. Investors find it helpful when companies provide some explanation of the effect of differing Brexit scenarios and mitigating actions, and how they are responding to the potential impact. Investors have their views on the potential impact Brexit will have and therefore find it helpful if companies explain how they are preparing to address some of the risks that may arise and, where possible, provide quantification of the risk or the impact of mitigating actions where available. One investor particularly noted that general segmental information provided by a company might not be in enough detail to determine the potential impacts of Brexit and that further specific breakdowns would be welcomed. Whilst some companies have begun to provide more information regarding specific disclosures, we would expect more disclosure to be made this upcoming reporting year and as they become material for a company.

Lab comment

During 2019 the Lab is undertaking a project on the disclosure of climate change and workforce information that will consider how companies can most effectively disclose relevant information.

Brexit

Likelihood: High
Impact: High
Change in risk level: New
Ownership:
 Group Operations Director,
 Group Finance Director,
 Group Human Resources
 Director
Categorisation:
 Industry General

What is useful?

Essentra has upgraded the risk impact from Brexit to a principal risk, and explained the change. They have also provided further clarity to users by identifying who owns the risk in the company. Investors considered the mitigating action disclosure to be helpful as a prompt to ask further questions.

Brexit could impact the Company in a number of ways, for example:

- > A material element of the operations of the Components division involves manufacturing products in the UK and distributing them into the EU. Should trade tariffs and / or a customs border be imposed this could lead to increased costs and complexity within the division's existing business model.
- > The Company has multiple manufacturing sites in the UK. Should trade tariffs or a customs border be imposed, this could restrict the supply chain opportunities available to these sites.
- > Depending on the outcome of negotiations, Brexit could increase the cost of, or restrict funding for, the Group's current and future investment plans.

Brexit has previously been identified as a key but not Principal Risk to the Company. As UK / EU negotiations continue, the Company has determined that it should now be managed, mitigated and monitored as a Principal Risk.

During 2017 and the early part of 2018, the Company conducted a thorough review of Brexit risks, including understanding Essentra's exposure. This included consultation with external experts and used third party support.

Coming out of this review, a range of potential mitigation options were identified, which the Company is now in the process of reviewing. These include:

- > Potential changes to the European asset and manufacturing footprint to optimise material flows
- > Optimisation of product manufacturing locations versus customer locations
- > Seeking alternative raw material supply sources to minimise cross-border flows
- > Seeking "Approved Economic Operator" status to minimise inspection delays

Essentra plc, Annual Report 2017 p46

Risk and viability reporting

Viability statement

Companies and investors are both clear that viability is a concept that is important in the decisions that each of them makes. For companies, their continuing existence and growth are dependent on the sustainability of their business model and strategy; their sustainability, as well as their resilience to risk, is a key consideration for boards. For investors, investment decisions are determined, at least in part, by the confidence they have both in the business model over the longer-term and in those who lead the company. While investors noted some evidence of an improved focus on viability through their discussions with boards, it was not being made clear in companies' disclosures.

Investors want companies to explain the long-term prospects of the company more clearly. Investors suggest that companies might expand their disclosure to think not just about the viability but also the assessment of prospects and the inherent trade-offs the directors make in balancing these two perspectives with other time frames used within the business.

The two stage process in developing a viability statement



Investors are not necessarily looking for a viability statement that covers the period over which they assess their investments. They encourage companies to consider their prospects over the longer-term relative to their specific business. They understand that the directors must have a reasonable expectation which covers the period over which they state viability, and that many companies have chosen a period that is limited to a medium-term strategic period.

Whilst many consider that the UK Corporate Governance Code aligns the period for the assessment of prospects and viability, the [Guidance on Risk Management, External Control and Related Financial and Business Reporting](#) focusses on the process of assessment. Consistent with the Risk Management Guidance, many investors seek disclosure of the risks and prospects over a period consistent with a company's longer-term investments and planning even if the viability statement itself is limited to a shorter period. Investors also find details of the stress and scenario testing that has been performed to be very useful in providing information on the company's resilience to risk.

Questions for boards on the viability statement

- Does the disclosure differentiate between the directors' assessment of long-term prospects and their statement on the company's viability, and clarify why different time horizons are used?
- When disclosing long-term prospects has the board considered their stewardship responsibilities, previous statements they have made (especially in raising capital), the nature of the business and its stage of development, and its investment and planning periods?
- Does the viability statement disclose any relevant qualifications and assumptions when explaining the directors' reasonable expectation of the viability of the company?
- Is the link between the viability statement and principal risks clear to the reader, particularly in relation to the scenario analyses?
- Are the stress and scenario analyses disclosed in sufficient detail (and quantification) to provide investors with an understanding of the nature and potential impact of those scenarios, and the extent and likelihood of mitigating activities?

Risk and viability reporting

The two-stage approach

In our original project, investors considered that viability statements were not delivering on their original promise – investors wanted a better indication that a company was looking at the longer-term. They considered that few companies used the viability statement as a means of communicating positive messages about the long-term prospects of the company, treating it rather as an extended going concern confirmation.

Our review of recent viability statements shows some positive developments in this area, with a number of companies now disclosing significantly more information about the factors considered when making an assessment of prospects. Investors that we spoke to as part of this implementation study consider this information to be useful, particularly where it references or is clearly aligned to the company's business model and strategy. However, there has not been any lengthening of the viability period, with most companies maintaining a three to five year period. Though the viability period has not changed overall, companies are starting to provide more disclosure on their rationale and reasoning for the chosen time period.

Many investors still feel that the time horizons are generally too short, often as a result of the use of going concern type processes to develop the statement.



KEY POINT: Investors want more from the viability statement than a slightly extended going concern assessment. The most effective viability statements describe how management balance the longer-term prospects of the company's business model with the risks and uncertainties that it might be subject to.

FACTORS IN ASSESSING LONG-TERM PROSPECTS

Group's current position

- Recurring revenue streams with strong cash dynamics, including positive working capital driving high cash conversion
- Diversified business model by geography of operations and customers
- Diversified business model by products and by the verticals in which Informa operates
- Strong market positions, brands that customers value and a focus on long-term customer relationships
- Flexible cost structure, enabling the business to respond effectively to changes in demand or in markets

See the Financial Review on page 62 for more detail.

Strategy and business model

- Clear growth strategy
- Focus on creating capabilities for future growth and scale under the 2014-2017 *Growth Acceleration Plan*
- Intention to build further operating scale and specialism in vertical industries, and in B2B information services, through the January 2018 recommended offer for UBM
- Business model that draws on talent, brands and intellectual capital, technology, relationships, access to financial resources

See the Business Model on page 20 and Strategy on page 21 for more detail.

Principal risks related to the Group's business model

- Colleague and talent-focused risks around change management
- Market risk related to new entrants and exit to access to finance
- The risk of technology failure, data loss and cyber security
- Customers and relationships impacted by market risk and reliance on key counterparties
- Acquisition and integration-related risk

See pages 27–32 for a description of each principal risk.

What is useful?

Informa clearly describes the factors considered in assessing long-term prospects including links to the business model.

They then undertake the assessment of viability, including the process of identifying risks and scenarios.

ASSESSING THE GROUP'S VIABILITY

For each principal risk, a severe but plausible scenario is created, to analyse how the risk could materialise and to calculate its financial impact.

Scenarios include considerably worse performance from acquired businesses than anticipated, general market downturns and external incidents in regions in which we hold events.

Where a severe but plausible scenario creates a financial impact of over 5% of EBITDA, the principal risk is modelled against the three-year financial plan to test whether it would adversely impact the Group's viability.

Additionally, the three largest risks in terms of their potential financial impact are modelled together as a single scenario, to understand their combined financial impact.

The Group is considered to be viable if gearing and interest cover ratios within its financial covenants are maintained within prescribed limits, and if there is available debt headroom to fund operations.

Viability testing is carried out against Informa's current debt facilities, with an assumption that the Group's present revolving credit facility is renewed in October 2020.

In all cases, including after modelling the largest three scenarios together, no mitigating actions are necessary in order for Informa to remain viable.

Informa plc, Annual Report and Financial Statements 2017 p33-34

Risk and viability reporting

Scenario and sensitivity analyses

Investors in the original project considered that scenario and sensitivity analyses related to the assessment of viability provided useful information, although often it was at too high a level. Simply stating that scenario testing had been done was welcomed but not enough; investors wanted to know what scenarios were tested and the outcome, as well as the underlying assumptions.

Our review of recent viability statements has shown a significant increase in scenario information, with this disclosure now covering:

- summaries of what the scenarios are;
- more detail on the severity of the scenarios tested; and
- less frequently, the rationale or process for deciding which scenarios to model, and the severity.

Whilst investors interviewed for the implementation study consider that the extra information on sensitivity and scenarios was generally helpful, often, if no rationale was given for the selected scenarios (or exclusions of certain risks), this raised additional questions. Investors commented positively on those companies who used both a bottom-up and top-down approach to scenario testing or reverse stress testing. This provides some extra comfort especially where there is a clear monetary impact ascribed to each direction.

Overall investors are somewhat encouraged by the changes in viability reporting. However, because of the lack of consistency in application across all organisations, investors don't see viability statements as universally useful, and therefore may not review them as a matter of course. Continued focus is needed on the quality of disclosure if the viability statement is to become more helpful to investors.

The downside scenarios applied to the strategic plan are summarised below:			
Severe but plausible scenarios:			
Strategic plan flexed for combinations of the following scenarios:	Link to principal risks and uncertainties:	Level of severity tested:	Conclusion:
Severe downturn in market conditions Aggressive competitor actions resulting in a severe loss of market share The loss of major customers	Market conditions Competitors Loss of major customers	<ul style="list-style-type: none"> • 22.0 per cent fall in Revenue in year one followed by flat revenues in the following two years • £15.0 million one-off exceptional cash cost in year one 	This cumulative scenario is significantly worse than the reductions experienced by the Group during the last downturn in 2007 to 2009. Tyman, after undertaking mitigating actions, should be able to withstand the impact of these severe but plausible scenarios.
Reverse stress test scenarios:			
Strategic plan flexed for combinations of the following scenarios:	Link to principal risks and uncertainties:	Level of severity tested:	Conclusion:
Extreme downturn in market conditions Aggressive competitor actions resulting in extreme loss of market share The loss of major customers	Market conditions Competitors Loss of major customers	<ul style="list-style-type: none"> • 27.0 per cent fall in Revenue in year one followed by 8.0 per cent fall in revenues in each of the following two years • £15.0 million one-off exceptional cash cost in year one 	This level of performance deterioration is considered extreme and highly implausible and would make the future viability of the Group less certain.

What is useful?

Tyman includes both the scenario testing and reverse stress test for the same scenarios, and gives specific details as to the severity of the scenarios in each case. Investors find quantification of scenarios tested in forming the viability statement useful.

Tyman plc, Annual Report and Accounts 2017 p43

Practice examples

Viability statement

Assessment of viability

Viability has been assessed by considering the 'top-down headroom' available in terms of the overall funding capacity to withstand events, together with the 'bottom-up headroom' assessing the potential financial impact of events reflecting the Company's principal risks, both individually and in combination.

Top-down headroom

Funding capacity

Bank leverage covenant The ratio of net debt to EBITDA at the end of 2017 of 1.0x remains substantially below the maximum covenant level under the Group's lending facilities of 3 times (p28), providing significant headroom. EBITDA would need to fall by more than 50% before triggering an event of default. Action could also be taken to conserve cash.

Debt headroom Current committed debt facilities largely mature after the viability assessment period (p28) and have significant undrawn credit available. In normal lending market circumstances, additional debt funding could also be raised.

Bottom-up scenarios

Each of the key risks identified on pages 32 to 34 has been assessed for its potential financial impact as part of the viability assessment. Of these, the most severe but plausible scenarios (or combinations thereof) were identified as follows:

Scenario modelled	Link to Key Risks
Uninsured catastrophic loss of a manufacturing site – the impact of losing the contribution from the single largest site was considered assuming no insurance cover. However, for most loss events, we carry insurance cover.	Major safety or environmental incident p33
Significant compliance breach – the financial impact of regulatory fines was considered along with the associated reputational damage.	Ethics and compliance p34
Disruptive technology – the impact of substitute technologies affecting current sales were modelled together with new digital technology impacting our route to market.	Product and technology innovation p32
Loss of IT systems (particularly SAP Enterprise Resource Planning system) for a prolonged period.	Security of business information and networks p34

The results of the bottom up scenario modelling showed that no individual event or plausible combination of events would have a financial impact sufficient to endanger the viability of the Company in the period assessed. It would therefore be likely that the Company would be able to withstand the impact of such scenarios occurring over the assessment period.

Croda International plc, Annual Report and Accounts 2017 p35

This analysis has then been used to carry out an assessment of the ability of the Group to continue in operation and meet its obligations. The assessment covers the three-year period from April 2018 to March 2021. This was considered appropriate by the Directors because:

- It is sufficient to complete almost all currently approved capital expenditure projects.
- As the Group does not have significant amounts of contracted income, and as most current projects will be completed in the three-year period, any projections beyond March 2021 will only vary as a result of estimates of sales growth and cost growth assumptions.

The assessment process consisted of stress testing, combined with considering potentially significant one-off impacts. The stress testing involved estimating the impact of revenue sensitivities on profitability and cash generation over the three year period, together with reverse stress testing to identify the theoretical revenue sensitivity that the Group could absorb, without impacting its viability.

Burberry Group PLC, Annual Report 2017/2018 p67

What is useful?

Burberry discloses its reasoning for choosing a three-year period. They also disclose that they have performed reverse stress testing, in addition to scenario testing. Investors find it is useful to know that reverse stress testing has been done, even if not all of the details are disclosed in the viability statement.

What is useful?

Investors liked Croda's disclosure, which combined a top-down analysis providing an overall understanding of capacity to absorb risk, with a bottom-up scenario approach. The scenarios selected clearly link back to the key risks.

Risk and viability reporting

Process of forming the viability statement

Investors value disclosure on viability and prospects which give more detail about the process undertaken, especially where it gives them some understanding of how this interacts with divisional structure or other capital or solvency regimes which might be crucial to the business. Again, information of this nature does not have to always be within the viability statement, but could be referenced clearly to ensure the whole document is consistent and builds the understanding of investors and other users. Of particular interest to investors is consistency between the narrative and numerical sections of the annual report and other documents.

The Committee noted the development of the Society's viability statement in line with best practice guidance issued by the Financial Reporting Council during the year. The Committee noted commentaries suggesting that viability statements should be extended beyond a period of three years but in the light of changes in our economic, technological and regulatory environment, the Committee did not consider it appropriate to alter its current timeframe of three years.

Nationwide Building Society, Annual Report & Accounts 2017 p61

What is useful?

In the Audit Committee report, Nationwide Building Society discloses their reasoning for using a three-year period for their viability statement.

The stress testing confirmed that in all cases the headroom remained positive and none of the scenarios tested, either individually or collectively, would threaten the viability of the business over the four-year assessment period.

Sustainability of dividends has been assessed and is discussed in more detail in note 33.

Superdry Plc, Annual Reports and Accounts 2018 p50

What is useful?

Superdry references their dividend policy, and how they assess the sustainability of dividends, in their viability statement.

The Three Year Plan assumes there will be no change to the continued availability of the Group's borrowing facilities, which run to April 2021, that dividends continue to be paid in accordance with the target pay-out ratio, that a consistent reserving policy is applied, and that

Advantage Insurance Company Limited (AICL) remains well capitalised by maintaining a margin above its Solvency Capital Requirement.

The Three Year Plan was then robustly tested by applying nine challenging scenarios designed to threaten the viability of the Group. The stresses applied reflect the crystallisation of the principal risks identified, including;

- pricing and reserve risks that arise from insurance activities;
- operational risk, including risk of cyber attack;
- commercial performance risk;
- liquidity, solvency and capital risk; and
- a combination of these risks crystallising concurrently.

Hastings Group Holdings plc, Annual Report 2017 p43

These were assessed independently at the Retail and Underwriting businesses before determining the impact at the consolidated Group level. The minimum requirements for the Group to be considered viable were to maintain throughout each modelled period, positive free cash, continued compliance with the Facility Agreement's two financial covenants and a surplus over the Solvency II minimum capital requirements in AICL.

In certain of the most severe scenarios, achievable, short term mitigating actions within the control of the Company and its subsidiaries were required. After the application of these, the Group maintained positive free cash as well as headroom over the financial covenants and Solvency II capital requirements throughout each of the modelled scenarios. On this basis, the Directors confirm that they have a reasonable expectation that the Group will continue to operate and meet its liabilities, as they fall due, for the next three years.

What is useful?

The extract of the viability statement from Hastings discloses the qualifications used to assess viability in the scenario testing, and also highlights that the scenarios were assessed at the individual business and group level.

Appendix A:

Process of change

Appendix A: Process of change

The improvement cycle

Here we provide a set of steps (plan, manage, do, evaluate) that companies might wish to take towards continuous improvement. This originally appeared in the Lab's [Towards Clear & Concise](#) report.



Plan (the change)

- It is never too early. Change happens when action is prioritised. In the 'plan' phase companies can build consensus that change is needed.
- Identify a project sponsor. Change needs leadership. Identify a sponsor (usually a senior board member or part of the executive team) and set targets and time-lines.
- Identify your audience. Be clear about the intended audience for the annual report (or its components); this helps identify relevant content.
- Speak to investors. Use comments received by the investor relations teams or from retail shareholders via the company's website. Taking part in a Lab project is also a good way of understanding what investors want.
- Use the data. Look at the analytical data from your website to understand what information is popular.
- Speak to advisors. Advisors can provide insight into what is current best practice. Looking at peers' reports can identify alternative ways of doing things.
- Decide on scope. Consider the scope of the project; decide if it will be focused just on the annual report or on the entire set of reporting channels.

Manage (the process)

- Understand governance. Ensure there is agreement and understanding on the governance of the process. Who needs to sign off each section?
- Set the overall aim. The annual report as a whole (narrative and financial statements) should be fair, balanced and understandable.
- Obtain board agreement. Get early agreement from the board on key elements such as the business model and strategy, to help focus the document.
- Assign responsibilities. Identify specific individuals who will be working on each disclosure.
- Set the number of pages. Each team needs to know how many pages they are allocated (e.g. through a shared pagination plan). Stress the importance of the document working as a whole.
- Get another perspective. Get some input from someone outside of the core team using last years' report. Which areas do they think could be cut or improved?
- Keep on track. Have regular steering meetings to keep the process on track.

Do (what's needed):

- Start with a blank piece of paper. This focuses the mind on what the key messages are for this year, rather than being constrained by last year's text.
- Ask whether it reflect the company's developments? Early on, challenge the emphasis of the narrative in the annual report to ensure that it clearly reflects the significant developments of the company in the period.
- Consider regulatory changes. Think how best to comply with and reflect new regulatory requirements.
- Ask whether it is material? Develop a common understanding of what is material (both qualitatively and quantitatively).
- Read the annual report all the way through. Don't duplicate information which is elsewhere in the annual report (unless required).
- Use each other. Ask teams to review each others' disclosures for clarity and conciseness.
- Involve the auditors early. Auditors will need to be comfortable with changes to the annual report. Early communications with the audit team and obtaining buy-in to the process from the audit partner will reduce the chance of last minute changes.

Evaluate (the changes)

- Debrief early. Review while the process is fresh to capture good quality feedback. One way to do this is to include a comments card in the mail out or put a survey online to collect peoples' views, both internally and externally.
- Ask investors. Ask investor relations teams to track the types of questions they receive from analysts. Analyst questions often present a good indication of where information is not clear or where further information could be useful. Think about bringing issues in relation to specific disclosures to the Lab as areas for a future projects.
- Start the cycle again. Improvement is a continuous process. Lessons learned in one cycle can be taken forward to the next as a basis for further improvement. What has been learned may also be relevant to the half year, or other forms of reporting.

Improvement of the annual report is a continuous process

Referenced reports

Reporting of performance metrics June 2018

The reporting of performance metrics continues to be of significant interest to investors. In light of this, the FRC has published this report to provide guidance on how to report performance metrics. The report covers the use of performance metrics in the investment chain, investors' use of performance metrics, the reporting of performance metrics, and the use of performance metrics in the investment chain.

Investors' use of performance metrics

Investors' use of performance metrics has increased significantly in recent years. This report provides guidance on how to report performance metrics in a way that is consistent with the expectations of investors.

Reporting of performance metrics

This report provides guidance on how to report performance metrics in a way that is consistent with the expectations of investors. It covers the use of performance metrics in the investment chain, investors' use of performance metrics, and the reporting of performance metrics.

Use of performance metrics in the investment chain

This report provides guidance on how to report performance metrics in a way that is consistent with the expectations of investors. It covers the use of performance metrics in the investment chain, investors' use of performance metrics, and the reporting of performance metrics.

Financial Reporting Council



https://www.frc.org.uk/getattachment/e94631d1-69c1-4349-8ce5-780d4eca455f/LAB_Reporting-of-performance-metrics_June-2018.PDF

Business model reporting October 2016

The reporting of performance metrics continues to be of significant interest to investors. In light of this, the FRC has published this report to provide guidance on how to report performance metrics. The report covers the use of performance metrics in the investment chain, investors' use of performance metrics, the reporting of performance metrics, and the use of performance metrics in the investment chain.

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This report provides guidance on how to report performance metrics in a way that is consistent with the expectations of investors. It covers the use of performance metrics in the investment chain, investors' use of performance metrics, and the reporting of performance metrics.

Use of performance metrics in the investment chain

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<https://www.frc.org.uk/getattachment/4b73803d-1604-42cc-ab37-968d29f9814c/FRC-Lab-Business-model-reporting-v2.pdf>

Risk and viability reporting November 2017

The reporting of performance metrics continues to be of significant interest to investors. In light of this, the FRC has published this report to provide guidance on how to report performance metrics. The report covers the use of performance metrics in the investment chain, investors' use of performance metrics, the reporting of performance metrics, and the use of performance metrics in the investment chain.

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Financial Reporting Council



<https://www.frc.org.uk/getattachment/76e21dee-2be2-415f-b326-932e8a3fc1e6/Risk-and-Viability-Reporting.pdf>

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