Restoring trust through the Resilience Statement

A PwC point of view and full illustrative example

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For questions on this paper, please contact:

John Patterson
Corporate Governance Specialist
john.t.patterson@pwc.com

Mark O'Sullivan
Head of Corporate Reporting
mark.j.osullivan@pwc.com

For any other questions relating to the proposals in the BEIS consultation, please contact:

Jayne Kerr
Director, Public Policy
jayne.l.kerr@pwc.com

PwC point of view

One of the most significant proposals from the Sir Donald Brydon review ("the Brydon review") that is taken forward in the BEIS "**Restoring trust in audit and corporate governance"** consultation (the Restoring trust consultation), and will now become a statutory requirement for Public Interest Entities (PIEs) with 750 or more employees and £750m or more annual turnover, is a 'Resilience Statement' that "incorporates, enhances and builds on the going concern and viability statements". Based on PwC's annual review of reporting practices in the FTSE 350, we fully agree that the time is right for changes in this area, and this paper is intended to help with that process.

What is 'resilience' and why is it important?

The term 'resilience' is not defined in the Restoring trust consultation but, between the Restoring trust consultation and the Brydon review that preceded it, it is clear that the focus is on the extent to which a company's going concern status and viability might be threatened.

In many instances, disclosures relating to going concern and viability should include some of the most significant information in the annual report. Indeed, when the viability statement was being introduced to the UK Corporate Governance Code there were those who suggested that a good viability statement would include almost everything an investor needed to know about a company. This hope has rarely been borne out in practice. Instead, the Brydon review noted that many respondents saw the current viability statement as "not so much a serious analysis of a company's future viability, but instead a piece of boilerplate supported by high level budget and cash flow forecasts…".

In the Restoring trust consultation, the Government (BEIS) particularly focuses on how the pandemic has created additional interest in 'resilience': "The experience of COVID-19 has further increased investor appetite for fuller and more meaningful disclosures by companies about how they are planning for potential future challenges. It has heightened expectations that companies will be able to explain how they are preparing to cope with liquidity, solvency and operational risks during a prolonged period of uncertainty".

This paper provides our view of the challenges that the Resilience Statement would need to overcome to be successful and how those challenges might be addressed. It includes an illustrative example that we've developed showing one possible approach to the Resilience Statement, tracing how a fictitious UK food manufacturer might report meaningfully on the changes in its business across three successive annual reports.

We would be delighted to discuss our ideas further with any interested party – please see our contact details on the previous page.

The Resilience Statement

The annual Resilience Statement will set out a company's approach to managing risk and developing resilience. It will incorporate companies' existing going concern disclosures and build on existing viability disclosures. It will require companies to report on matters they consider a material challenge to resilience over the short and medium term, together with an explanation about how they have arrived at this judgement of materiality. In doing so, companies will be required to have regard to a set of risks (as opposed to being required to address each risk, as was proposed in the consultation), including, for example, any materially significant financial liabilities or expected refinancing needs, significant accounting judgements or estimates that are material to the future solvency of the company, the sustainability of the company's dividend policy, and the impact on the company's business model of climate change. There will not be a minimum five year mandatory assessment period for the combined short and medium term sections of the Resilience Statement, as was originally proposed. Instead, companies will be obliged to choose and explain the length of the assessment period for the medium term section and describe how resilience planning over that period aligns with the company's strategy and business investment cycle. Our interpretation of the Government's response is that there will still be a requirement to set out what the directors consider to be the main long term challenges to the company and its business model.

Companies will be required to provide a minimum of one reverse stress test and disclose material uncertainties to going concern that existed prior to taking mitigating actions or the use of significant judgement, which the directors consider are necessary for shareholders and other users of the Resilience Statement to understand the current position and prospects of the business.

How different is this from the current framework?

Overall the Resilience Statement sounds quite similar to the existing model, but now incorporating the going concern statement, and being the equivalent of the two-stage approach to the viability statement that is currently set out in the FRC guidance on board effectiveness – the ‘assessment of viability’ being the medium-term element and the ‘assessment of prospects’ the long-term part.

BEIS’s focus on how a company would cope during another prolonged period of uncertainty such as the COVID-19 pandemic is new, and feels different from the usual approach to both the existing going concern and viability statements: going concern assessments tend to avoid very hypothetical scenarios (the stress tests in current going concern reporting almost always relate to the COVID-19 situation); and viability statements generally focus on the medium-term prospects for a company’s strategy and would generally not regard a pandemic-like event as sufficiently plausible to model. It remains to be seen how meaningful such disclosures of the potential impact of external events that are often seen as beyond a company’s control will be.

Two important challenges that the Resilience Statement will need to overcome

Whatever its merits, the Resilience Statement will be faced with two important challenges that affect forward-looking information in general. These include:

1. A widespread reluctance on the part of companies and boards to be specific about the nature and timing of their future prospects and plans, and a particular reluctance to look out beyond one year – partly to avoid teeing up future questions from the market, and partly to avoid the perceived legal risks attaching to disclosures if they turn out not to have been fully accurate; and
2. The need to avoid giving away commercially sensitive information. This is particularly relevant to information that relates to going concern and viability, where disclosing an issue can potentially become a self-fulfilling prophecy as customers and suppliers stop dealing with a company overnight. But there are also perennial challenges around where the boundary lies in general between information that should remain ‘internal only’ and what should be included in external disclosures.

Our practical suggestions for addressing these challenges

So, what might help the new Resilience Statement to move reporting forward?

First, as a general observation, UK companies and boards need to be given more confidence in their ability to provide forward-looking information in good faith without risking future litigation – the safe harbour protections in the Companies Act need to be promoted, tested and, if necessary, strengthened.

In relation to the details of the statement itself:

- Sir Donald Brydon proposed that the Resilience Statement should be "linked firmly to the directors' risk report", and the BEIS list of content areas that should be considered includes a number of areas of risk for companies to address. In our view, the Resilience Statement would be best positioned near the most relevant aspects of risk reporting in the strategic report, and could also be partially or fully integrated with them. Few existing principal risk and uncertainty disclosures (and much the same applies for emerging risk disclosures where these are included) feel as though they are written with the viability statement in mind, although the UK Corporate Governance Code makes an explicit link between the two. And principal risk disclosures are themselves often boilerplate statements that change little year on year. If the new model is to work, the Resilience Statement and the principal risks would need at least to be drafted together as part of a single unified process, so that there is an overall narrative that puts the risks and responses in their context and explains how significant each risk could be for the resilience of the business. Following on from this, there should also be consistency between the Resilience Statement and the critical accounting judgements and estimates note in the financial statements (and other notes to the accounts that deal with judgements, forecasts and ranges of outcomes): more explicit connections can and should be made across all three disclosures.
- In our view, the Resilience Statement model should start from a company's strategy and the business issues and risks that it entails, and bring in the timeline – not vice versa. The Sir Donald Brydon review states that although "the future can be broken down into different time periods about which the directors should be able to make statements with varying degrees of confidence [i.e. the short, medium and long-terms]… it would better inform users of financial statements if these three time periods were brought together to form a coherent view of the future…". A statement that focuses on a full description of the nature and extent of the risks, bringing in and explaining the expected timing as part of this, is, in our view one of the best ways to get to such a coherent view. This approach would allow companies to recognise more easily that a single issue can have short, medium and long-term aspects. It also has the potential to allow a far more coherent narrative to be built up year-on-year, giving an update on how issues are developing that is not bound to a largely time-based going concern/viability structure.

Using these observations as our starting point we have set out below, for illustrative purposes only, one form that a Resilience Statement disclosure could take in practice, and included comments on the thought process that lies behind it.

Those who remember the discussions leading up to the introduction of the viability statement will recall that it was originally intended to focus on risk rather than confirming 'viability' over a particular period, but that this was seen by some as not sufficient to hold directors to account. No doubt the balance between reporting on risk and the need for (and content of) formal statements or confirmations will again be debated in relation to the Resilience Statement. Changes to reporting always depend on the quality of the drafting of the requirements and on how well they are communicated, and we believe that will be particularly true in this case. We are not convinced, however, that simply switching the statement to being a statutory requirement (as opposed to being driven by the Code) will be enough to change behaviours – it will be necessary to focus on achieving proper buy-in to the value of any new disclosures as well.

About the illustrative example

Our illustrative example is based on a fictitious UK-based food manufacturer, ABC Food Manufacturers. The matters discussed are relevant for the industry but it is just an illustration, so readers should focus on the form of the disclosures rather than the specific details of the scenario. Our illustrative example is laid out in a generic format, but in practice the disclosure would be produced in line with the specific company's branding.

A full disclosure is included for year one (the year ended 31 December 2020) of a three year period, with relevant extracts also included for years two and three. We believe that it can be extremely helpful to the understanding of a company's strategy, risk and response for a narrative to be built up over a number of years, including recognition of what has changed about the board's view year-on-year, and why. Such an approach is likely to create a deeper understanding of the opportunities and challenges facing a company and reduce the risk of bad news being misunderstood or having an exaggerated effect. In our example the company moves from the time immediately after a major piece of M&A through to a material uncertainty over a number of years and the disclosures track how the situation develops and is explained over the period.

The key elements of our example Resilience Statement are as follows:

- Strategic context
- Related risks and priorities
- Management actions
- Board actions
- Board view – impact on resilience.

The formal confirmations then follow from page 15 taking the form of confirmations based on the information already provided and cover each of the relevant timeframes (note the confirmations are based on the timeframes suggested in the original Restoring trust consultation). The formal confirmations could of course be made first, with only minor amendments to the language in them.

The two appendices are not intended to be part of the annual report disclosure. They relate to:

Appendix 1 – Potential website content setting out the standing procedure that a board could use to assess resilience.

Appendix 2 – An internal template for a board paper that could be used to document a board's assessment.

We are aware that the illustrative example might appear lengthy; our priority has been to show the level of transparency that would be involved if these disclosures are to be meaningful – and it should be remembered that this would cover many of the more important aspects of the strategic report.

Illustrative example of a Resilience Statement

Year one – Year ended 31 December 2020

Resilience Statement of ABC Food Manufacturers

A Approach and process used by the board

In order to assess the future prospects and resilience of the company, including the long-term sustainability of the business model, the board looked in detail at the following matters during a specific session dedicated to considering resilience at the 2020 strategy day, when the company's refreshed strategic pillars for the next five years (as set out on page [x] of the strategic report) were agreed. 1 2

Taking as its starting point the risk register and principal risks and uncertainties arising from the systems of risk management and internal control, the board used an established and consistent approach to inform its discussions – this approach is outlined on the company's website. 3

The discussion on resilience at the 2020 strategy day is summarised below, along with the actions taken by management and the board to address the matters discussed and the board's current view of them at the time of approving the annual report. The board has reconfirmed that no new relevant matters have arisen since the strategy day. 4

1 This assessment could of course be carried out on other occasions and/or by other means, as long as it provides the appropriate opportunity to consider the issues.

2 The board's focus here will be on the company's strategic plan. The quality of the underlying risk management and governance processes could be addressed at the same time but are more likely to be considered separately as part of the annual review of effectiveness of the systems of risk management and internal control, for instance.

3 See Appendix 1 of this paper for an outline of the approach used and Appendix 2 for the board's internal paper applying it in the relevant year.

4 Where there are new factors to consider they would need to be added, with an explanation of how they have arisen and are being managed.

B Analysis of factors relevant to the company's resilience

Factor 1 – Building scale and margins

Strategic context 5

A key strategic goal for the business is to move to tier 1 supplier status with a number of our key supermarket and wholesale customers. This should mean increased negotiating power and an opportunity to improve trading margins. We are targeting this through organic growth in business units [X] and [Y], but M&A activity is also a priority. We expect it to take three to five years from now to achieve this status with most of the relevant customers. 6

The major acquisition during the year was the [A] Group business. This adds significantly to our scale in business unit [Z]. It also helps us infill our existing range, supplementing our existing New Product Development ('NPD') activities. Further M&A activity is planned to follow.

Related risks and priorities

a. Achievement of synergies 7

The business is subject to new debt covenants as a result of the debt funding associated with the major acquisition in the year. In order for the expanded group to stay within the covenant ratios, it is important for us to achieve the synergies we have targeted in good time, and also to develop the combined businesses according to plan.

The synergies are forecast to be achieved from 12 months post-acquisition. The initial steps in the plan have already been taken, including the announcement of the restructuring of manufacturing in business unit [Z].

Information on the maturity of debt can be found in note [x] to the financial statements. The covenant ratios are set out in the financial review, along with comments on how we have performed against them in the first six months. Indications so far are that the ratios are challenging but reasonable based on the overall business plan.

Our overall business plan includes (on a rolling annual basis) a short to medium-term plan covering years one to three, and a medium to long-term plan covering years four to five. Matters beyond that horizon are also considered by management and the board on a more qualitative basis or, where appropriate, through separate quantitative analysis.

Although there is some crossover between this disclosure and the likely contents of the principal and emerging risk disclosures, the value that this form of resilience disclosure adds is that it explains the significance of the matters considered and how they are interconnected.

The factors discussed in our illustrative example are based on the circumstances of the industry in 2020/21. To bring the example fully up to date the following concerns could also be discussed in the same way:

Supply chain continuity: following on from factor 2 in our example, wider issues have now arisen across the supply chain.

Inflation: these wider supply chain issues and a range of other macroeconomic developments have led to increases in the price of commodities, energy and labour that are affecting margins and prices very significantly.

5 The headings in this illustration are not mandatory but we believe they could generally be a useful framework to consider.

6 References to the relevant timeframes are included throughout the matters discussed. The formal confirmations then relate back to this information. In practice these links could be made in different ways and in different levels of detail.

7 The headings at this level will depend on the specific circumstances of each business.

b. Wider development of the business

We also need to build the wider business through organic growth and leveraging our additional scale. This forms part of the overall business plan for the next five years shared with the lending syndicate, including specific targets for market share and trading margins.

c. Availability of suitable M&A targets

We have developed a pipeline of possible projects over the next three years, though there is always a risk that others will move first, given the importance of scale to the industry.

d. Availability of finance

As we implement our strategy it is possible that amendments to the plan caused by new opportunities or delays could result in a need to raise additional finance. Some of our facilities will also come up for renewal during the period of the current strategy, starting with the [A] Notes in year four (2024).

Operating outside the covenant ratios set for the business for an extended period would be likely to result in a need to renegotiate debt covenants and/or raise additional equity finance.

Any significant failure to deliver on our strategic goals could also affect our credit rating, making additional finance more costly (or ultimately impossible) to obtain.

e. Business interruption

Significant interruptions to the business (such as uninsured major health & safety related events or food safety issues, cyber attacks or matters outside the control of the company like COVID-19) could have an impact on trading performance sufficient to affect covenant compliance.

Management actions 8

- The overall business plan was developed with advice from [Advisory Firm A], taking into account the results of other M&A activity in the industry.
- A programme of internal audit reviews has been established to test the data used in the tracking of the synergies for the first 12 months. Any revisions to our internal policy will be agreed with the audit committee.
- Detailed key performance indicator (KPI) and key risk indicator (KRI) measures have been established to allow progress against the delivery of the business plan to be tracked, and corrective actions taken if necessary.
- Each of the operational and financial priorities indicated by the lending syndicate are separately identified in the plan and tracked by management.
- As they are key to the initial delivery of the plan, the synergies are subject to specific risk indicator thresholds that escalate issues to the executive committee and ultimately the board.

8 The management actions and board activities content are part of setting out the mitigating activities that result in the net risk relating to the matters discussed above.

- Management has carried out stress testing on the delivery of the overall business plan using a number of severe but plausible scenarios. 9 10
  - Scenario 1: [a-b]% of the synergies not achieved in year one and [x-y]%in year two, equating to approximately a three month delay overall; organic growth in business unit [x] revenues is zero in year one and [x]%in year two; trading margin is reduced by [x] percentage points due to unplanned increase in ingredient prices; food safety issue causing significant damage to brand [b].
  - Scenario 2 etc…
- Reverse stress testing has been carried out to determine the extent of financial change that would threaten the business, along with an assessment of how this could most realistically happen in practice and the likelihood of this occurring. Two scenarios have been used, one based on a major downturn in the business affecting organic growth and one based on a major operational issue.

9 More details and the results of the stress tests and reverse stress testing are included in the **board view – impact on resilience** section below.

10 The details of stress tests become more meaningful when put in the context of the overall strategy.

Board activities 11

- On behalf of the board the audit committee assessed the effectiveness of the risk management systems on which the above analysis was based, and the effectiveness of the controls around budgeting and forecasting and synergy tracking in particular.
- The board as a whole considered the outcome of the scenarios tested in the stress testing and assessed the likelihood of the potential issues used in the reverse stress testing.
- The board also considered at each of its meetings the ongoing relationship with the lending syndicate, including the plans for delivering on its priority areas.

11 In this example the outcomes of the various board activities are picked up in the board view section below, but more could be said here about the board's challenge of management, for instance.

Board view – impact on resilience 12

The company is still in the early stages of its refreshed strategy and of the financing arrangements around the major acquisition in the year, but these developments represent a significant step up in our risk appetite, particularly around the increased leveraging of the balance sheet. The covenants mean that we need to trade in line with our business plan over the next 12 months, so it is important that the business delivers on the forecast synergies without significant lag.

Our view is that the plans in place to deliver on the overall business plan and strategy over the next three to five years are sound (including the risk management and internal control arrangements), and that reasonable contingency plans are also in place in the event that the plan needs to be flexed. The financing arrangements we have taken on to date are manageable and contain no unusual terms or conditions.

12 This is the key opportunity to draw the strands together and explain the board's overall judgement.

The results of the stress testing showed that additional management action would be needed by the second half of 2022 if scenario 1 occurred. The initial actions to address this (which would also be needed to stay within the related covenant tests) would most likely focus on delaying certain marketing activity and rephasing the ongoing programme of improving the energy efficiency of plant and equipment at our older sites. The most challenging reverse stress test was carried out by sensitising several specific parameters such as net revenue, EBITDA and free cash flow individually. This demonstrated that an [x]% fall in net revenue would be the first factor to affect overall solvency. The board noted that this would in effect equate to the loss of two of the top four customers. All stress testing is carried out in the context of a number of uncertainties, some of them relatively short-term, that are discussed further below.

Overall, the refreshed strategy is vital to the ongoing sustainability of the business model in that it prepares us to face the generally more medium to long-term challenges that are identified below. 13 It is also vital to our ability to cope successfully with a long period of uncertainty, such as that experienced in connection with the COVID-19 pandemic. Our business is inherently resilient in such circumstances as an important part of the UK food industry. 14

13 This recognises the connections between the more 'external' issues that follow and the resilience of the business model and strategy.

14 This addresses one of the drivers for the Resilience Statement referred to in the Restoring trust consultation paper – the need for companies to be able to explain how they would deal with a new period of uncertainty.

Factor 2 – Brexit and the workforce

Strategic context

The UK food industry has historically relied heavily on the availability of seasonal labour, much of it from overseas in some areas.

The company's workforce (including agency staff) includes up to [x]% on short-term contracts from EU countries. [y]% of the permanent workforce are also from other EU countries, primarily Eastern Europe.

Related risks and priorities

The seasonal workforce caused significant reputational risk in the past, but much has been done to address this in recent years so that the risk from 'gangmasters' is now seen as low.

However, it appears likely that Brexit will at least cause more cost and delays in the process by which seasonal labour from the EU can be employed, if at all. There is also a risk that members of the permanent workforce who originate from other EU countries will decide to leave the UK.

Management actions

- Management, as part of the main industry bodies, has kept in close touch with the Government on the seasonal workforce matter and made the potential implications clear. Other sources of labour have been explored by the company's Brexit planning group.
- The HR function has developed a programme through which permanent workers from the EU have been engaged with, supported, and encouraged to stay in the UK where appropriate.
- Additional costs of labour have been built into the short and medium-term business plans and the executive team monitors the situation on a monthly basis.

Board activities

- As well as the strategy day discussions the board has received regular reports on management's contact with Government and on the pattern of EU citizens leaving during the current transitional period.
- The financial impact of this issue, and the projected availability of the seasonal workforce are reported to and discussed at each board meeting.

Board view – impact on resilience

Notwithstanding the high-level agreement reached at the end of 2020, the uncertainty connected with Brexit in the food industry continues to be significant and the final outcomes will depend on the UK's relationship with individual EU Member States. These issues have the potential to become very significant for the sustainability of the business model in the medium-term [15] but there is also a short-term concern about the 2021 season. The operational and cost implications of the seasonal labour issue in particular could go beyond those included in our plans, and the situation is being monitored as closely as possible.

15 The reference to the medium-term here is not specifically defined, because to do so would imply more transparency on the issue than the company is likely to have.

Factor 3 – Changes in the UK grocery market

Strategic context

The UK retail grocery market has seen significant innovation in recent years, and further changes – potentially more fundamental – are likely to occur in the short to medium-term. The company needs to have appropriate regard for these changes and the direct and indirect effects on the business. They represent opportunities as well as risks, but they do make it more challenging to forecast accurately, particularly in the medium to long-term.

Related risks and priorities

a. New bricks and mortar entrants to the market

There have been a number of new, generally low-cost entrants to the UK grocery market in recent years. These have already had an impact on price negotiations with existing supermarket customers and could increase in significance over time. Other new entrants could also emerge.

Where an issue affects our ability to achieve prices with our customers, this will often have a knock-on effect on our negotiations with suppliers. The new entrants have also directly affected the supply chain within the UK industry by introducing new sources of product to meet their price points.

b. Technological change and other new entrants

The grocery market has also been affected by wider changes in retailing, and particularly the move from bricks and mortar stores to online. The distribution centres operated by the major supermarkets insulate us to some extent from the effects of store closures and the increasing use of online delivery services, but we need to ensure we build appropriate working relationships with the major online retailers who are moving into the grocery market, including Amazon.

Management actions

- A cross-functional working group has been in place for several years, modelling the future trends in the market and directing our response.
- The strategy embedded in our five-year business plan to increase scale and margins also addresses this issue and includes targets for working with the new entrants.
- This area is not currently covered by the stress testing of the short-term element of the plan discussed above as the projections are subject to more uncertainty, but the cross-functional group has carried out separate quantitative analysis.
- The structural changes in the market are also a focus for the lending syndicate so our response is part of the regular quarterly reporting to them.

Board activities

- As well as the strategy day session, the board receives regular reports on the cross-functional working group from executive management. We requested a specific analysis of Amazon's relationship with the company's main competitors for our meeting in June.
- The board also receives regular updates on the lending syndicate's view of progress.

Board view – impact on resilience

The business needs to keep on top of the structural changes to the market and we are satisfied with the plans to build relationships with the bricks and mortar entrants and the related targets.

The rise of online only retailers could fundamentally change the customer base of the business and this could happen relatively quickly, given the rate of take-up among consumers of online shopping generally – something which the pandemic has emphasised. Projections are included in the later years of our business plan, but the situation with them is harder to model. The board believes that appropriate consideration has been given and planning done, however. No major additional capital requirements are envisaged at this stage.

Factor 4 – Climate change

Strategic context

As it is for business in general, climate change is relevant to the prospects of the company in a number of ways, over different time frames. In the short-term there could be direct financial effects from new levies or taxes, and we have already seen other direct implications such as business interruption caused by extreme weather events. Supermarkets are also looking to their supply chains to take positive action as they come under pressure from their own retail customers.

Related risks and priorities

a. Energy efficiency of plants

Our factories are in some cases relatively old buildings, reflecting the history of the business – particularly site [A]. Although we have a programme in place to improve their energy efficiency, there is still more that can be done and it is possible that Government action will mean this must be done sooner than our business plan envisages. 16

16 Again, this disclosure avoids implying more transparency on the issue than the company is likely to have.

b. Location of plants

Some of our factories are located in areas that were originally chosen because they were particularly suitable for growing crops that we use in our products. Changing weather patterns, including flooding, are already causing yields to fall in some areas, and in the longer term the climate may affect our supply chain by making it uneconomical to grow certain crops in, for example, the East of England.

Management actions

- Contingency planning and insurance is in place for short-term business interruption.
- Short-term measures have been taken to improve the efficiency of the existing infrastructure.
- Assurance is obtained on our ongoing energy use and other sustainability related data.
- As well as the ongoing efficiency measures, the medium-term business plan includes provision for a programme of major plant overhauls.
- Our partnership with the University of [X] is looking at the future in the UK of a number of key ingredient crops, and supply chain alternatives.
- Where applicable, these matters are being factored into a stress testing model on the resilience of our strategy to different climate-related scenarios, including a 2° Celsius or lower scenario, in preparation for full reporting against the Taskforce on Climate-related Financial Disclosures ('TCFD') framework.

Board activities

- As well as the strategy day discussion, several members of the board are members of Chapter Zero, a directors' climate forum in the UK, and have brought insights from that group to the company.
- The board was closely involved with the development of the short and medium-term business plans including the timing of the actions already taken to improve energy efficiency, and the planned overhauls.
- Regular updates on the University partnership work are provided to the board by executive management.

Board view – impact on resilience

The short-term impacts of extreme weather events are significant but should largely be covered by insurance, so the most immediate direct effects are likely to be the need to carry out major overhauls of some of our plant and equipment. These are factored into the business plan and financial forecasts over the next five years, funded through a combination of scale and margin growth and our existing debt facilities – emphasising again the importance of delivering on the early part of our refreshed strategy, including acquisition synergies.

The longer term implications of climate change could be very significant for the current heavily UK-based business model and management and the board are monitoring this closely as the situation develops, including the outcomes of TCFD scenario tests. Any actions required (such as any longer term need to relocate operations) are currently envisaged as being beyond the strategic planning period.

Factor 5 – Demographic change

Strategic context

The company's brands are long-established British institutions and approximately [x]% of our customer base is aged over 60. Changes to life expectancy are therefore good for us, but it is also important to develop broader and deeper appeal to younger customers. This is directly relevant to our ability to increase scale and become a tier 1 supplier over the next three to five years.

Related risks and priorities

Our products need to continue to reflect the move among much of the younger population towards healthier eating, as well as our responsibilities to our existing customer base.

We need to develop and successfully market new products that will appeal to the younger population, or acquire them through our M&A programme.

In some instances our products will also need to adapt to respond to Government requirements to reduce their sugar and salt content.

Management actions

- The acquisition strategy helps to address this issue to some extent, as it gives us a wider product range.
- Investment in NPD has been increased in the business plans and a new development kitchen facility has already been installed at site [x].
- Salt and sugar have been reduced across the product range and targets for further reductions are in place.
- Where we don't produce our own ingredients, ethical sourcing is now a priority for our procurement team.
- NPD is another area of interest for the lending syndicate, and regular reporting is provided to them.

Board activities

- As well as the strategy day discussion the board receives regular reports on brand demographics and NPD activities, as well as the lending syndicate's views on progress.

Board view – impact on resilience

This is clearly a vital set of issues in the medium to long-term, which management has in hand and the lending syndicate and board are closely monitoring.

C Formal confirmations

The content of the formal confirmations reflects the wording of the Restoring trust consultation paper. It is expected that these would be largely standard, with company-specific cross-references and matters highlighted as necessary, as shown below.

Short-term resilience

Having considered all of the matters set out above, and factors 1 and 2 in particular, the board believes it is appropriate to prepare the financial statements on the going concern basis. 17 18

No material uncertainties were identified and there were no matters that were decided by the board not to be material uncertainties after the use of significant judgement and/or the introduction of specific mitigating action. 19

Medium-term resilience – five years from 1 January 2021 20

The directors confirm that on the basis of the above assessment of the company's prospects and resilience, including the results of the short and medium-term stress testing described in factor 1), they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over a period of five years from 1 January 2021. 21

There were no other matters that the directors judged necessary to report in relation to short or medium-term resilience, including in relation to digital security risks (see page [x] for more information) or the sustainability of the company's dividend policy. 22

17 This confirmation language is important as it reflects the fact that the front half disclosures on going concern do not go beyond the IAS 1 requirement.

18 The assessment of going concern should also take into account all available information about the future, and the disclosures above explain where information is potentially relevant to this assessment.

19 This part of the confirmation relates to the proposed requirement that 'close-calls' for material uncertainties should be disclosed.

20 The Restoring trust consultation paper proposes to mandate a five year time period for the medium-term confirmation.

21 It is not specified in the Restoring trust consultation whether the period would be expected to start from the beginning of the next financial year or the date of signing the annual report for the previous year.

22 This approach would allow companies to explain when items are not relevant to their assessment of resilience. In this case, for example, digital security risk might have been dealt with in the disclosures of risk management and internal control, and dividends might not have been paid for some years.

Long-term resilience

The matters above, and factors 3 to 5 in particular, reflect the directors' assessment of the long-term challenges to the company and its business model, and how these are being addressed.

External auditor reporting 23

The company's Audit and Assurance Policy sets out the directors' approach to obtaining independent assurance in respect of certain aspects of the above disclosures and statements including [list], but none of them forms part of the financial statements on which the auditors express their opinion. 24

The auditors' report sets out their views on the directors' decision to use the going concern basis of accounting in preparing the financial statements.

23 This is not mandatory reporting, but could be a useful reminder to readers about which aspects of the content above were assured, and in what way.
The BEIS requirement for companies to establish an Audit and Assurance Policy is also included in the Restoring trust consultation.

24 This language makes it clear that the Resilience Statement itself is not subject to audit. The company's adoption of the going concern basis of accounting (and the need for disclosure of any material uncertainties) is subject to audit, but this relates to the choice of the going concern basis of accounting for the financial statements, not the Resilience Statement disclosures.

Year two – Year ending 31 December 2021

Resilience Statement of ABC Food Manufacturers

Factor 1 – Building scale and margins

Board view – impact on resilience

What we said last year 25

Because the company was still in the first year of the refreshed strategy and had only recently entered into the new financing arrangements for the [A] Group acquisition it was too early to tell how well the business would perform against the five-year plan. We noted that the increased leveraging of the balance sheet represented a significant step up in the company's risk appetite and that it was vital for the business to deliver on the forecast synergies without significant lag if it was to stay within the lending covenants. This was confirmed by the initial stress testing we undertook.

Current position

The planned synergies have been slower to come through than forecast and, although the organic growth achieved in business units [X] and [Y] has been above budget, the group traded outside the interest cover covenant in the second half of 2021. The lending syndicate agreed to waive the interest cover covenant for the relevant quarters and trading has improved in the first quarter of 2022. Relationships remain positive and we have kept in close touch with them throughout, including on our progress with all their areas of particular focus in the business plan. The board considered whether this situation represented a material uncertainty for going concern purposes but judged that it was not, due to the improvement in performance in Q1 2022 and the forecasts for the rest of the year. 26

We continue to believe that the overall business plan and strategy are sound (including the risk management and internal control arrangements), but it is clearly very important both that the synergies are now achieved in line with budget and that business units [X] and [Y] continue to perform well. The results of this year's stress testing again confirmed this view.

As we reported last year when the refreshed strategy was established the medium to long-term sustainability of the business model also depends on its success and we again report below on the other matters most relevant to it. Our strategy also remains vital to our ability to cope successfully with a long period of uncertainty, such as that experienced in connection with the COVID-19 pandemic. Our business continues to be inherently resilient in such circumstances as an important part of the UK food industry.

In year 2, disclosures similar to those above (around **strategic context, related risks and priorities, management actions** and **board activities**) would be given, updated for the year two position in each area and any new factors. In our example of year 2, only the **board view** sections and an amended **short-term resilience confirmation** and **external auditor reporting** section have been given, to illustrate how this model could work in the event of a 'close call' that was close to being a material uncertainty for going concern purposes.

25 This kind of year-on-year narrative around the relevant matters could be a valuable part of building support for a board's approach.

26 This is the disclosure of the board's judgement about the potential material uncertainty.

Factor 2 – Brexit and the workforce

Board view – impact on resilience

What we said last year

We were still in the transitional period this time last year, so there was still significant uncertainty around the impact both on our seasonal workforce and on those EU citizens who would have the right to remain in the UK – together these formed a significant proportion [x]% of our workforce. We had factored operational and cost implications into our business plan, though very much on an estimated basis. The seasonal labour issue was regarded as of the most immediate concern.

Current position

Further temporary measures for the seasonal labour have been put in place by Government, partly on the basis of industry lobbying, so the uncertainty discussed last year remains in the medium-term, but the short-term risk has fallen. The business plan continues to reflect our best estimate of the ongoing impact.

Factor 3 – Changes in the UK grocery market

Board view – impact on resilience

What we said last year

We noted the significant structural changes affecting our customers in the UK grocery market. We were confident in our plans to build our position in the short to medium-term with the new bricks and mortar entrants, but saw the risk of online only retailers as harder to manage and plan for. No major additional capital requirements were envisaged, however.

Current position

Plans have progressed well with our new customers and our general scale and margin initiative also helps with those relationships.

The development of online only grocery retailing also continues but is still restricted to the major urban centres, and our products form only a very small proportion of the business being done. This is still a potentially highly significant development in the medium to long-term, however, and management's cross-functional working group continues to report to the board regularly.

Factor 4 – Climate change

Board view – impact on resilience

What we said last year

We were satisfied that our planning for the short-term impacts of, for example, extreme weather events was appropriate and would manage our exposure. There was, however, a direct connection with the strategy to grow scale and margins to cover the plan to overhaul our older sites to increase their energy efficiency (and potentially to meet the Government targets that were widely expected). We were also working on some very significant longer term implications for our business model associated with the economics of growing certain crops in the parts of the UK in which our plants are situated.

Current position

The flooding around location [B] in 2021 meant that production and deliveries from the site were significantly affected for a period of [x] weeks. As we have reported, the direct financial impact was covered by insurance. The reputational impact was well-managed by the executive team, and must be seen in the context of the wider disruption to the region.

Work continues with our academic partners on the longer term implications of climate change for agriculture in the UK.

As noted above in relation to emerging risks and management actions the group outsources its logistics and transport needs, but Government action on diesel vehicles could have a knock on effect on costs which are being discussed with our partners. Similar action in relation to diesel plant has been factored into our business plan.

Factor 5 – Demographic change

Board view – impact on resilience

What we said last year

Although the long-established nature of most of our brands is positive in many ways, we also need to remain relevant and attractive to the younger market. We noted last year how our acquisition strategy was intended to help broaden our range, supplementing our existing NPD programme.

Current position

The [x]% growth of brand [C] following the TV campaign in March and April 2021 demonstrated that our plans are on track. As further acquisitions occur we expect to be able to repeat this process. The board continues to monitor our market share and demographics closely.

Formal confirmation

Short-term resilience

As noted in factor 1 above, the group did not trade in line with its interest cover covenant for the second half of 2021 but trading has improved in the early part of 2022 and forecasts indicate that this will continue. 27

Having considered this and all the other matters set out above, the board believes it is appropriate to prepare the financial statements on the going concern basis.

No material uncertainties were identified.

External auditor reporting

The company's Audit and Assurance Policy sets out the directors' approach to obtaining independent assurance in respect of certain aspects of the above disclosures and statements including [list], but none of them forms part of the financial statements on which the auditors express their opinion.

The auditors' report sets out their views on the directors' decision to use the going concern basis of accounting in preparing the financial statements. It also includes a Key Audit Matter in relation to going concern due to the matters relating to covenant compliance discussed above. 28

27 Follows on from the disclosure above of the board's judgement about the potential material uncertainty.

28 This recognises that the auditors are likely to draw attention to the work done on going concern to establish that it was correctly not judged to be a material uncertainty.

Year three – Year ending 31 December 2022

Resilience Statement of ABC Food Manufacturers

Factor 1 – Building scale and margins

Board view – impact on resilience

What we said last year/in previous years

We noted the delays in synergies following the [A] Group acquisition in 2020. Although there was encouraging organic growth in business units [X] and [Y], this had meant approaching the lending syndicate to waive the interest cover covenant in the last quarter of 2021 and we were clear that the synergies must be achieved in line with budget during 2022 and that business units [X] and [Y] must also continue to perform well.

Current position

Although the planned synergies have now largely been delivered, trading in business units [X] and [Y] has not continued to grow according to our projections. Alongside this, the price of several of the ingredients used by the [Z] business unit has risen substantially as a result of movements in the world market. Together, these issues have meant that we have been trading outside the covenant ratios for the second half of 2022 and to date.

In order for the lending syndicate to continue its support, the board is now planning a rights issue in May 2023. As well as strengthening solvency and liquidity, the proceeds from this would be used to ensure we continue to address the medium to long-term issues discussed above, including the structural changes in the market and the impact of climate change on our business model.

We continue to believe that the overall business plan and strategy are sound and we are satisfied that our risk management and internal control arrangements have meant that the executive team has been able to keep the board and the lending syndicate fully apprised of the position throughout the year.

At the time of approval of the annual report and financial statements the rights issue has not been completed, though plans are well-advanced on a fully underwritten basis. As a result this has been disclosed as a material uncertainty in note [x] to the financial statements.

In year 3, disclosures similar to those above (around **strategic context, related risks and priorities, management actions and board activities**) would be given, updated for the year three position in each area and any new factors. In our example of year 3 only the **board view** section for **1) Building scale and margins** and an amended **short-term resilience confirmation** and **external auditor reporting** section have been given, to illustrate how this model could work in the event of a major issue resulting in a material uncertainty for going concern purposes.

Formal confirmation

Short-term resilience

As noted in factor 1 above, the directors do not currently have finance in place to ensure that the business can operate for a period of at least twelve months from the date of approval of the financial statements. Although they believe it is appropriate to prepare the financial statements on the going concern basis, they have therefore explained the related material uncertainty in note [x] to the financial statements. 29

There were no matters that were decided by the board not to be material uncertainties after the use of significant judgement and/or the introduction of specific mitigating action.

29 As noted earlier, the accounting basis is the element subject to audit under ISA (UK) 570 currently.

External auditor reporting

The company's Audit and Assurance Policy sets out the types of assurance obtained by the directors in respect of certain aspects of the above disclosures and statements including [list], but none of them forms part of the financial statements on which the auditors express their opinion.

The auditors' report sets out their views on the directors' decision to use the going concern basis of accounting in preparing the financial statements and on the material uncertainty described in note [x] to the accounts. 30

30 A cross-reference to the material uncertainty disclosure that would be included in the audit report.

Appendices

Appendix 1 – Example website content on resilience assessment

Resilience Statement – approach used

A statement like this on a company's website would reduce the need to explain in detail the process used in the assessment of resilience.

1. This statement sets out how the directors assess the resilience of the company and its business model, including:
    - The company's access to sufficient finance in the short-term
    - The probability of the company's survival in the medium-term (defined as five years for this purpose), based on its current forecasts
    - Longer term threats to the business model.
2. This approach is used consistently year-on-year, subject to any updates approved by the board.
3. Robust financial forecasts are used in relation to the short and medium-term assessments, and are subject to appropriate scenario and stress tests, including reverse stress testing.
4. In carrying out their assessment of resilience the directors consider the following in the light of the company's ongoing strategy and the major developments in the business during the year:
    - The principal risks and uncertainties
    - Any emerging risks that have been identified
    - Risks that have already crystallised
    - Other matters, often beyond the company's control, about which they need to make assumptions.
5. When making their judgements in relation to these the directors consider, where applicable:
    - The time horizon associated with the relevant matter
    - The extent to which a matter can be quantified, as opposed to needing to be assessed on a qualitative basis
    - The degree of flexibility available to the company to adapt or take other actions
    - Whether capital or other financing is held to address the matter
    - The effectiveness of the relevant aspects of the control environment
    - The assurance available to the board.
6. The matters set out in the legal reporting regulations that established the Resilience Statement are also considered each year and incorporated into reporting as required. These include:
    - threats to liquidity, solvency and business continuity in response to a major disruptive event (such as a pandemic) which disrupts normal trading conditions;
    - supply chain resilience and any other areas of significant business dependency (e.g. on particular markets, products or services);
    - digital security risks (both including external cyber security threats, and the risk of major data breaches arising from internal lapses);
    - the business investment needs of the company to remain productive and viable;
    - the sustainability of the company's dividend and wider distribution policy; and
    - climate change risk.
7. The audit committee takes the lead on behalf of the board in relation to the Resilience Statement disclosure in the annual report, which reflects the approach above.

Appendix 2 – Example internal paper supporting the Resilience Statement

This example paper, being internal, would contain more detail on the executive team and board's views on the issues than is carried through to the external disclosures above. It would also be available to the auditors. The factors shown are those from the illustrative example included in this document.

Matters considered most relevant to resilience:	Building scale and margins: Achievement of synergies	Building scale and margins: Wider development of the business	Building scale and margins: Availability of finance	Building scale and margins: Business interruption
Time horizon				
Quantitative/ qualitative				
Degree of flexibility available				
Capital/financing position				
Implications of control environment				
Going concern or longer term resilience (or both)?				
If going concern, material uncertainty indicated?				

Matters considered most relevant to resilience:	Brexit and the workforce	Changes in the UK grocery market: New bricks and mortar entrants	Changes in the UK grocery market: Technological change and other new entrants
Time horizon			
Quantitative/qualitative			
Degree of flexibility available			
Capital/financing position			
Implications of control environment			
Going concern or longer term resilience (or both)?			
If going concern, material uncertainty indicated?			

Matters considered most relevant to resilience:	Climate change: Energy efficiency of plants	Climate change: Location of plants	Demographic change
Time horizon			
Quantitative/qualitative			
Degree of flexibility available			
Capital/financing position			
Implications of control environment			
Going concern or longer term resilience (or both)?			
If going concern, material uncertainty indicated?			

Notes

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