Deloitte.

October 2014

Governance *in brief*
FRC publishes 2014 Corporate Reporting Review and sets out areas of focus for the coming reporting season

Headlines

- Findings from the review:
  - The standard of corporate reporting by large public companies, particularly FTSE 350 companies is generally a good standard, but the FRC continues to see a higher number of poorer quality accounts at smaller full list and AIM companies.
  - A number of common areas require more focus by boards: More balance in the strategic report, more careful presentation of exceptional items, more tailoring of disclosures of judgements and accounting policies.
- In this reporting season, the FRC calls for particular focus on areas arising from M&A (control and acquisition accounting), enhanced focus on tailoring disclosure on judgments, and revenue recognition, where the new accounting standard can present considerable challenge for companies.

Quality of corporate reporting

The FRC's report provides an overview of the Corporate Reporting Review (CRR) activities for the year ended 31 March 2014 and is written for those with board-level responsibility for preparing company reports and accounts. This year the CRR team reviewed 271 annual reports and wrote to 100 companies asking for additional explanation or information. Over three quarters of cases were closed in the reporting year and resulted in undertakings to make specific improvements or changes to future reporting.

Two company-specific Press Notices were issued: one related to estimating the fair value of biological assets and the other in relation to pension accounting. Two generic FRC Press Notices were issued: one in relation to their review into pension funds in Scottish Limited Partnerships, the second regarding the disclosure of exceptional items.

Rather than make public correspondence with regulators as SEC comments letters are in the United States, the FRC can now request that companies make reference in the annual report to the fact that the changes a company is making were prompted by the CRR team's review to provide public evidence of the Conduct Committee's engagement with a company.

The FRC acknowledges that the quality of reporting by smaller listed and AIM quoted companies is more variable than in the FTSE 350. To address this, in April 2014 the FRC launched a three year project to drive a step change in the overall quality of reporting by smaller companies. The first phase is gathering evidence and performing root cause analysis and exploring ways to help companies to make improvements – for example, accounting for complex transactions is a key area of focus.

Common findings from the review

The following areas were those most commonly raised with companies during the year:

- **Strategic reports** which were focused only on 'good news', where trend information was not sufficient to explain the effect of non-recurring items or where there was inappropriate balance between IFRS and non-IFRS measures.
- Treatment of **exceptional items** was highlighted in a press release from the FRC in December 2013 and greater consistency and consideration of whether items were truly exceptional is a recurring challenge.

- Explanations of **critical judgements** could be more precise, and clarity can be enhanced about the effect on the financial statements – in particular, the disclosure of critical judgements should not simply repeat or refer to the relevant accounting policy. Disclosures should differentiate between critical judgements and areas of estimation uncertainty and deal with both separately, even if they relate to the same item.

- **Accounting policies** which are 'boilerplate' and not sufficiently tailored to the facts and circumstances of the business – particularly with reference to revenue recognition.

- Poor quality disclosures on the key assumptions and sensitivities around **impairments**.

- Unclear policies or explanation on the critical judgement and estimates involved in **pension accounting**, including around minimum funding requirements.

- Inadequate disclosures around tax accounting, in particular in relation to deferred tax, especially loss recognition, and the reconciliation of the tax charge on accounting profit to the effective tax rate.

- Companies which present a voluminous list of possible **risks** without emphasising those they believe are most important.

- Reporting of **cash flow** information which either misclassifies the cash flows, inappropriately nets items or reports non-cash movements as cash flows (e.g. the conversion of convertible debt).

Emerging reporting issues for board focus

The FRC highlights for board attention a number of areas where the FRC will also focus in this year's review round, some in sharper focus given the recent increase in M&A activity:

- Considerations of whether a company controls another set out in IFRS 10, including whether a company exerts **'de facto control'** over an entity.

- Identification and recognition of **intangible assets**, such as brands or customer lists, acquired as part of a business combination. Companies will be challenged where a business combination has resulted in the **recognition of material goodwill but few or no separate intangible assets**.

- Companies are encouraged to report the likely effect of the changes to be introduced in 2017 by IFRS 15, **'Revenue from contracts with customers'**, as soon as this is, or should be, reasonably estimable. For many companies this new standard represents a considerable undertaking.

- **Compliance** with the financial reporting requirements of the Companies Act 2006 and other relevant legislation or regulations, as the FRC has been encouraged to make enquiries into areas required to be included in the annual report, but that are not directly related to annual financial reporting.

- The impact of the revision to the pension accounting standard, IAS 19, to include the requirement to disclose information about the level of any **minimum funding requirements**. The CRR expects these disclosures to include quantitative, as well as qualitative, information.

Deloitte view

- The FRC is to be commended that it has provided a comprehensive list of reporting hot topics almost three months before December year end to ensure these matters can be addressed in pre year end audit committee agendas.

- The focus on financial reporting judgments is only intensifying – and the CRR provides useful prompt for audit committees to review the basis of all material judgments, their impact on the financial statements and the quality of disclosures, which should of course be fair, balanced and understandable.

- The focus on smaller companies is to be welcomed. The regulatory burden has been felt more acutely by smaller companies and it will be interesting to see the conclusions of the review.

To read the full report

The full report can be accessed at: https://frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2014.pdf

Contacts – we value your feedback:

corporategovernance@deloitte.co.uk
If you find our publications useful or would like to see other topics covered please provide your feedback

Tracy Gordon – 020 7007 3812 or trgordon@deloitte.co.uk

William Touche – 020 7007 3352 or wtouche@deloitte.co.uk

The Deloitte Academy

The Deloitte Academy, located on the ground floor of Deloitte's Stonecutter Court offices, has been designed for main board directors of listed companies. The Deloitte Academy provides support and guidance to boards, board committees, individual directors and company secretaries of listed companies through a programme of briefings and update sessions. Bespoke training for the whole board or individual directors is also available.

If you would like further details about the Deloitte Academy, including membership enquiries, please email enquiries@deloitteacademy.co.uk.

UK Centre for Corporate Governance

For further information on corporate governance matters please click here
http://www.corpgov.deloitte.com/site/uk/

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. 39265A