THE 100 GROUP

A collective voice for the development of UK-based business

THE HUNDRED GROUP
OF FINANCE DIRECTORS

Looking ahead

What you need to know Autumn 2019

September 2019

The 100 Group briefing

Dear members of The 100 Group,

Welcome to the fourth edition of The 100 Group briefing for the financial year 2019.

Since our last edition, PwC has released our *Future of Audit* perspectives paper, which provides insights into how audit could evolve. This edition explores some of the findings from the public discussions which took place across the country, alongside an assessment of where change could be most usefully made.

We also address some of the key findings from our Annual Review of Corporate Reporting in the FTSE 350 which demonstrates how the approach to corporate reporting has changed, with many companies aiming to produce good quality, informative and useful narrative which is underpinned by their strategy.

And finally, Environmental, Social and Governance (ESG) matters remain firmly on the agenda with an article by David Marriage on the disruptive power of conscious investing.

I hope you find the briefing useful - please do let me know what you'd like to see more of in future publications.

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Looking ahead

The 100 Group briefing, *Looking ahead*, is a quarterly briefing commissioned by the 100 Group of Finance Directors. Its aim is to brief the Group on key developments in the capital markets and proposed changes in regulation and standards that might require response, lobbying, or which are important for general awareness.

For further information, please contact *Gilly Lord.*

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Key: M – Monitor R – Respond/React L – Lobby

Reporting

PwC's Annual Review of Corporate Reporting

In July, PwC released its annual review of corporate reporting in the FTSE 350. In over a decade of performing this review, it is clear the approach to corporate reporting on the whole has changed; increasing numbers of companies are aiming to produce good quality, informative and useful narrative that is underpinned by their strategy. However, the pace of change remains evolutionary rather than a revolution - and this year was no different. PwC's Richard Haig looks at this year's findings.

Significantly, the most notable change in reporting over the last cycle has related to companies addressing the "stakeholder agenda". In general, this has involved a greater focus on how companies consider their stakeholders, and some signs of response to upcoming regulatory reporting requirements, including so-called 'section 172 reporting'.

Some of the key findings from our review were as follows:

Length of the annual report

The report continues to grow, with the average document this year increasing by 8 pages to 182 pages in length. Much of this is a result of extended reporting in the financial statements, but new regulatory requirements continue to impact the "front-half" as well.

Forward-looking content

The proportion of companies setting out a strategic time frame in their report has fallen from 52% to 48%, and those setting out forward-looking trends for the markets in which they operate have dropped from 38% to 33%.

As we live in uncertain times, with disruption in the commercial world, it may be more difficult for companies to set out clear goals and plans. Yet it is exactly in these times that investors demand further clarity about the next steps a company may take.

Underlying change

Whilst overall the pace of change in reporting is slow, there are some notable changes. In particular, 65% of the FTSE 350 had made a change to their KPIs in recent years - often to introduce a new non-financial KPI or adjust a previous financial metric - and 27% of companies identified a change in their principal risks from the previous year.

In most cases it was unclear why the change had been made, but it provides some reassurance that companies are giving thought to their corporate reporting and how it reflects strategy and performance, rather than maintaining boilerplate disclosures.

Reporting (cont'd)

The non-financial information statement

The statutory requirement for a non-financial information statement was introduced for reporting periods beginning in 2017. But it was only in July 2018 that the FRC clarified the need for a specific statement, and issued guidance as to what was required.

Unfortunately only 62% of companies attempted to tackle this specific requirement (for a separate statement) in their report, meaning there are many reports that were not fully compliant.

Section 172 reporting

It was unlikely that many companies would adopt early the new reporting requirement for any large UK company to include a clear statement in the strategic report that explains how the directors have fulfilled their obligations under section 172 of the Companies Act 2006. The requirement is effective for periods beginning on or after 1 January 2019.

However, 22% of the FTSE 350 chose to make reference to section 172 in their report, with some going further and including official statements. This practice will evolve as the requirement comes into effect from the end of the year.

Stakeholder engagement reporting

Reporting against stakeholder engagement is the other key statement required for the next series of annual reports, effective for periods beginning on or after 1 January 2019. However, there was already a significant amount of change detected from our review.

The proportion of companies referencing stakeholder engagement leapt from 26% in the prior year to 82% this year, and in general there was a much heavier focus on stakeholders throughout the report.

However, many companies failed to take these disclosures to the next level and explain the outcomes of the engagement (25%) and crucially how they had responded to those outcomes (15%).

Group members may wish to familiarise themselves with this year's findings and revisit any new requirements as they enter the next reporting cycle, in particular where process change is required before appropriate content can be reported.

Investor engagement

Mindful asset management: The disruptive power of conscious investing

Investing in an ESG-compliant way is becoming mainstream. PwC's David Marriage looks at the increasing popularity of mindful asset management.

When we try to define disruption in the context of the financial services industry, it's easy to paint a picture of achingly innovative start-ups and complex technological developments threatening to shake up the practices we've become accustomed to.

That's certainly one face of disruption. But an equally powerful force of change is a growing awareness of how the way we live our lives is shaping the world around us, and therefore of the responsibility we bear: that we can't allow our desire to do well to stop us from doing good.

Mindful asset management becoming mainstream

Just a few years ago, investing in an ESG compliant way - that means in a way that follows a criteria prescribed by environmental, social and governance factors - was considered niche. But that's changed. It's becoming mainstream.

Television programmes like Blue Planet have honed our collective focus on issues around sustainability and preserving the diversity of the natural world. We've become acutely aware of our impact on the environment through high profile campaigns to discourage the use of disposable coffee cups and plastic straws. Generation Z, born between the mid-1990s and the mid-2000s, is emerging to be a demographic of change-makers, not shy to exert pressure on their older peers to be greener, socially responsible and more conscious of what ethical governance really looks like. Just think of Swedish teenager Greta Thunberg telling world leaders at this year's Davos WEF, in no uncertain terms, that they are imperilling her future.

The investment industry, and the public businesses that rely on the support, trust and endorsement of asset managers for their success, are sitting up and taking note. ESG is no longer a nice-to-have or a flash-in-the-pan gimmick. It's becoming the infrastructure upon which the global finance industry of the future is being built. It's a non-negotiable.

A new generation of asset managers

According to data compiled by financial services firm Morningstar, a record number of mutual funds and exchange-traded funds that are considered to be 'socially conscious' - so compliant with an ESG criteria - were launched by asset managers in 2018.

Likewise, the Global Sustainable Investment Alliance data shows over $30 trillion of assets were managed under sustainable investment strategies globally in 2018, up 34% from two years before.

The PwC Private Equity Responsible Investment Survey 2019 found that 91% of the 162 firms surveyed had adopted or are currently developing a responsible investment or ESG policy, an increase from 80% who said this in 2013.

Investor engagement (cont'd)

Norway's sovereign wealth fund, the largest sovereign wealth fund in the world, has been a pioneer in this regard. It's committed to only holding companies in its portfolio that comply with criteria that are broadly aligned with the UN Sustainable Development Goals. It publishes a regularly updated list of companies that are excluded from its investment universe, along with an explanation of why. These range from companies producing coal, coal-based energy or tobacco, to them being accused of seriously violating human rights.

What's facilitating this shift towards more mindful investing is that it doesn't have to be done at the expense of securing solid returns.

In fact, a meta-analysis by Friede, Busch and Bassen (2015) of over 2000 studies found that around 90% of the analysed studies reported a positive or neutral relationship between ESG rating and corporate financial performance. A University of Oxford meta-analysis (2014) on companies' ESG performance supports this, finding that in 88% of studies companies with robust sustainability practices had better operational performance, and in 80% of studies good sustainability practices had a positive impact on investment performance.

Looking ahead, the shift towards ESG-compliant investing is only going to gather pace. In fact, I wouldn't rule out the possibility of a future in which no major asset manager is prepared to invest in a company that has not explicitly committed to protecting the world we live in and championing ethical governance.

The UK leads the way

The UK Government, as part of its Green Finance Strategy published early in July, has already announced that it expects all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022. According to a UKSIF study (2018), integrating ESG factors into investment decisions has grown by 76% in the UK compared with 60% in Europe overall.

UK plc has already proved itself an international leader when it comes to switching to low carbon fuels and being more energy efficient when producing, transporting and consuming goods. While understandably firms involved could see this as a challenge, we should also hail it as an opportunity.

The asset management industry now has the power to provide companies with the incentive to cement that lead. It might not be disruption as we know it, but we'd be foolish not to take it seriously.

Responsible impact investment is an opportunity, not an imposition. Asset owners and managers use a number of tools, techniques and criteria to assess investment options. Group members may wish to think about how they share their ESG credentials with Investors, Analysts and the Market to ensure as broad an investor pool as possible.

Assurance

Future of audit: Update on current reviews of the audit sector

The audit matters, and it needs to evolve. That's the message PwC heard around the country as we opened up a public discussion on the future of audit. PwC's Rachel Price takes a closer look.

Last year PwC launched its Future of Audit initiative. We aimed to explore the broad issue of how auditing needs to evolve for the future, given indications that the audit had not kept pace with society's expectations. Since then we've run a programme of events across the UK to speak directly with those who have an interest in the audit. We heard the views of over 600 people in all – investors, business leaders, academics and representatives from the public sector – through a series of roundtables, an extensive survey, an online forum, and many individual conversations.

We've used these insights to write a perspectives paper that highlights the views we heard, as well as where we think the opportunities for change lie. The key themes that emerged from the debate were:

- Auditors must deliver consistently high quality audits.
- The audit and the entire corporate reporting system need to evolve to provide more insight into a company's potential risks.
- Greater assurance should be provided beyond a company's financial statements.
- In the time since the initiative was launched, Sir Donald Brydon has opened his independent review into the quality and effectiveness of audit. This is a positive step and we have shared the output from our Future of Audit initiative with him. We hope this paper will make a valuable and timely contribution to his review.

The UK has a world leading audit industry and it is critical that we continue to keep the conversation going about how to deal with the challenges it faces, and to explore in more detail some of the key ideas that have emerged so far.

You can download the full report, as well as a short summary, on our Future of Audit site at www.pwc.co.uk/who-we-are/the-future-of-audit.html.

Given the growing interest in this area, Group members may wish to read the report and engage on these issues as appropriate.