Deloitte.

Channel Islands Annual Report Insights Survey
The highlights

Contents

1. Executive summary	**3**
2. Introduction and survey objectives	**5**
3. Understanding the basics	**7**
4. The Extended Audit Report	**9**
5. The Strategic Report	**11**
6. The Remuneration Report	**13**
7. Shareholder engagement	**14**
8. Audit tenure	**15**
9. Valuation disclosures	**17**

1. Executive summary

The listed market continues to be very important for the Channel Islands fund industry with 222 Channel Island companies listed on the London markets as at 31 December 2015 with market capitalisation of £152 billion. This represents nearly 25% of all companies classified by the London Stock Exchange as equity investment companies or nearly 30% by market capitalisation.

As part of this report, we have focussed on the investment company sector and data from the Association of Investment Companies ('AIC') also suggests that significant funds are still raised through Channel Island incorporated companies with £3.9 billion raised in 2015 (2014: £4.1bn) through new and existing structures.

This is the second year Deloitte have surveyed the annual reports of Channel Island London Listed Funds ('CILLFs'). Our 2014 survey considered the extent to which CILLFs rose to the challenge of the changes in corporate governance, regulatory and accounting requirements and how they met investor and broker expectations. We were very encouraged by the quality of annual report surveyed and the level of compliance, particularly where disclosures were adopted voluntarily.

As there were no significant changes in corporate governance or accounting requirements this year, rather than producing a full survey, we instead focussed our attention on specific areas of interest. Key highlights are noted below:

- Most companies have not taken advantage of the lack of corporate governance and accounting changes in the year to revisit their annual reports with the aim of "cutting clutter" as there has been no overall reduction of length of annual reports. An increase in the front-end of the annual report was offset by reductions in the financial statement disclosures.

- Speed of reporting has improved overall by 3% which is to be expected given the minimal changes noted above.

- There has been limited take up in respect of including audit findings in enhanced audit reports, with just below 3% of reports disclosing these.

- More companies are voluntarily including a remuneration report, with over 53% of companies sampled now including this, including 70% of Premium and Standard listed companies. These remuneration reports are typically adapted from the Companies Act 2006 layouts and tailored to suits offshore companies.

- 39% of companies have voluntarily presented a strategic report, 17% more than last year.

- The 2012 UK Corporate Governance Code changes focussed on better engagement by Companies on Shareholder engagement. Our survey highlights that only 36% of Companies fully disclosed voting results from AGMs and hence there remains a lack of disclosure transparency.

- As auditor rotation comes under more scrutiny, there has been an increase in disclosures relating to audit tenure with 64% of annual reports disclosing the length of audit relationships. Despite this, only 3% of companies surveyed changed auditor over the period.

- The level of disclosure relating to valuations methodologies and sensitivities was consistent across entities surveyed, particularly in respect of Real Estate and Infrastructure entities.

Overall, we have continued to see an increase in transparency and quality in the annual reports surveyed which demonstrates that CILLFs continue to strive to adopt best practice in their reporting.

In undertaking this survey we have collated a significant amount of detail that allows us to benchmark company reporting to both peers and best practise. We would be delighted to discuss this with any boards or management and we note contact details are documented at the end of this publication.

As auditor rotation comes under more scrutiny, there has been an increase in disclosures relating to audit tenure with 64% of annual reports disclosing the length of audit relationships.

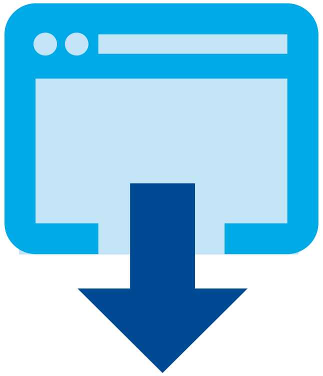
2. Introduction and survey objectives

CILLFs continues to be recognised as the investment vehicle of choice for alternative asset classes and it is important for CILLFs to continue to meet new requirements associated with listed entities particularly around corporate governance to key stakeholders. The need for transparency is still increasing and appears to be key for investors. Indeed, in a recent survey across a range of investors, nearly two thirds thought disclosures in an annual report about strategy, risks and opportunities and other value drivers could have a direct impact on a company's cost of capital.

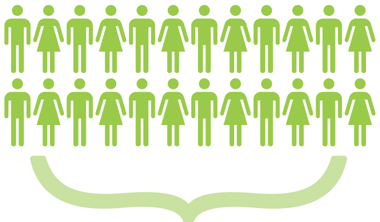
This is the second year Deloitte have surveyed the annual reports of CILLFs. Our 2014 survey was compiled on the back of changes to the UK Corporate Governance Code ("the UK Code") which came into effect in October 2012 and assessed the level of compliance and quality of these reports. In particular, we focussed on the following areas:

- The basics of the annual report, including its length, the balance between narrative and financial reporting and the time taken by companies to issue their reports;
- KPIs and performance reporting;
- Reporting Principal risks and uncertainties;
- The implementation of the new enhanced auditor's report;
- The implementation of the new audit committee report; and
- The level of adoption of voluntary disclosures, such as the strategic report and the remuneration report.

We were pleased to note that overall, the level of compliance seen in the companies surveyed was very encouraging, particularly where disclosures were adopted voluntarily. A copy of that report can be downloaded at **www.deloitte.co.uk/annualreportinsights** .



A copy of the report can be downloaded at ***www.deloitte.co.uk/ annualreportinsights***



115

Companies were included in our 2015 Survey

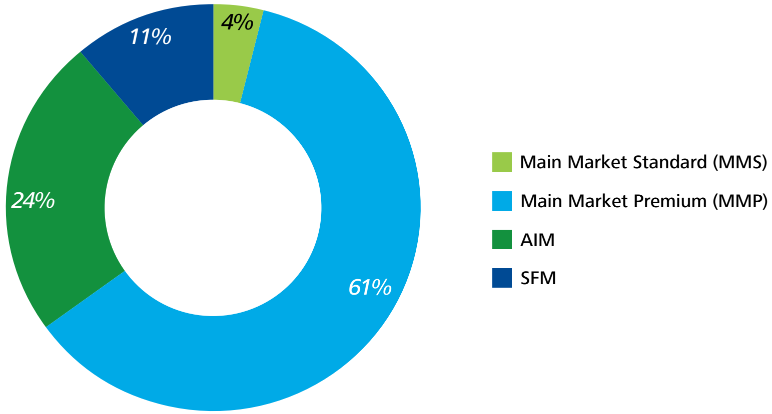
This year, our sample captured December 2014 to June 2015 year-ends. Whilst a number of changes in the UK Code were applicable for periods beginning on or after 1 October 2014 (e.g. for 30 September 2015 year-ends onwards), no material changes were made since we released our 2014 survey. As such, we have not carried out an in-depth review for the current year, but instead have focussed on a more limited number of areas of interest. These include:

- An update on the basics of the annual report;
- The extended audit report;
- The extent to which the strategic report has been voluntarily adopted;
- The extent to which the remuneration report has been voluntarily adopted;
- Shareholder engagement;
- Auditor tenure and rotation; and
- An analysis of IFRS 13 fair valuation measurement disclosures.

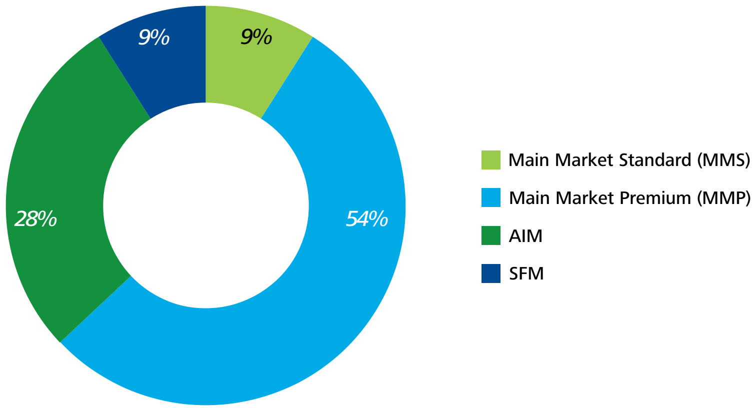
The sample selected for this year consisted of 115 London Listed Companies, with 91 domiciled in Guernsey and 24 in Jersey, across a number of markets and asset classes. This is comparable with the 2014 survey.

This publication provides highlights of our findings.

Number of companies by listing type – 2015



Number of companies by listing type – 2014

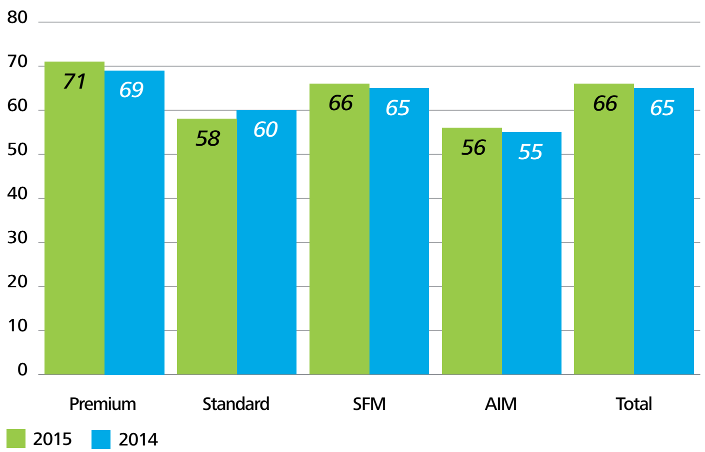


3. Understanding the basics

How long are Annual Reports?

- Overall, the length of audit reports has not changed significantly with the average length increasing from 65 pages to 66 pages. This is not unexpected given the lack of new requirements under the UK Code or accounting standards over the period.
- Thee FRC has, for some years, encouraged companies to “cut clutter” from their annual reports as they believe this undermines the usefulness of annual reports and accounts by obscuring important messages. We anticipated that some companies would take advantage of the limited accounting and regulatory changes in 2015 to revisit their annual reports with a view to rationalising disclosures; however this does not seem to have happened.

Average pages in the annual report



What is the balance between narrative and financial reporting?

- For the first time, the length of the front end of the annual report is longer then the back end when looking at the average across the sample.
- We expect this overall trend will continue given additional UK Code requirements being introduced for 30 September 2015 year-end onwards which will require additional disclosures around the robust assessment of risks and inclusion of the longer term viability statement.
- Companies in every market have seen an increase in the front half of the annual report, with premium listed companies showing the longest front halves (55% of the annual report) which is expected given the more extensive requirements for these companies.
- AIM quoted companies saw the biggest movement in the balance of the financial statements with the front narrative increasing from 37% of the annual report to 42% in the current year, driven mainly by a small number of companies significantly enhancing their disclosures relating to the business model.

51% 49%

was the average split between front end and back end of annual reports

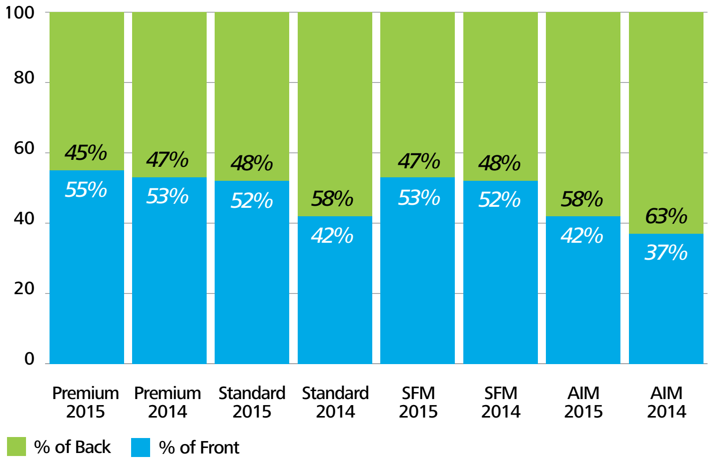
days was the average annual reporting time for our comparable companies

- The FRC has been focussing increasing attention on smaller listed and AIM companies as it noted significant shortcomings in the reporting from these entities. In June 2015 it issued a discussion paper on its initial findings and proposals from its review of these entities. The key areas which required improvement included:
  - The description of the business model, principal risks and uncertainties;
  - Cash flow statements;
  - Understanding the underlying performance of the company;
  - Disclosure of accounting estimates and judgements;
  - Tailoring of accounting policies; and
  - Description of provisions.
- We would therefore expect to see a continued increase in the size of the front half of the annual reports as companies seek to provide more visibility to investors, particularly given the significant number of AIM quoted and smaller listed companies in the Channel Islands.

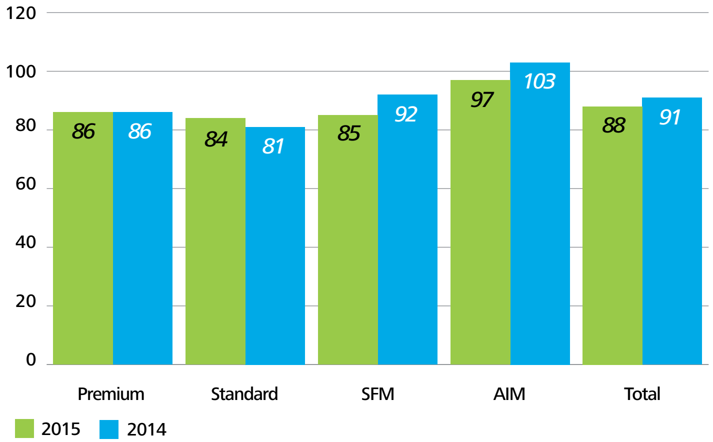
How quickly do companies report?

- Overall companies have been able to report marginally quicker in the current year which is to be expected given there were no significant changes in requirements this year.
- There is, however, some variation between different markets with SFM and AIM companies reporting significantly quicker (nearly 7 days) than the prior year. In contrast, the speed of reporting for premium listed companies has not changed.

Percentage split between the front and back sections of the Financial Statements



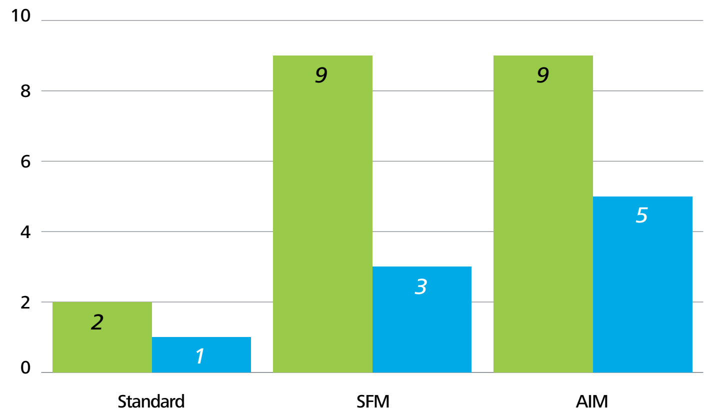
Average days for audit report sign off



4. The Extended Audit Report

Where companies are either required to apply the UK Code (such as premium listed companies), the AIC Code or where they have done so voluntarily, the UK version of the International Standards on Auditing (International Standards on Auditing (UK and Ireland) or "ISA (UK and Ireland)") requires auditors to prepare an extended audit report. The Extended Audit Report is not a requirement where audits are carried out under the international version of auditing standards (International Standards on Auditing, "ISA"). The chart below shows the proportion of companies voluntarily adopting either the UK or AIC Code:

Number of companies voluntarily adopting the UK or AIC Code

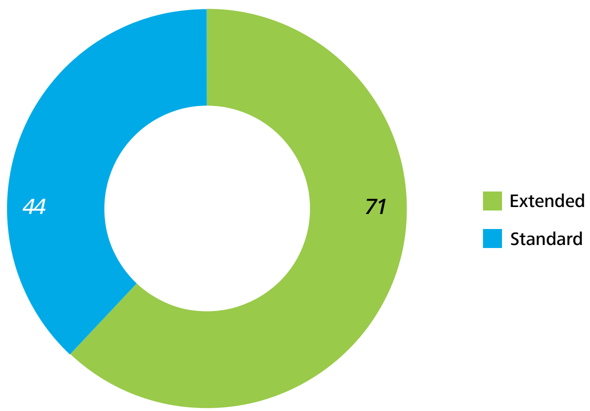


How many annual reports included an extended audit report?

- The proportion of annual reports including an extended audit report has not changed significantly from the prior year.
- Overall 61% of annual reports surveyed included extended audit reports. This is broadly consistent with the proportion of companies adopting either the UK Code or the AIC Code.
- 97 companies surveyed were audited under ISA (UK and Ireland), with the remaining 18 being audited under ISA. Of the directly comparable companies in our sample, there was no change in the auditing standards applied, compared to the prior year. We expected the auditors which used ISA last year (and hence did not provide an extended report) to do so this year as this has become industry standard; this has not happened.
- The average number of risks disclosed in the Extended Audit Report was 2. This is consistent with the prior year.

of audit reports were extended

Number of companies voluntarily adopting the UK or AIC Code



of the extended audit reports disclosed results of findings

of the extended audit reports referred to reliance on a third party controls reports

How many extended audit reports included findings?

- The first enhanced audit reports including auditors' findings relating to significant risks were issued in the period and were welcomed by investors. EU audit reform legislation is expected to come into force from June 2016, which will require all audit reports for public interest entities to contain "where relevant" key auditor observations relating to selected risks.
- Early adoption seen in our dataset has been limited, with only 2 audit reports including findings arising from the audit process. These included The Renewables Infrastructure Group and Ruffer LLP, both Deloitte audit clients.
- Audit committees should be aware of these developments, particularly as this is expected to become mandatory in the future for UK incorporated companies and auditors should be liaising with audit committees to ascertain the appetite of the Channel Islands Boards to this level of reporting in the audit opinion.

How many extended audit reports referred to reliance on service auditor control reports?

- With increasing corporate governance requirements, and the focus on the monitoring of internal controls, Boards and Audit Committees are increasingly seeking additional assurance from service providers on their internal controls, primarily through requesting external assurance reports such as ISAE3402 reports, or SSAE16 reports. We would also expect auditors to also place some reliance on these reports where available.
- Out of our sample, only 6 audit reports referred to reliance on such reports, which is surprising given the reliance of CILLFs on external service providers. We would expect a greater number of audit reports to refer to external controls reports going forward given the 2014 UK Code changes requiring a robust assessment of controls.

5. The Strategic Report

Last year, the long awaited narrative reporting regulations were issued by the Department for Business, Innovation & Skills (BIS). The regulations were the UK Government's response to a project that began in 2010 and are intended to make the narrative reporting simpler, clearer and more focussed. As a result of these changes, all UK incorporated companies, other than smaller companies, were required to include a Strategic Report in their annual report. Channel Island incorporated companies are not required to include these, but many saw the addition as best practice.

How many annual reports included a Strategic Report?

- As we predicted, there has been an increase in the number of companies adopting the Strategic Report, with 17% more companies including this in their annual report compared to prior year. For UK incorporated companies, directors benefit from the so called "Safe Harbour" provision in respect of information included in the Strategic Report. This does not apply to Channel Island companies.
- We would expect to see this number continue to increase as this becomes best practice and more familiar.
- On average, the length of this report was 16 pages which compares to 19 pages in the prior year.
- The FRC's guidance on the Strategic Report sets out how UK companies can meet their legal requirements when preparing the strategic report. This should be seen as a source of best practice for Channel Island entities. This can be found at the following link **https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Clear-and-Concise-Reporting/Narrative-Reporting/Guidance-on-the-Strategic-Report.aspx** . The guidance provides useful guidance in respect of the purpose of the Strategic report, materiality in the context of the report, communications principles, and expected content.
- 51% of premium listed companies surveyed included a Strategic Report; this is an increase on the 33% seen in last year's survey. 21% of AIM companies included a Strategic Report, compared to 6% in the prior year.
- This shows that companies were applying a "wait and see" attitude to the voluntary disclosure of the Strategic Report. Now the UK entities have reported on 2014 annual reports and are more example reports available for guidance, we would expect that even more Channel Islands entities to continue to include a strategic report for years ending in 2015/2016.

39%

of companies included a Strategic Report

As a result of these changes, all UK incorporated companies, other than smaller companies, were required to include a Strategic Report in their annual report.

Below is a brief summary of the FRC guidance taken from our UK survey "Annual report insights 2015 – Building a better report" which covers UK listed companies:

1. When setting out your strategy, clearly specify the objectives it is intended to achieve. For CILLFs this tends to reflect the entity's investment policy – good examples where companies have more complex business models include infrastructure and real estate funds such as John Laing Infrastructure Fund and F&C Commercial Property Trust Limited

2. Provide context to your business model; provide shareholders with a high level understanding of the markets you operate and how you engage with these markets. Again, for CILLFs, this can be mostly covered by the investment policy.

3. When explaining material, environmental, employee related, social, community or human rights issues, consider including a description of the entity's policy and any measures taken to embed a commitment within the entity.

4. Provide information that enables shareholders to understand KPIs used in the strategic report

5. A strategic report should be fair, balanced and understandable, comprehensive but concise, appropriately forward looking, entity specific, explain linkages to the rest of the annual report, have the structure reviewed annually, have content reviewed annually

6. Preparers need to think carefully about whether disclosures are material

7. Linkage is key to an effective report, this goes beyond cross referencing the information in your annual report – the information itself needs to relate in a meaningful way.

The full UK survey can be found at **www.deloitte.co.uk/annualreportinsights**

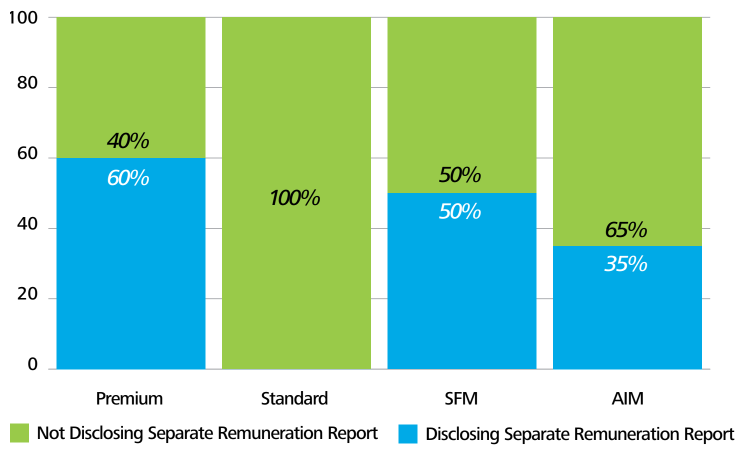
6. The Remuneration Report

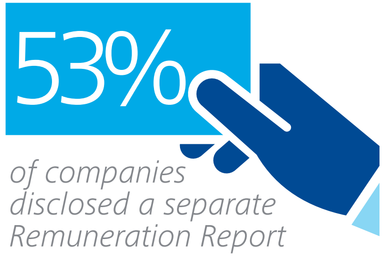
UK incorporated companies reporting under the Companies Act 2006 are required to include a Directors' Remuneration Report; however these requirements are not mandatory for Channel Island incorporated companies.

How many annual reports included a Remuneration Report?

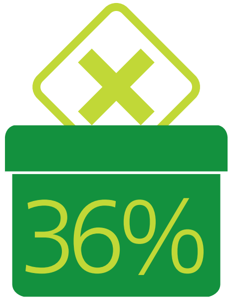
- There has been a continuing increase in companies including a separate Remuneration Report as part of their annual report, with 53% of companies surveyed doing so compared to 49% in prior year. This is consistent with the increased focus on directors' remuneration and the need for transparency.
- Whilst more CILLFs are including a separate report, most are not complying fully with the Companies Act 2006 requirements but instead are adopting a report format more suited to the nature of the company, reflecting the non-executive status of directors and the lack of performance based remuneration. Frequently omitted disclosures include a formal statement of remuneration policy, and a comparison of pay against performance (including a comparison of total shareholder return to increases in director pay). As noted above, this is not unexpected given the non-executive status of the majority of Board members and the fixed nature of remuneration. A good example of a fuller remuneration report can be found in the annual report of The Renewables Infrastructure Group Limited.
- A higher proportion of main market listed funds include a separate report which is consistent with the perceived greater need for transparency.

Disclosure of Separate Remuneration Report





7. Shareholder engagement



disclosed a full breakdown of shareholder voting results in their AGM notices

Votes against

From our analysis, shareholders voted against;

- *Re-appointment of directors;*
- *Re-appointment of auditors;*
- *Waiver or pre-emption rights;*
- *Approval of annual report; and*
- *Authority to repurchase shares*

The FRC announced in its 2014/15 annual report that it would be taking forward work on corporate governance and stewardship, in particular measures to enhance levels of engagement between investors and companies.

In addition following changes to the UK Code, companies are now required, when announcing the results of an AGM, to set out how they intend to engage with shareholders on any AGM resolutions which have received a significant proportion of votes in opposition. The company is not required to state how they will respond to the concerns at this point.

Given the increased level of focus from the FRC we identified this as an area of interest, particularly in understanding the level of transparency around shareholder engagement and reporting. This is also an area where proxy voting agencies have an increasing role, as investors delegate their voting rights to these agencies. This is discussed further below.

As such, we have examined announcements made by companies to understand how many fully disclose detailed voting results from shareholder meetings and what typically shareholders vote against.

How many companies disclose detailed voting results?

- Only 36% of companies fully disclosed voting results from the Annual General Meetings.
- Other companies simply commented whether resolutions had been passed without detailing the percentage of votes for and against.
- We would expect more transparency going forward given the increased focus from the FRC and the requirements of the UK Code.

What are shareholders voting against?

- Where shareholders voted against the re-appointment of directors, this tended to occur where there was either a perception that the director was no longer independent or where directors had been in office for a significant length of time. The UK Code requires directors who have been in office for more than nine years to be subject to an annual re-election vote but does not prohibit re-election. Indeed, the AIC Code states the AIC does not believe there is any evidence to suggest that lengthy service can compromise independence for Investment Companies.
- Where shareholders voted against the re-appointment of auditors, this was almost invariably due to high levels of non-audit fees.
- There were a surprising number of cases where shareholders voted against the approval of the annual report. Whilst no reasons are given for this, we understand these instances arose due to proposed dividends differing from initial expectations.
- We note that the voting is often influenced by proxy voting agencies which will advise investors to vote against specific resolutions where certain standard criteria are not met. For example, where reporting accountants are engaged for an IPO and subsequently retained as auditors, it is typical for non-audit fees in that year to exceed audit fees and does not cause a breach in independence rules, and is common practice for the Reporting Accountant to become the auditor, our experience is that proxy agencies would typically advise investors to vote against the auditor re-appointment as a result.
- We have been actively lobbying the main proxy voting agencies via the AIC to ensure specific circumstances are taken into account, but, based on initial feedback, we understand this is unlikely to happen in the short term. We would therefore recommend, if Boards can foresee an issue, that they engage with their sponsor or broker early to ensure that investors are briefed appropriately.

8. Audit tenure

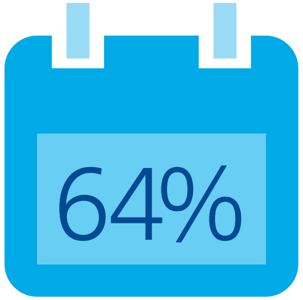
The Department for Business Innovation & Skills and the Financial Reporting Council have both issued consultation papers on audit reform. These discuss options for UK implementation of the EU Audit Directive on Audit Regulation and on Audit Reform and also build on the work of the Competition and Markets Authority (CMA). These regulations cover primarily auditor rotation, non audit fees and the definition of Public Interest Entities (PIEs).

Both the FRC and BIS consultations are now closed for comments and their final decisions on implementation of the directive are expected later in 2016. It should be noted that the Directive and Regulations are only applicable to companies incorporated in the EU and as such Guernsey and Jersey companies are not within their scope, however some entities may adopt as best practice.

We have below examined the level of disclosures in annual reports relating to audit tenure and rotation.

How many annual reports disclose audit tenure?

- We have continued to see an increase in annual reports disclosing audit tenure with nearly two thirds now including this disclosure. This is expected given the greater drive for transparency and expect most companies to disclose this going forward. Also, this disclosure is required under Section C.3.8 of the 2015 version of the UK Code.
- For companies where disclosure was made, average tenure was 5.7 years, with 11% of the sample showing tenure of 10 years or more.



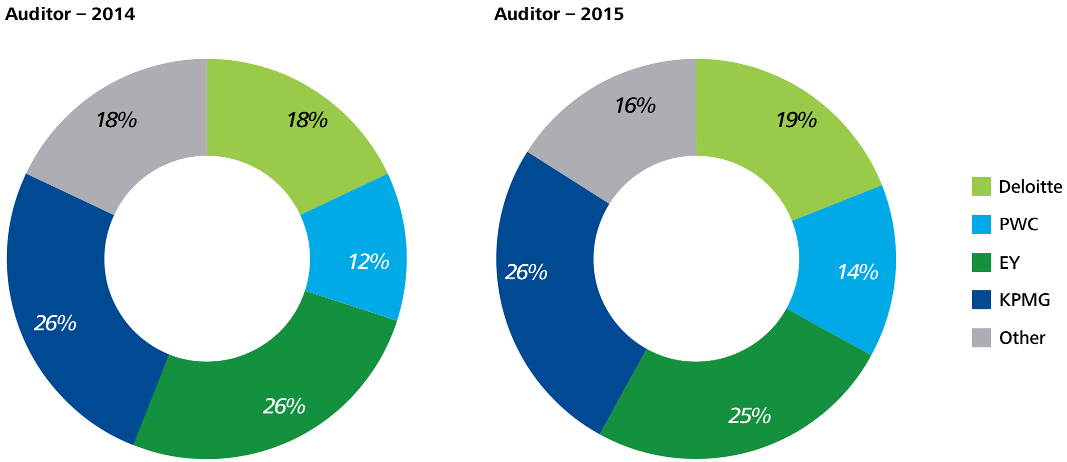
disclosed auditor tenure in the annual report

5.7

years is the average auditor tenure

How many companies changed auditors in the last year?

- Only 3% of companies sampled changed their auditors in the last year. This is surprising given the recent changes on auditor rotation.
- Where changes had occurred, this was primarily to change to a "Big Four" firm, with the other firms now only making up 16% collectively. This seems to indicate that the recent changes introduced in respect of auditor rotation are not having the anticipated effect of reducing the "Big Four's" share of the market.
- For the companies which did rotate, average audit fees increased by 14%, partially as a result of moving to a Big Four firm.



9. Valuation disclosures

The focus of many CILLFs is on alternative asset classes which can often involve complex valuations. IFRS 13 "Fair Value Measurements" introduced a requirement for companies to provide more clarity around key valuation inputs and their sensitivity for more illiquid investments. These disclosures, and the level of detail disclosed, will vary greatly depending on the underlying asset classes.

As part of our review of annual reports, we have examined the disclosures given by companies in the Real Estate, Infrastructure and Private Equity sectors to identify key disclosures and the level for consistency across the market. Our findings are shown below:

What are the typical inputs and sensitivities for infrastructure companies?

- All entities sampled used a discounted cash flow model to determine fair value of underlying projects.
- We found that the inputs were variable depending on asset type (e.g. infrastructure or renewables), but that there was a high level of consistency across sampled entities.
- Nearly 40% of entities surveyed used independent valuers. In all cases, this was the same Big Four firm.

A good example of disclosures include The Renewables Infrastructure Group.

Typical inputs	Range of sensitivity
Inflation rate	*0.25-1%*
Discount rate	*0.5-1%*
Power prices	*10-20%*
Energy yield	*P90/P10*
Operating costs	*10%*
Currency rate	*5-10%*
Tax rates	*1%*
Deposit rates	*0.5-1%*

What are the typical inputs and sensitivities for real estate companies?

- Sampled entities all used external valuers to value the portfolio under RICS guidelines. We found there was a range of valuations firms used.
- All companies quoted income and yield inputs.
- Variations in inputs depended on the nature and location of properties.
- Whilst valuation methodologies differed in some cases, this was primarily due to the different jurisdictions in which the valuers and properties were based. There was a high level of consistency when looking at the methodology across individual jurisdictions.

UK Commercial Property Trust Limited provides a good example of expected disclosures.

Typical inputs	Range of sensitivity
Expected rental (ERV)/ERV persquare foot	*2-5%*
Equivalent yield	*0.25-0.5%*
Initial yield	*0.25-0.5%*
Current rental income	*2-5%*
Discount rate/capitalisation	*0.25-0.5%*
Currency rate	*2-5%*
Tax rates	*0.25-0.5%*

What are the typical inputs and sensitivities for Private Equity companies?

- Valuation methodologies were more varied reflecting the acceptable bases under International Private Equity and Venture Capital ("IPEV") valuation guidelines.
- These valuations were also more bespoke reflecting the specifics of individual investments.
- In many cases, very extensive disclosures were given to explain each valuation basis in the financial statements, however sensitivity analysis was mostly narrative rather than quantitative, the latter being the expectation of the standard.

JZ Capital Partners Limited provides a good example of expected disclosures.

Typical inputs	Range of sensitivity
Discounted cash flows	*Sensitivities applied to discount rates – sensitivity depended on nature of investment*
Quoted multiples	*Depend on multiple used – little quantification beyond saying that drop in multiple will have a proportionate impact on valuation*
Net asset value	*No sensitivity given*
Recent transaction prices	*No sensitivity given*
Expected sales proceeds	*No sensitivity given*

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. J4740